# FINANCIAL SERVICES MODERNIZATION FOR TEXAS

**Impact of the Gramm-Leach-Bliley Act of 1999**

**August 15, 2000**

*A Joint Study Conducted by:*


**Texas Department of Banking**

**Texas Department of Insurance**

**Texas Savings and Loan Department**

**Texas State Securities Board**

# Acknowledgements

This study was conducted under the direction of the Commissioners of the four agencies and their allocation of resources to complete this task is greatly appreciated. Task Force Members provided invaluable contributions of time, research, and personal commitment to complete this endeavor. Sincere appreciation is extended to all the participants of this study.

## Commissioners

| | |
|---|---|
| Randall S. James | Texas Department of Banking |
| Jose Montemayor | Texas Department of Insurance |
| James L. Pledger | Texas Savings and Loan |
| Denise Voigt Crawford | Texas State Securities Board |

## Task Force Participants

| | |
|---|---|
| Robert Bacon | Department of Banking |
| Kevin Brady | Department of Insurance |
| Lynda Drake | Department of Banking |
| Ryan Eckstein | Department of Banking |
| Gayle Griffin | Department of Banking |
| Don Hanson | Department of Insurance |
| Jack Hohengarten | Attorney General's Office |
| Tim Irvine | Savings and Loan Department |
| Everette Jobe | Department of Banking |
| Steve Martin | Department of Banking |
| David Mattax | Attorney General's Office |
| John Morgan | State Securities Board |
| Tom Spradin | State Securities Board |
| David Weaver | State Securities Board |

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# GLOSSARY

ACRONYMS AND OTHER SHORT FORM REFERENCES USED IN REPORT

| Term | Definition |
| --- | --- |
| Agencies | DOB, SSB, TDI, and TSLD |
| BHC | Bank holding company |
| BHC Act | Bank Holding Company Act of 1956 |
| Commissioners | Texas Banking Commissioner, Savings and Loan Commissioner, Insurance Commissioner, and Securities Commissioner |
| Committees | Texas Senate Economic Development Committee, House Financial Institutions Committee, and House Insurance Committee |
| Committees' Letter | Letter from the Committees to the Commissioners dated March 31, 2000, requesting a study of the impact of GLBA on state law, excluding the impact of the financial privacy provisions of GLBA |
| CRA | Community Reinvestment Act of 1977 |
| CSBS | Conference of State Bank Supervisors |
| DOB | Texas Department of Banking and/or Commissioner |
| FDI Act | Federal Deposit Insurance Act |
| FDIC | Federal Deposit Insurance Corporation |
| FRB | Board of Governors of the Federal Reserve System |
| FHC | financial holding company, a category of a bank holding company |
| FTC | Federal Trade Commission |
| GLBA | Gramm-Leach-Bliley Act of 1999 |
| NAIC | National Association of Insurance Commissioners |
| NARAB | National Association of Registered Agents and Brokers |
| NASAA | North American Securities Administrators Association, Inc. |
| NASD | National Association of Securities Dealers |
| OCC | Office of the Comptroller of the Currency |
| OTS | Office of Thrift Supervision |
| SEC | Securities and Exchange Commission |
| SSB | Texas State Securities Board and/or Commissioner |
| TAC | Texas Administrative Code |
| TDI | Texas Department of Insurance and/or Commissioner |
| Thrift | A state or federal savings bank or savings and loan association |
| Thrift holding company | Savings and loan holding company |
| Treasury | U.S. Secretary of the Treasury |
| TSLD | Texas Savings and Loan Department and/or Commissioner |
| Unitary thrift | A savings and loan holding company that owns only one savings bank and is empowered to engage in unlimited nonbanking activities |

# FINANCIAL SERVICES MODERNIZATION FOR TEXAS

# Impact of the Gramm–Leach–Bliley Act of 1999

## August 15, 2000

## I. EXECUTIVE SUMMARY AND REPORT OVERVIEW

### A. Background

In November 1999, Congress passed the Gramm–Leach–Bliley Act ("GLBA"), commonly referred to as Financial Services Modernization. (*See* Appendix A for the GLBA Congressional Conference Committee Report.)

The enactment of GLBA followed several years of difficult negotiations, not just among the banking, thrift, securities and insurance industries, but also among the regulators with regulatory responsibility over these industries. The negotiation difficulties were due in part to the historical separation of banking from insurance and securities. In 1934, federal law separated securities and commercial banking. In 1955, federal law separated insurance and commercial banking. In the intervening years, the industries developed separately to the point that each now has its own distinct culture. The nature of state and federal regulation of these industries likewise developed separately and distinctly. The implementation of GLBA in a manner that is both practical and effective therefore presents a unique challenge for the industries and the regulators and will require cooperation and communication among these groups to an extent that has not been practiced or needed in the past.

A brief description of the provisions of GLBA that, from the state's perspective, most impact Texas will facilitate an understanding of this **Executive Summary and Report Overview**.

**First,** GLBA eliminates pre-existing federal and state restrictions that prohibited common ownership of entities that engage in insurance, securities, and banking activities. GLBA also preempts state agent licensing laws that prevent or significantly interfere with the ability of a depository institution to engage in the sale, solicitation or cross marketing of insurance.

**Second**, GLBA directs the states to develop more uniform and efficient insurance agent licensing laws. If the states fail to adopt laws consistent with the GLBA mandate, the Act provides for the establishment of a national-level, self-regulatory insurance body, the National Association of Registered Agents and Brokers ("NARAB").

**Third**, GLBA directs that **functional regulation** concepts will govern the regulation of these combined businesses and activities. Congress has chosen the concept of functional regulation to establish the general regulatory parameters for the primary regulatory agencies at both the federal and state levels, and to provide a process for the resolution of differences among the regulators. Functional regulation effectively avoids duplicative regulatory burdens on the industries, and at the same time maintains existing and applicable functional regulatory expertise where needed.

As a result, to the extent that a bank, its holding company or its affiliates engage in insurance or securities sales, either as agent or principal, the entity will be subject to regulation by multiple state and federal regulators. For this reason, GLBA preserves a framework to facilitate coordinated and delineated functional regulation by the applicable federal and state regulators.

## B. The Texas Response

Before Congress passed GLBA in 1999, Lt. Governor Rick Perry and House Speaker Pete Laney assigned interim charges to the Senate and House committees that oversee the Department of Banking ("DOB"), the Savings and Loan Department ("TSLD"), the Texas Department of Insurance ("TDI") and the State Securities Board ("SSB"). The interim charges directed the committees to, among other things, monitor federal financial services modernization developments and evaluate their impact on state law.

After GLBA's enactment, Senator David Sibley, Representative Kip Averitt, and Representative John Smithee, the chairs of the Senate Economic Development Committee, House Committee on Financial Institutions and House Committee on Insurance, respectively, by letter dated March 31, 2000, charged the Banking Commissioner, in consultation with the Insurance, Securities, and Savings and Loan Commissioners, to study the impact of financial services modernization on Texas law (*see* Appendix B). Privacy issues were excluded from the study. The charge instructs the Commissioners to study those portions of GLBA that preempt Texas statutes and rules, and also to develop consensus legislative recommendations that would provide a means for the Texas state chartered banking system to be innovative in financial services.

In January 2000, the Commissioners and their staffs first met to discuss the impact of GLBA on the agencies' activities. Since that time, the agencies' key staff members have met on a regular basis. They have discussed their respective agency's response to the Committees' charge. They have also discussed, and helped each other understand, their agency's perspective on financial services modernization and have identified and addressed matters of mutual and individual agency concern. (*See* Appendix C for a profile of the Agencies and the industries they regulate.)

The Commissioners have targeted two primary areas that respond to the Committees' study charge and also to the agencies' concerns: (1) GLBA-mandated statutory changes and possible preemption; and (2) cooperation between functional regulators through broad-based interagency agreements. To this end, the Commissioners solicited input from the affected industries and consumers.

**First**, the Commissioners have reviewed the statutes that they each administer and enforce. As discussed in greater detail in Part II of this Report, each Commissioner has concluded that none of the laws for which he or she is responsible directly prevents or significantly interferes with affiliations among the insurance, banking or securities industries. Commissioner Montemayor has, however, determined that GLBA either preempts or threatens to preempt certain laws in the Texas Insurance Code that involve the sale, solicitation and cross-marketing of insurance and pertain to insurance agent licensing and change of control. The TDI is working on recommended legislation to address these matters.

As previously noted, GLBA directs the states to develop more uniform and efficient insurance laws and provides for the establishment of NARAB if they fail to do so. The National Association of Insurance Commissioners ("NAIC") is leading the states' efforts to coordinate the development of state-level insurance regulation that will not be preempted by GLBA. Commissioner Montemayor is an active participant in the NAIC effort to find state-acceptable solutions.

This Report addresses the possible preemption issues known to the Commissioners at this time. However, additional issues can arise. The U.S. Comptroller of the Currency, regulator of national banks ("OCC"), is currently soliciting public input regarding whether it should issue opinions preempting certain insurance laws in West Virginia, Massachusetts, and Rhode Island. If the OCC opines that GLBA preempts any of the laws in question, its opinion may be challenged in court. In the event that no resolution of these issues is forthcoming before the conclusion of the next Texas legislative session, the upcoming session will be the only opportunity to enact the necessary legislation within GLBA's three-year time frame to avoid preemption.

**Second**, functional regulation is a key component of financial services modernization. The Commissioners are in consensus that the resolution of functional regulation issues is critical to the successful implementation of GLBA, and that functional regulation should be maintained at the state level. In order for financial services modernization to work and for its benefits to be realized, interagency cooperation and communication will be essential.

Functional regulation permits each of the agencies to retain existing authority over its respective functional areas of responsibility and to use its expertise and experience to meet its individual legislative mandate and mission. Under functional regulation, the state's depository institution regulators continue to have the authority to determine what constitutes banking and other authorized activities for the depository institutions they regulate. To the extent a depository institution engages in insurance or securities activities, those activities are conducted in Texas under the licensing and regulation of TDI and SSB, respectively.

Immediately prior to the submission of this Report, the Commissioners met with the federal securities and banking regulatory officials responsible for financial services modernization issues in Texas. Additionally, Commissioner James has represented the Conference of State Bank Supervisors ("CSBS"), and Commissioner Montemayor the NAIC, at similar meetings convened by the federal

regulators. Various interagency meetings, both unilateral and bilateral, will no doubt continue as needed. (*See* Appendix D for a listing of GLBA activities involving the Commissioners.)

In addition, in May, the Commissioners sought input concerning financial services modernization from the affected industries and consumer representatives through a joint mail solicitation (*see* Appendix E). Those who responded to the mailing posed approximately fifty questions that the agencies have answered. These questions and answers are included in this Report as Section III. This Report, including responses to industry questions, will be posted on the DOB financial services modernization web site (http://www.finmod.state.tx.us).

## C. Summary of Consensus Conclusions and Legislative Recommendations

The Committee Chairs asked the Commissioners to provide consensus statutory recommendations for the legislature's consideration. The Commissioners have reached consensus on the recommendations set out below. Recommendations listed under Paragraph 1 below are considered critical to avoid federal preemption, while the remaining Paragraphs contain recommendations designed to modernize financial services in Texas consistent with GLBA.

### 1. Legislation to Address Preempted State Law

**(a) Agent Licensing—**The 76th Legislature's S.B. 956 should be revised to permit GLBA-mandated agent licensing and to adopt agent licensing requirements intended to be uniform among the states. (*See* Section II–D.)

The insurance agent licensing qualifications and restrictions in the Texas Insurance Code are preempted in a number of respects with regard to the ability of a depository institution to become licensed as required by GLBA. As a temporary measure, the Insurance Commissioner is interpreting the Insurance Code to permit licensing, as described in Commissioner's Bulletin No. B–0005–00, "Interim Guidelines Concerning Insurance Agent Licensing in Texas Under the Gramm–Leach–Bliley Act" (Jan. 18, 2000) (*see* Appendix F). In addition, GLBA requires at least a majority of the states and U.S. territories (29) to either adopt uniform agent licensing requirements or institute reciprocal agent licensing prior to November 12, 2002. Failure to do so will result in creation of a new self-regulatory organization that will institute uniform licensing at the expense of state control of that function.

**(b) Affiliation Review Period—**Insurance Code Article 21.49–1 should be amended to shorten the review time to 60 days in conformity with GLBA. No state law pertaining to the regulation of banking, insurance or securities may directly prevent or restrict affiliation among these industries. Article 21.49–1 in some circumstances gives TDI a longer period to review affiliations than is permitted under GLBA. (*See* Section II–A.)

**(c) ATM Reform—**Finance Code §59.202 should be amended to conform to the "ATM Fee Reform Act of 1999," a series of amendments to the Electronic Fund Transfer Act (15 U.S.C.

§§1693 *et seq*.) enacted by GLBA Sections 701–705. The Electronic Fund Transfer Act explicitly preempts state law that is inconsistent with the Act, and then only to the extent of the inconsistency. A state law is not inconsistent with the Act to the extent it provides greater protection to consumers than the Act itself. (*See* Section II–A.)

### 2. Legislation to Enhance Regulatory Cooperation

**(a) Information Sharing—**Legislation should be enacted adding a provision to each of the Agencies' statutes (in the Finance Code, Insurance Code, and Texas Securities Act) to effectively protect the confidentiality of shared regulatory information. Each provision will vary based on its statutory setting, but should:

- Specifically disclaim and prevent waiver of any privilege or loss of confidentiality applicable to information that might otherwise be waived or lost as a result of sharing the information with another regulatory agency;
- Preserve each Agency's discretion regarding the appropriate use of its confidential regulatory information as well as each Agency's discretionary authority to directly examine, inspect or require information filings from a functionally regulated affiliate; and
- Authorize the use of interagency agreements for the purpose of specifying procedures regarding use and handling of shared information, and allowing greater specificity regarding the types of information to be shared and under what circumstances, details that can be developed over time as the Agencies gain experience in cooperative regulation. (*See* Section II–E.)

**(b) Confidentiality of Insurance Company Data—**Government Code §552.112(a) should be amended to clarify the status of an insurance company as a "financial institution" for purposes of the exception to public disclosure for "information contained in or relating to examination, operating, or condition reports prepared by or for an agency responsible for the regulation of financial institutions or securities, or both." (*See* Section II–E.)

### 3. Legislation to Enhance Regulatory Adaptability to Future Developments

Insurance Code §36 should be amended to ensure that TDI has adequate rulemaking authority, consistent with the other Agencies, to adapt its regulatory practices promptly to allow financial institutions to compete in an ever-changing, technology-driven market, subject to application of full functional regulation. (*See* Section II–F.)

### 4. Legislation to Enhance State Banking Activities

State law should grant the Banking and Savings and Loan Commissioners authority to enhance the ability of state banks, bank holding companies, trust companies, savings and loans, state savings banks and thrift holding companies to engage in new activities subject to application of full functional regulation. (*See* Sections II–B, II–C, II–D, and II–G.)

**(a) State Banks—**Finance Code Title 3, Subtitle A should be amended to clarify the authority of state banks to conduct activities beyond those allowed for national banks to the extent consistent with principles of functional regulation, safety and soundness, and consumer protection. (*See* Section II–B.) Specifically:

(1) Finance Code §32.001 should be amended to (A) characterize a state bank as a corporation with banking powers to increase future flexibility (or limited liability company, in the case of a limited banking association), and (B) authorize a state bank to (i) act as a financial agent, and (ii) engage in nonbanking activities that are financial in nature or incidental or complementary to a financial activity, with the approval of the Banking Commissioner.

(2) Finance Code Chapter 32, Subchapter A, should be amended to add a new §32.011 granting authority to the Banking Commissioner to determine an activity to be financial in nature or incidental or complementary to a financial activity, based on similar considerations as contained in federal law.

(3) Finance Code Chapter 34, Subchapter B, regarding state bank investments, should be substantially amended to modernize treatment of securities eligible for bank investment and permissible activities for subsidiaries, and for conformity with other amendments and with federal law.

**(b) State Savings Banks and Holding Companies—**Finance Code, Title 3, Subtitle C should be amended to preserve the authority of a grandfathered “unitary thrift” (a savings and loan holding company that owns only one savings bank and is empowered to engage in unlimited nonbanking activities) operating in Texas, and to create authority for the Savings and Loan Commissioner to determine activities to be financial in nature, incidental to a financial activity, and complementary to a financial activity for state savings bank holding companies and subsidiaries. (*See* Sections II–B, II–C, and II–G.) Specifically:

(1) Finance Code §93.001(c) should be amended to authorize a state savings bank to act as a financial agent and to engage, with the approval of the Savings and Loan Commissioner, in activities deemed to be financial in nature or incidental to or complementary to a financial activity, based on similar considerations as contained in federal law.

(2) Finance Code Chapter 94 should be amended to conform the range of permissible investments for a state savings bank to reflect those investments permitted by the amendments to Chapter 93.

(3) Finance Code Chapter 97, should be amended to explicitly preserve the powers of unitary thrifts, confirm the powers of all other state savings bank holding companies, confirm the ability of a bank holding company ("BHC") which controls a state savings bank to become a financial holding company ("FHC"), add new definitions to incorporate the terminology created by GLBA, and authorize information sharing among state and federal regulators as a means of promoting efficient regulatory activity.

**(c) State Trust Companies**—Finance Code Title 3, Subtitle F should be amended to enhance and preserve the state trust company charter and allow trust companies to remain competitive by permitting state trust companies to engage in financial activities. (*See* Section II–B.) Specifically:

(1) In alternate form because of pending codification, Finance Code §182.001 and Texas Civil Statutes Article 342a–3.001 should be amended to authorize a state trust company, to the extent consistent with existing fiduciary duties, to (A) act as a financial agent, and (B) engage in other activities that are financial in nature or incidental or complementary to a financial activity, with the approval of the Banking Commissioner.

(2) Finance Code §182.001 should be amended to add a new subsection (g) characterizing a trust company as a corporation for purposes of other state law (or limited liability company, in the case of a limited trust association).

(3) Finance Code Chapter 182, Subchapter A, should be amended to add a new §182.020 granting authority to the Banking Commissioner to determine an activity to be financial in nature or incidental or complementary to a financial activity, based on similar considerations as contained in federal law.

**(d) Bank Holding Companies**—Finance Code, Title 3, Subtitle G should be amended to facilitate the ability of a BHC to become a FHC and engage is expanded nonbanking financial activities. (*See* Sections II–C and II–G.) Specifically:

(1) Finance Code §201.002 should be amended to incorporate definitions related to financial holding companies and financial activities.

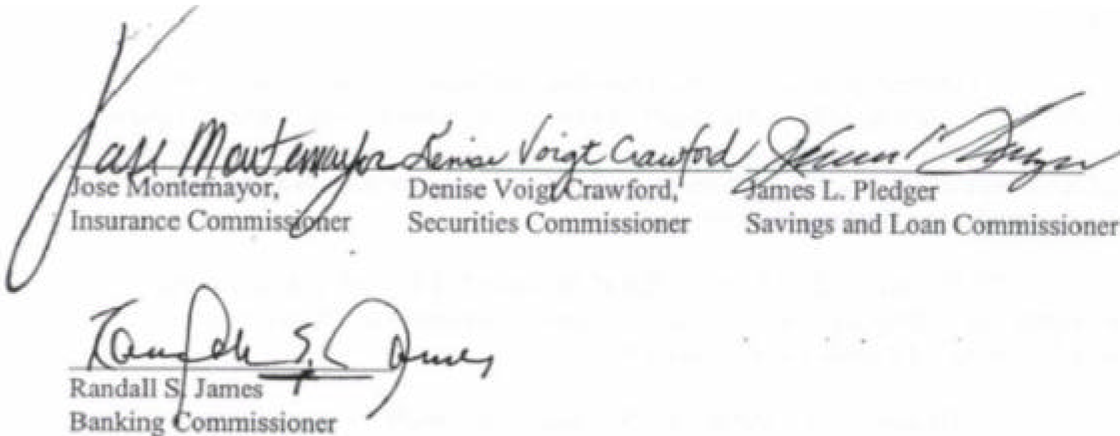
(2) Finance Code Chapter 202, regarding BHC regulation, should be amended to explicitly affirm the ability of a BHC to become a FHC, to authorize information sharing among state and federal regulators as a means of promoting efficient regulatory activity, and to create authority for the Banking Commissioner to determine activities to be financial in nature, incidental to a financial activity, and complementary to a financial activity for BHCs and subsidiaries, based on similar considerations as in federal law.

## D. Matters For Further Consideration and Research

The Commissioners and their respective staffs have worked diligently to address and resolve issues encountered during the preparation of this Report. The Commissioners remain committed to continue to work together as new issues surface, on an as-needed basis.

We hope this Report is responsive to your request, and the Commissioners will be pleased to answer any questions you may have.

Sincerely,




cc: Governor George W. Bush
Lt. Governor Rick Perry
Speaker of the House Pete Laney
Members of the Senate Economic Development Committee
Members of the House Committee on Financial Institutions
Members of the House Committee on Insurance

# II. FINDINGS, ANALYSIS AND RECOMMENDATIONS

## A. State Laws Preempted or Impaired by GLBA[1]

Paragraph 3.A of the Committees' Letter requested study and recommendations regarding eliminating state law that prevents or restricts an insured depository institution (state or national) from affiliating with insurance or securities firms, or prevents or significantly interferes with the ability of an insured depository institution to engage in the sale, solicitation, or cross marketing of insurance as contemplated by GLBA. The Agencies examined these issues and further attempted to evaluate potential GLBA preemption of state law from a broader perspective.

### 1. Summary of Conclusions and Legislative Recommendations

No state law pertaining to the regulation of banking, insurance or securities directly prevents or restricts affiliations among these industries. GLBA preempts one state insurance law, Insurance Code Article 21.49–1, to the extent that it gives the TDI a longer period to review affiliations than is permitted under GLBA. This Article should be amended to shorten the review time to 60 days in conformity with GLBA.

Certain state insurance agent licensing laws could be viewed, possibly, as interfering with the ability of a depository institution to engage in the sale, solicitation or cross-marketing of insurance because the licensing requirements, although implemented in a manner that accommodates depository institutions, were not written with the licensing of banks in mind. Section II–D of this Report recommends specific legislative changes to the agent licensing statutes.

To avoid potential preemption, Finance Code §59.202 should be amended to conform to the "ATM Fee Reform Act of 1999," a series of amendments to the Electronic Fund Transfer Act[2] enacted by GLBA Sections 701–705.

The Agencies, in researching their laws, have not identified any consumer protection statutes that would be preempted by GLBA, including those applicable to the business of insurance.[3]

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[1] Gramm–Leach–Bliley Act, Pub. L. No. 106–102, 113 Stat. 1338 (1999). *Also see* H.R. Conf. Rep. No. 434, 106th Cong., 1st Sess., 145 Cong. Rec. H11,255 (daily ed. Nov. 2, 1999) (*see* Appendix A). The Conference Report was adopted by the House and Senate on November 4, 1999. 145 Cong. Rec. S13,871-13,881; H11,526-11,551 (daily ed. Nov. 4, 1999)).

[2] 15 U.S.C. §§1693 *et seq.*

[3] Several requests for preemption opinions relating to statutes in other states are currently pending before the OCC. Should the OCC opine that the statutes in these other states are preempted, some Texas statutes could be impacted.

### 2. Preemption Analysis under GLBA

Federal preemption analysis under GLBA requires an examination and understanding of the relationship between several different and potentially overlapping GLBA provisions. GLBA Section 104,[4] the section that most directly and comprehensively addresses preemption and permissible impact of state law, generally preempts state law that prevents or restricts affiliations between depository institutions and other financial companies (e.g., securities firms and insurance companies or agents) that are authorized or permitted by GLBA or other federal law. It also preempts state law that prevents or restricts financial activities that are authorized or permitted by GLBA or other federal law. Section 306[5] and certain other GLBA provisions, however, specifically permit state law restrictions that exceed those in federal law[6] and address subjects that are possibly within the scope of Section 104.

GLBA preemptions generally apply for the benefit of "depository institutions," "insurers," and their "affiliates."

A "depository institution"[7] is a bank or savings institution, or a foreign bank with U.S. operations, including, without regard to whether its deposits are federally insured: (1) a national bank, federal savings bank, federal savings association, state savings association, or a state bank organized in the District of Columbia; (2) a state commercial bank, banking association, trust company, savings bank, savings association, industrial bank, or another banking institution engaged in the business of accepting deposits (other than funds held by an insured depository institution in a fiduciary capacity), whether organized under Texas law or the laws of another state; and (3) a foreign bank that maintains a branch, agency, or commercial lending company in the United States. For purposes of GLBA, therefore, a depository institution is not limited to an entity commonly understood to be a "bank." Moreover, it appears that a depository institution need not be physically present in Texas to have an "affiliate" that offers nondeposit financial services and products in Texas.

The definition of "insurer,"[8] for purposes of preemption, is equally broad, including "any person engaged in the business of insurance." Thus the term includes insurance companies (underwriters), regardless of the type or nature of its charter or business, agents, adjusters, risk managers—a list without significant limits.

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[4] 15 U.S.C. §6701.

[5] 12 U.S.C. §6715.

[6] *See, e.g.,* 12 U.S.C. §1831x(g)(2) (New FDI Act §46, as enacted by GLBA Section 305) (permitting states to adopt insurance customer protection laws that that provide greater protection for consumers than the protection provided by federal law), and 15 U.S.C. §6807(b) (codified location of GLBA Section 507(b)) (permitting states to adopt privacy laws that provide greater protection for personal information than the protection provided by federal law).

[7] 12 U.S.C. §6715(g)(3) (incorporating 12 U.S.C. §1813(c)(1) and related definitions by reference).

[8] 12 U.S.C. §6715(g)(4).

Finally, an "affiliate"[9] is any person or entity controlling, controlled by, or under common control with a company. GLBA's preemptive effect reaches not only to a depository institution affiliate, but also to any entity or person "associated" with a depository institution. Exactly what constitutes a "person who has an association with any such depository institution or affiliate" is open to interpretation but, in context, would appear to cover joint venture, contractual, or other relationships among individuals, companies, or other persons engaged in financial or other activities.

The Agencies' conclusions and recommendations are presented below. Because the language of GLBA is not a model of clarity, litigation to test the scope and effect of state law preemption under GLBA would appear possible in the foreseeable future. For the benefit of the Committees, the Agencies submit two papers (*see* Appendix G) to provide additional preemption explanation and analysis, by Professor Arthur E. Wilmarth, Jr., of the George Washington University Law School in Washington, D.C., and by Gibson, Dunn & Crutcher LLP of Washington, D.C.[10]

### 3. Texas Statutes Preempted or Impaired by GLBA

The Agencies believe that the substantive statutes they administer, governing banking, insurance, and securities activities in Texas, are consistent with minimum standards in GLBA and are not subject to federal preemption, with the exception of Insurance Code provisions regarding agent licensing.[11]

#### a. DOB

##### i. Impact on Regulated Entities

When it enacted the Texas Banking Act (1995), the 74th Texas Legislature recognized that federal law relating to the regulation of depository institutions would change and incorporated sufficient flexibility into the Act to accommodate that change. The Banking Act (Finance Code Title 3, Subtitle A) thus poses no impediment to a state commercial bank's full participation in the expansion of bank authority contemplated and authorized by GLBA.

A Texas trust company has the corporate power to accept deposits in certain circumstances and would be a "depository institution" for purposes of GLBA if actually engaged in receiving deposits. Most trust companies, however, are not actually engaged in the business of

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[9] 12 U.S.C. §6715(g)(1).

[10] These two papers are identified as follows: (1) Arthur E. Wilmarth, Jr., "Preemption of State Law under the Gramm–Leach–Bliley Act" (June 30, 2000, unpublished) (on file with the Conference of State Bank Supervisors); and (2) Robert C. Eager and Cantwell F. Muckenfuss III, Gibson Dunn & Crutcher LLP, "New Federal Preemption Rules Concerning Insurance and Other Affiliates of Depository Institutions: Section 104 of the Gramm–Leach–Bliley Act" (Nov. 30, 1999, unpublished) (http://www.gibsondunninstitute.com/docs/FinInst/gdi_104.htm).

[11] The Agencies have not reviewed "all" state law for potential preemption and have primarily focused on laws regarding insurance, banking and securities. To the extent evident as a result of study, the Agencies have looked at other laws and present their conclusions in this Report.

receiving deposits and are therefore subject to state law restrictions that are inconsistent with GLBA. Legislative recommendations to permit trust companies to remain competitive are addressed in Section II–B of this Report.

In addition, 28 foreign banks with U.S. operations operate in Texas, 11 through licensed agency offices and another 17 through representative offices in Texas. Each of these foreign banks is a depository institution for purposes of GLBA. Foreign bank activity in Texas is governed by Finance Code Chapter 204, none of which is inconsistent with GLBA.

**ii. User Fees for Automated Teller Machines (ATMs)**

The "ATM Fee Reform Act of 1999," a series of amendments to the Electronic Fund Transfer Act[12] enacted by GLBA Sections 701–705, requires ATMs that charge a fee for providing services to customers of other institutions to notify customers of the existence and amount of the fee.[13] Disclosure must appear on the machine itself and on the screen, at a point that allows the customer to cancel the transaction without a fee. ATM owners are exempt from liability if the posted notices are damaged or removed. Financial institutions are also required to notify customers when they issue an ATM card that ATMs of other institutions may charge for services.

Machines that lack the technological capability for on-screen display are grandfathered until December 31, 2004. Unless grandfathered, ATMs that do not provide these disclosures cannot charge these fees.

Texas law already requires ATM fees to be disclosed to users in certain circumstances but not to the extent required by federal law, *see* Finance Code §59.202. The Electronic Fund Transfer Act explicitly preempts state law that is inconsistent with the Electronic Fund Transfer Act, and then only to the extent of the inconsistency. A state law is not inconsistent with the Act to the extent it provides greater protection to consumers than the Act itself. To avoid a potential preemption, Finance Code §59.202 should be amended to conform to the ATM Fee Reform Act of 1999.

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[12] 15 U.S.C. §§1693 *et seq.*

[13] GLBA Section 704 required the General Accounting Office to study the feasibility of requiring ATMs to disclose all the fees involved in an ATM transaction, including the fees charged by the customer's own institution and other parties involved in completing a transaction. The report was completed in July 2000. *See* U.S. General Accounting Office, "Automated Teller Machines: Issues Related to Real-time Fee Disclosures," (GAO/GGD/AIMD-00-224, July 2000) (http://www.gao.gov/new.items/g100224.pdf).

### b. TSLD

The TSLD regulates state savings banks pursuant to provisions of the Finance Code designed to facilitate and maximize the types of affiliations and activities specifically contemplated by GLBA. The Finance Code thus permits a state savings bank to affiliate with insurance and securities firms. Although state savings banks have historically been authorized to engage in insurance activities, they have elected not to do so because of the Insurance Code's agent licensing requirements, which include the required licensing of all directors, officers, and shareholders of a corporate licensee. GLBA preempts these agent licensing restrictions. As discussed in Section II–D of this Report, TDI will propose legislation that permits a depository institution, including a state savings bank, to sell insurance as agent in Texas.

### c. TDI

#### i. Affiliations

Texas insurance law does not directly prevent the types of affiliations contemplated by GLBA. Under current law, an insurance company may affiliate with other entities under a common holding company, including a depository institution. Current law also permits an insurance company to directly own a depository institution, subject to appropriate state and federal regulatory approvals.

TDI has identified a law concerning the review of proposed affiliations that is preempted by GLBA. Under GLBA, insurance regulators have a maximum of 60 days to review affiliations between depository institutions and insurers. Insurance Code Article 21.49–1, however, provides for a longer review period in certain instances. Legislation should conform the review time in these cases to the 60 days contemplated by GLBA.

#### ii. Agent Licensing Laws

GLBA impacts a number of Texas laws relating to insurance agents, and preempts certain of them. Some of these laws are identified in Commissioner's Bulletin B–0005–00 (Jan. 18, 2000), issued as a partial and temporary means of providing interim guidance on insurance agent licensing under GLBA (*see* Appendix F). In the Bulletin, TDI identified certain licensing provisions of the Insurance Code that are inconsistent with the requirements of GLBA, including the statutory definition of the term "bank", the "place of 5,000" licensing requirement, and certain licensing requirements for corporate agencies and managing general agents. Legislation should be adopted to amend the insurance agent licensing statutes, as specifically addressed in Section II–D of this Report.

### d. SSB

The Texas Securities Act (TSA) focuses on investigation and enforcement actions with respect to fraud or deceit or unlawful conduct in connection with securities or securities transactions, and the registration of securities dealers, investment advisers, and associated persons. The TSA was designed to adapt to developments in the securities industry and in other law. Neither the TSA nor the SSB Rules restrict the ability of a depository institution to engage in the activities permitted by GLBA. The TSA does not prohibit affiliation among depository institutions, insurance companies and securities firms. Consequently, GLBA does not preempt any portion of the TSA.

The SSB does not believe that the TSA needs to be amended in order for a depository institution to fully participate in the securities business as contemplated by GLBA. Additionally, under its rulemaking authority, the SSB can effectively regulate securities activities in Texas, including the securities-related activities of any entity within its statutory jurisdiction. GLBA neither expands nor contracts the jurisdiction of the SSB over the securities business in Texas, and the SSB will continue to regulate firms and individuals that sell securities or provide investment advisory services in or from Texas as it did prior to the enactment of GLBA.

### e. Laws Other than Insurance, Banking, and Securities

#### i. Consumer Protection Laws

Based on TDI review, GLBA does not preempt any state insurance consumer protection law. TDI notes that certain of these consumer protection laws are explicitly permitted in GLBA and saved from preemption.[14] Based on limited DOB review, GLBA does not preempt any provisions of the Texas Deceptive Trade Practices Act.[15]

#### ii. Other Licensing Laws

GLBA defines "financial activities" to include those activities determined by the Board of Governors of the Federal Reserve System ("FRB") by means of regulation or order to be so closely related to banking as to be a proper incident thereto.[16] (*See* Appendix H for a list of these approved activities.) Some of these activities require a permit or license from a state agency other than DOB, TSLD, TDI, or SSB. The Agencies have not contacted other licensing agencies in connection with this Report.[17]

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[14] 15 U.S.C. §6715(d)(2)(B).

[15] Texas Business & Commerce Code §§17.41 *et seq*.

[16] 12 CFR §225.28.

[17] Specifically, state licensing is or may be required in the areas of real estate appraising, real estate brokerage and agency, tax planning and tax-preparation service, career counseling, and the operation of armored car and courier services, among others, possibly implicating licensing requirements administered by the Texas Appraiser Licensing and Certification Board, Real Estate Commission, Board of Public Accountancy, Department of Licensing and Regulation, and Commission on

## B. Enhanced Authority for State-Chartered Banks and Trust Companies

Paragraph 3.B of the Committees' Letter requested study and recommendations regarding expanding the authority of state-chartered banks and their subsidiaries to conduct non-banking activities of the nature contemplated by GLBA, and to conduct activities beyond those allowed for national banks and their subsidiaries to the extent consistent with principles of safety and soundness and applicable federal law. The Agencies examined these issues in a manner consistent with principles of functional regulation and further examined the competitive position of state-chartered trust companies.

### 1. Summary of Conclusions and Legislative Recommendations

To enhance and preserve the state bank charter, Finance Code Title 3, Subtitle A should be amended to clarify the authority of state banks to conduct activities beyond those allowed for national banks to the extent consistent with principles of functional regulation, safety and soundness, and consumer protection. Specifically:

- Finance Code §32.001 should be amended to:
  - characterize a state bank as a corporation with banking powers to increase future flexibility (or limited liability company, in the case of a limited banking association), and
  - authorize a state bank to (1) act as a financial agent, and (2) engage in nonbanking activities that are financial in nature or incidental or complementary to a financial activity, with the approval of the Banking Commissioner;
- Finance Code Chapter 32, Subchapter A, should be amended to add a new §32.011 granting authority to the Banking Commissioner to determine an activity to be financial in nature or incidental or complementary to a financial activity, based on similar considerations as contained in federal law;
- Finance Code Chapter 34, Subchapter B, regarding state bank investments, should be substantially amended to modernize treatment of securities eligible for bank investment and permissible activities for subsidiaries, and for conformity with other amendments and

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Private Security. The Committees may wish to contact the above-listed agencies to determine how each agency would treat an application for licensure by a depository institution or affiliate, and whether the statutes they administer would prevent or restrict the ability of a depository institution, an affiliate of a depository institution, or a person associated with a depository institution or affiliate, to engage in a licensed activity determined to be closely related to banking (*see* Appendix H). Any inquiry should address whether a licensee engaged in any such activity is restricted from affiliating with a depository institution, an affiliate of a depository institution, or a person associated with a depository institution or affiliate. Based on the agencies' responses, additional legislative suggestions may be appropriate to cure any conflict or inconsistency with those agencies' laws and GLBA.

with federal law.

Finance Code Title 3, Subtitle C should be amended to allow state savings banks to take advantage of GLBA while preserving the authority of grandfathered unitary thrifts operating in Texas. Specifically:

- Finance Code §93.001(c) should be amended to authorize a state savings bank to act as a financial agent and to engage, with the approval of the Savings and Loan Commissioner, in activities deemed to be financial in nature or incidental to or complementary to a financial activity, based on similar considerations as contained in federal law; and

- Finance Code Chapter 94 should be amended to conform the range of permissible investments for a state savings bank to reflect those investments permitted by the amendments to Chapter 93.

To enhance and preserve the state trust company charter and allow trust companies to remain competitive, Finance Code Title 3, Subtitle F should be amended to permit state trust companies to engage in financial activities. Specifically:

- In alternate form because of pending codification, Finance Code §182.001 and Texas Civil Statutes Article 342a–3.001 should be amended to authorize a state trust company, to the extent consistent with existing fiduciary duties, to (1) act as a financial agent, and (2) engage in other activities that are financial in nature or incidental or complementary to a financial activity, with the approval of the Banking Commissioner;

- Finance Code §182.001 should also be amended to add a new subsection (g) providing that a "trust association" and a "limited trust association" are treated as a business corporation and a limited liability company, respectively, for purposes of other state law; and

- Finance Code Chapter 182, Subchapter A, should be amended to add a new §182.020 granting authority to the Banking Commissioner to determine an activity to be financial in nature or incidental or complementary to a financial activity, based on similar considerations as contained in federal law.

Proposed legislation should explicitly continue functional regulation as contemplated by GLBA. This concept is strongly endorsed by the Agencies, and should require notification and provide for consultation with an affected functional regulator before implementation. To the extent an approved activity is subject to licensing and regulation by another state or federal agency, a state bank, state savings bank, trust company, or a subsidiary of any of them, as the case may be, must apply for and obtain the license and submit to regulation by the other agency before it may engage in the new activity, based on similar considerations as contained in federal law.

## 2. Impact of GLBA

### a. State Banks, State Savings Banks, and GLBA

Although state banks and state savings banks are materially different under state law, both are defined as "state banks" under the Federal Deposit Insurance Act ("FDI Act")[18] and are generally treated as such without distinction by GLBA. One federal distinction between the two charters relates to holding company regulation. Federal law permits a state savings bank holding company to elect to be treated as a thrift holding company or as a BHC.[19] (The Office of Thrift Supervision ("OTS") regulates thrift holding companies and the FRB regulates BHCs and FHCs.) Before GLBA, this election was advantageous because a unitary thrift could engage in an unlimited array of businesses and activities, including those authorized by GLBA for a FHC. This broader activity authority was prospectively eliminated by GLBA but grandfathered for existing unitary thrifts and for applications pending as of May 4, 1999. GLBA does not disturb the ability of a state savings bank holding company to elect to be treated as a thrift holding company.

Other than this holding company distinction, GLBA provisions relating to state banks apply equally to a state savings bank and a state bank. References to "state banks" in this Section II–B-2-a of the Report apply to both state banks and state savings banks. The Report addresses GLBA treatment of national banks first because the Act's treatment of state banks is in some respects derivative of its treatment of national banks.

#### i. National Bank Activities and GLBA

GLBA Section 121(a) adds new Section 5136A to the Revised Statutes of the United States[20] to provide that a national bank, through a financial subsidiary, may engage in certain activities that are financial in nature or incidental to a financial activity, and other activities that national banks may engage in directly. Treasury may deem an activity "financial in nature" for subsidiaries of national banks under this section, after consulting with the FRB. The FRB has the authority to disapprove a Treasury determination; additionally, the FRB may separately recommend activities as "financial in nature" to the Treasury, and the Treasury has 30 days to act on that recommendation.

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[18] 12 U.S.C. §1813(a)(2).

[19] 12 U.S.C. §1467(l).

[20] 12 U.S.C. §24a.

GLBA initially establishes a handful of pre-approved financial activities for national bank financial subsidiaries:

- lending, exchanging, transferring, investing for others, or safeguarding money or securities;
- engaging as agent or broker for purposes of insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, death, defects in title, or providing annuities as agent or broker;
- providing financial, investment, or economic advisory services, including advising an investment company;
- issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly;
- underwriting, dealing in, or making a market in securities;
- engaging in an activity the FRB had determined to be closely related to banking prior to November 12, 1999 (*see* list in Appendix H); and
- engaging, in the United States, in activities that a BHC may engage in outside the United States if determined by the FRB, as in effect on November 11, 1999, to be usual in connection with the transaction of banking or other financial operations abroad (*see* list in Appendix H).

Finally, a national bank financial subsidiary may engage in activities that the Treasury determines to be financial in nature or incidental to a financial activity, subject to consultation with the FRB and the FRB's veto power over such determinations.

### ii. State Bank Activities and GLBA

#### (A) New Section 46 of the FDI Act

GLBA Section 121(d) adds new Section 46 to the FDI Act[21] to expressly govern state bank subsidiaries that engage in certain financial activities. In general, this new provision requires minimum safety and soundness firewalls between a state bank and its subsidiary if the subsidiary is engaging in activities as principal that a national bank could conduct only through a financial subsidiary. The activity of a state bank subsidiary as agent is not restricted by federal law, and should not be restricted by state law either.

If a state bank elects to engage in an activity that must be conducted in the equivalent of a financial subsidiary, the bank may not engage in the activity unless it is well capitalized under applicable federal law after deducting its investment in the subsidiary. Additionally, it must have risk-management procedures in place for both the bank and subsidiary, must preserve the separate corporate identity and limited liability of the parent bank, and must, along with its subsidiary, comply with the restrictions applicable to transactions between a national bank and its financial subsidiaries.

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[21] 12 U.S.C. §1831w.

(State banks that on November 12, 1999, already had operating subsidiaries engaged in activities that would be subject to Section 46 are "grandfathered" and may keep them without complying with the new Section 46.)

Most importantly, the end of this new Section 46 clarifies that, *under federal law*, state banks *may* — where authorized by their own states — own and operate subsidiaries that engage in activities not allowed for national banks, subject to Federal Deposit Insurance Corporation ("FDIC") review and approval. The law expressly reaffirms FDIC authority under Section 24 of the FDI Act[22] to review and approve state bank subsidiary activities.

### (B) Section 24 of the FDI Act

Under Section 24 of the FDI Act, an insured state bank may not engage as principal in a type of activity that is not permissible for a national bank unless the FDIC has determined that 1) the activity poses no significant risk to the federal deposit insurance fund; and 2) the bank is in compliance with applicable federal capital standards. (However, the FDIC cannot approve state banks engaging in insurance underwriting beyond the extent that the activity is permissible for national banks.) Similarly, Section 24 provides that a subsidiary of an insured state bank may not engage as principal in a type of activity that is not permissible for a subsidiary of a national bank unless the FDIC has determined that 1) the activity poses no significant risk to the federal deposit insurance fund; and 2) the bank is in compliance with applicable federal capital standards. (Again, the FDIC cannot approve a subsidiary of a state bank to engage in insurance underwriting beyond the extent that such activities are permissible for national banks.)

Further explanation of bank powers, Section 24, Section 46, and the FDIC's related rules[23] and past determinations are beyond the scope of this Report. Opportunities still clearly exist, however, for state banks to engage in activities beyond the power of national banks. The key lies in the creativity of state lawmakers and in the complex interstices of federal law. The significant conclusion is worth repeating: *Although federal law restricts the activities of national banks, federal law does not impose the same restrictions on state banks.* State law therefore should be formulated in a manner that preserves the separate and distinct nature of the state bank charter.

### (C) The Net Impact of GLBA on State Banks

The enactment of GLBA is the latest chapter in a long history of innovation through the dual banking system. It is no exaggeration to say that the advances in GLBA are possible only because so many states have acted, over the past several years, to expand the powers of state-chartered banks. Many of the activities newly approved for national banks by GLBA were approved for state banks by the FDIC under Section 24 within the past decade. Bank sales of securities, insurance and real estate all originated at the state level, and states developed their own

[22] 12 U.S.C. §1831a.

[23] 12 C.F.R. Part 362.

systems of coordinated, "functional" regulation with respect to these activities. GLBA not only preserves these systems, but extends them to apply to federally chartered depository institutions.

Based on a comparison of GLBA Section 121(a) and (d) and an examination of the activities authorized, securities underwriting and dealing (in the capacity of principal) is the only current financial activity authorized by GLBA for national bank financial subsidiaries that must be similarly placed in a state bank financial subsidiary. Future determinations by Treasury and the FRB regarding new financial activities must be periodically evaluated to determine whether a new activity by a state bank must be conducted in a financial subsidiary.

### (D) Agency Discretion to Adapt

State banks and state savings banks currently have some flexibility to engage in financial activities as contemplated by GLBA, in large part because of regulatory discretion provided for in the Finance Code. This flexibility was specifically designed to permit adaptation to increasingly frequent changes in federal banking law. However, in light of GLBA, some language in the Finance Code is suggestive of limitations and should be amended.

The Banking Commissioner has regulatory discretion to approve additional activities for state banks that he deems "closely related to banking" pursuant to Finance Code §32.001(b)(4). In addition, Finance Code §32.001(b)(1) provides flexibility for a state bank to "exercise incidental powers as necessary to carry on the business of banking." State banks also have constitutional "parity" with Texas-based national banks. A state bank has "the same rights and privileges that are or may be granted to national banks of the United States domiciled in this State."[24] Finance Code §32.009 provides a mechanism for assessing the validity of constitutional parity claims and addressing otherwise inconsistent state law. Finally, additional parity authority is contained in Finance Code §32.010, added in 1999 to address the interstate environment.

The Savings and Loan Commissioner has broad authority to authorize new activities that are permitted for state or national banks, or state or federal thrifts, or new activities that are otherwise "incidental" or "reasonably necessary" to accomplish the purposes of a savings bank, *see* Finance Code §§93.001, 93.002, and 93.008.

[24] Section 16(c), Article XVI, Constitution of the State of Texas 1876. Article XVI §16 empowers the Texas Legislature to establish a regulated state banking system. Interpreting the meaning of §16, fully 80% of which is obsolete or irrelevant today, is the artful mystery of a handful of banking lawyers. Much of the irrelevancy is directly attributable to federal preemption, but not by GLBA. Consequently, no recommendation is made regarding amending the Constitution. The Banking Commissioner has previously recommended amending Article XVI §16 by written testimony dated April 17, 2000, delivered to the House Select Committee on Constitutional Revision.

### b. State Trust Companies and GLBA

To enhance and preserve the state trust company charter and allow trust companies to remain competitive, Finance Code Title 3, Subtitle F should be amended to permit state trust companies to engage in the same financial activities as their competitors.

A Texas trust company has the corporate power to accept deposits in certain circumstances and would be a "depository institution" for purposes of GLBA if actually engaged in receiving deposits. Most trust companies, however, are not actually engaged in the business of receiving deposits and are therefore subject to state law restrictions that are inconsistent with GLBA.

To the extent a state law prohibits a trust company from engaging in the expanded financial activities authorized by GLBA for depository institutions, it likely will do so because of definitional constraints. Although corporate in nature, a trust company is a "trust association." Finance Code §182.001 should be amended to add a new subsection (g) providing that a "trust association" and a "limited trust association" are treated as a business corporation and limited liability company, respectively, for purposes of other state law. Because Texas licensing statutes applicable to business entities consistently use the term "corporation," this amendment should remove any impediment to licensing trust companies as a result of definitional ambiguities.

Even if a trust company is viewed as a "corporation" by other state law for licensing purposes, it cannot obtain a license if it lacks the inherent power to engage in the licensed activity. Finance Code §182.001 and Texas Civil Statutes Article 342a–3.001(both in alternate form because of pending codification) should be amended to authorize a state trust company, to the extent consistent with existing fiduciary duties, to (1) act as a financial agent; and (2) engage in other activities deemed financial in nature or incidental or complementary to a financial activity, with the permission of the Banking Commissioner.

Finally, to permit adaptability of trust company powers in response to future developments, Finance Code Chapter 182, Subchapter A, should be amended to add a new §182.020 granting authority to the Banking Commissioner to determine an activity to be financial in nature or incidental or complementary to a financial activity, based on similar considerations as contained in federal law.

## 3. Legislative Recommendations

Proposed legislation enhancing financial institution powers should explicitly continue functional regulation as contemplated by GLBA. This concept is strongly endorsed by the Agencies, and should require notification and provide for consultation with an affected functional regulator before implementation. To the extent an approved activity is subject to licensing and regulation by another state or federal agency, a state bank, trust company, or a subsidiary of either, as the case may be, must apply for and obtain the license and submit to regulation by the other agency before it may engage in the new activity, based on similar considerations as contained in federal law.

### a. DOB

Statutory language in Finance Code §32.001 and in Chapter 34, Subchapter B, suggest limitations on state bank authority that are inconsistent with the full scope of GLBA. Although DOB can administratively use constitutional parity to work around those limitations, the statutes should be amended to clearly address nonbanking financial activities and investments. In addition, the FRB and the Treasury may approve new financial activities that are "financial in nature or incidental to such financial activity" or "complementary to a financial activity." State law should give the Banking Commissioner similar authority to enhance the flexibility of the state bank charter. Specifically:

- Finance Code §32.001 should be amended to:
    - characterize a state bank as a corporation with banking powers to increase future flexibility (or limited liability company, in the case of a limited banking association), and
    - authorize a state bank to (1) act as a financial agent, and (2) engage in nonbanking activities that are financial in nature or incidental or complementary to a financial activity, with the approval of the Banking Commissioner;
- Finance Code Chapter 32, Subchapter A, should be amended to add a new §32.011 granting authority to the Banking Commissioner to determine an activity to be financial in nature or incidental or complementary to a financial activity, based in similar considerations as in federal law; and
- Finance Code Chapter 34, Subchapter B, regarding state bank investments, should be substantially amended to modernize treatment of securities eligible for bank investment and permissible activities for subsidiaries, and for conformity with other amendments and with federal law.

To enhance and preserve the state trust company charter and allow trust companies to remain competitive, Finance Code Title 3, Subtitle F should be amended to permit state trust companies to engage in financial activities. Specifically:

- Finance Code §182.001 and Texas Civil Statutes Article 342a–3.001 (both in alternate form because of pending codification) should be amended to authorize a state trust company, to the extent consistent with existing fiduciary duties, to (1) act as a financial agent; and (2) engage in other activities that are financial in nature or incidental or complementary to a financial activity, with the approval of the Banking Commissioner;
- Finance Code §182.001 should be amended to add a new subsection (g)

characterizing a trust company as a corporation for purposes of other state law (or limited liability company, in the case of a limited trust association); and

- Finance Code Chapter 182, Subchapter A, should be amended to add a new §182.020 granting authority to the Banking Commissioner to determine that an activity is financial in nature or is incidental or complementary to a financial activity, based on considerations similar to those contained in federal law.

### b. TSLD

The TSLD supports expanding the authority of all state-chartered financial institutions to engage in a broad range of activities. However, numerous unitary thrifts that are grandfathered under GLBA operate in Texas and are permitted under federal law to engage in virtually any type of nonbanking activity. This authority must be carefully preserved.

To enhance and preserve the state savings bank charter, Finance Code Title 3, Subtitle C should be amended to allow state savings banks to take advantage of GLBA while preserving the authority of grandfathered unitary thrifts operating in Texas. Specifically:

- Finance Code §93.001(c) should be amended to authorize a state savings bank to act as a financial agent and to engage, with the approval of the Savings and Loan Commissioner, in activities deemed to be financial in nature or incidental to or complementary to a financial activity, based on similar considerations as contained in federal law; and

- Finance Code Chapter 94 should be amended to conform the range of permissible investments for a state savings bank to reflect those investments permitted by the amendments to Chapter 93.

### c. TDI and SSB

TDI and SSB note that this is essentially a “bank powers” issue. TDI and SSB endorse these recommendations based on the understanding that the proposed new discretionary authority for Texas banking regulators will be exercised within the system of functional regulation as contemplated by GLBA.

## C. Formation of Financial Holding Companies (FHCs)

Paragraph 3.C of the Committees' Letter requested study and recommendations to ensure that state laws allow BHCs to become FHCs and engage in activities that are financial in nature or incidental to such financial activity, or complementary to a financial activity, as determined in the manner provided by GLBA, or to the extent otherwise permissible under federal law.

### 1. Summary of Conclusions and Legislative Recommendations

Current state law is silent on the ability of a BHC to become a FHC and then engage in activities that are financial in nature, or that are incidental or complementary to a financial activity, in the manner contemplated by GLBA.

Finance Code Chapter 202, regarding BHC regulation, should be amended to explicitly affirm the ability of a BHC to become a FHC and to authorize information sharing among state and federal regulators as a means of promoting efficient regulatory activity. In addition, Finance Code §201.002 should be amended to incorporate definitions related to FHCs and financial activities.

Finance Code Chapter 97, regarding state savings bank holding company regulation, should be amended to explicitly preserve the powers of unitary thrifts, confirm the powers of all other state savings bank holding companies, confirm the ability of a BHC which controls a state savings bank to become a FHC, add new definitions to incorporate the terminology created by GLBA, and authorize information sharing among state and federal regulators as a means of promoting efficient regulatory activity.

Recommendations concerning information sharing among regulatory agencies are discussed in Section II–E of this Report.

### 2. Operation of Existing Law

#### a. Finance Code

A FHC is a BHC that has filed an election with the FRB under Section 4(k)(6) of the BHC Act,[25] as added by GLBA Section 103(a), to engage in the additional activities authorized by GLBA.

Finance Code §202.004 requires a BHC doing business in this state to file with the DOB a copy of any application or notice submitted to the FRB under Section 4 of the BHC Act if the application or notice involves an office located or to be located in this state. Therefore, under current Texas law, a BHC's notice that it elects FHC status must be filed with DOB. Texas law similarly captures a notice filed by a FHC to expand or engage in new activities, including an application to

[25] 12 U.S.C. §1843(k)(6).

engage in activities that have not yet been determined by the FRB to be "financial in nature or incidental to such financial activity" or "complementary to a financial activity."[26]

Under Finance Code §202.004, DOB may hold a hearing to aid in determining whether to approve the acquisition or activity proposed in the notice or application. The Banking Commissioner may not approve the proposed acquisition or activity if he finds that it will probably cause adverse effects detrimental to the public interest, including undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. If the Banking Commissioner disapproves the proposed acquisition or activity, he must file a response to the application or notice with the FRB, and may request a hearing. If the FRB grants the hearing request, the Banking Commissioner must present evidence at the hearing to support his denial of the proposed acquisition or activity. If the FRB disagrees with the Banking Commissioner's determination, the Commissioner may accept the adverse decision or appeal it pursuant to Section 9 of the BHC Act.[27]

Finance Code §202.005 authorizes DOB to examine a BHC that controls a Texas bank as if the holding company were a Texas state bank and to bring an administrative enforcement action against a holding company that violates applicable laws as if the company was a state bank. DOB routinely participates with the FRB in examining a BHC that controls a state bank to keep informed regarding the activities and financial condition of the parent company and affiliates of the state bank. The DOB will, to the extent possible, gather information from other functional regulators regarding FHCs in such a manner as to reduce the regulatory burden on these entities.

Finance Code §97.002 requires a holding company that owns a state thrift to register within 90 days of becoming a thrift holding company. Finance Code §§97.004–97.006 set forth requirements regarding reports, books and records, and examinations.

**b. Insurance Code**

Texas insurance law does not distinguish between different types of holding companies. In essence, if an insurance company is "controlled by" another entity, then that insurer is considered to be a part of an Insurance Holding Company System. Similarly, any holding company that owns an insurer (such as a BHC or FHC) is considered to be an Insurance Holding Company System for purposes of the functional regulation of insurance.

Article 21.49–1 of the Texas Insurance Code governs state regulation of Insurance Holding Company Systems. This law essentially requires that transactions between affiliates involving an insurer be "fair and equitable" so that an insurer is not disadvantaged by an entity that controls the insurer to the detriment of its policyholders. Various sections within art 21.49–1 address transactions between insurers and affiliates, including dividends, changes of control of an insurer, and investment limitations.

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[26] 12 U.S.C. §1843(k)(1)–(4).

[27] 12 U.S.C. §1848.

Article 21.49–1 §9 specifically authorizes TDI to conduct examinations of non-insurer affiliates in certain instances. Although TDI uses this examination authority as needed in lieu of regularly scheduled examinations, TDI considers the authority to examine non-insurer affiliates essential to adequately fulfill its mission. TDI will, to the extent possible, gather needed information from other functional regulators to reduce the regulatory burden on FHCs and to take advantage of the expertise of other functional regulators.

### 3. Legislative Recommendations

Finance Code Chapter 202, regarding BHC regulation, should be amended to explicitly affirm the ability of a BHC to become a FHC and to authorize information sharing among state and federal regulators as a means of promoting efficient regulatory activity. In addition, Finance Code §201.002 should be amended to incorporate definitions related to FHCs and financial activities.

Finance Code Chapter 97, regarding state thrift holding company regulation, should be amended to explicitly preserve the powers of unitary thrifts, confirm the powers of all other thrift holding companies, confirm the ability of a BHC which controls a state savings bank to become a FHC, add new definitions to incorporate the terminology created by GLBA, and authorize information sharing among state and federal regulators as a means of promoting efficient regulatory activity.

Recommendations concerning information sharing among regulatory agencies are discussed in Section II–E of this Report.

## D. Uniform Licensing and Education for Insurance Agents and Companies

Paragraph 3.D of the Committees' Letter requested study regarding actions required to implement uniform licensing and continuing education requirements for insurance agents and companies as contemplated by Title III of GLBA. TDI assumed primary responsibility for this portion of the study. The Agencies note that uniform licensing and continuing education for insurance "companies" is not addressed in GLBA, although the states through NAIC are addressing increased uniformity of treatment of insurance companies in the interstate environment.

### 1. Summary of Conclusions and Legislative Recommendations

Each state, including Texas, currently establishes its own insurance agent licensing requirements. As a result, requirements vary from state to state. GLBA seeks to bring greater uniformity to insurance agent licensing. In order for state control of the agent licensing function to continue, at least a majority of the states and U.S. territories (29) must either adopt uniform agent licensing requirements or institute reciprocal agent licensing prior to 2002. The Texas Insurance Code does not currently address uniform licensing and continuing education requirements for insurance agents and therefore does not satisfy the mandate of GLBA. As part of the effort to maintain state control of agent licensing, the 76th Legislature's S.B. 956 should be revised to fully implement GLBA and be re-introduced in the 77th Texas Legislature.

### 2. Operation of Existing Law

GLBA Title III, Subtitle C,[28] establishes NARAB effective November 12, 2002, unless at least a majority of the states and U.S. territories (a total of 29 jurisdictions) either enact uniform agent licensing requirements or institute reciprocal agent licensing. The stated purpose of NARAB is to provide a mechanism for the adoption and application of uniform licensing, continuing education and other qualification requirements for non-resident insurance agents. Under Title III, NARAB would be a self-regulating body. The establishment of NARAB would eliminate the states' authority to prescribe non-resident agent licensing requirements.

Current Texas insurance law does not address uniform licensing and continuing education requirements for insurance agents. In 1999, the 76th Texas Legislature passed Senate Bill No. 956, an agent licensing reform bill. S.B. 956 provided for reciprocal licensing between states and also contained a majority of the uniform provisions that formed the core of a model agent licensing law that was subsequently adopted by the National Association of Insurance Commissioners in its Producer License Model Act. The Governor vetoed S.B. 956, however, because of an amendment unrelated to agent licensing that was added to the bill late in the process. As a result, Texas insurance law does not include the uniform agent licensing requirements or provisions for reciprocal agent licensing contemplated by GLBA.

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[28] 15 U.S.C. §§6751 *et seq.*

Unless current law is reformed, a very real possibility exists that states will lose control of the agent licensing function for non-resident agents. The TDI strongly believes the licensing function should remain with the states. The number of disciplinary actions taken by TDI and other insurance regulators against agents every year underscores the public policy concerns that would arise under NARAB.

The desire to avoid triggering NARAB creates an impetus for changes to the Insurance Code's agent licensing provisions. In addition, certain Insurance Code provisions are inconsistent with GLBA provisions concerning bank insurance sales. TDI recommends amending the Insurance Code to properly implement financial services modernization in Texas.

### 3. Non–Legislative Solutions

TDI has worked within the current statutory framework to address a number of the issues created by GLBA. As previously reported, the Commissioner of Insurance issued Commissioner's Bulletin No. B–0005–00 (Jan. 18, 2000) (*see* Appendix F), as a partial and temporary means to provide interim guidance on certain agent licensing issues created by GLBA.

GLBA did not address uniform licensing for insurance companies. TDI is pursuing several initiatives in this regard, however, in the interest of modernization and interstate uniformity. For example, TDI recently implemented a streamlined system of insurance company licensing by adopting a uniform license application and related procedures corresponding to the NAIC's Accelerated Licensure Evaluation and Review Techniques (ALERT) program. In the past, insurers had to file different license applications with each of the 50 states. Under ALERT, an insurer may file a uniform application with participating states that have implemented the uniform procedures and processing time frames. The ALERT program also allows streamlined admissions for subsequent expansions into other states. The expansion application process introduces elements of reciprocal reliance on the work performed by other states. In addition, the NAIC is pursuing the development of an electronic repository for company applications to facilitate "one-stop" license applications.

TDI is also working with the NAIC to develop a state-based equivalent of a national charter for insurance companies, and is a charter member of the NAIC's National Treatment of Insurer's Working Group. This Working Group was established to further modernize the licensing process for insurers and envisions allowing certain companies to operate on a national basis after an initial review process. The Working Group has established an aggressive time frame for completing its mission.

### 4. Legislative Recommendations

TDI is committed to maintaining state control of the agent licensing function by achieving the uniformity in insurance agent licensing required by GLBA. TDI has worked with other insurance regulators through the NAIC to design effective uniform licensing standards, which are reflected in the NAIC's Producer Licensing Model Act. TDI recommends that the 76th Legislature's S.B. 956, which contained many of the model act's uniformity provisions, be revised to fully implement GLBA and be re-introduced in the 77th Texas Legislature.

The legislative proposal will:

- substantively amend Insurance Code Articles 1.14–2; 17.25; 20A.15; 20A.15A; 21.01; 21.01–1; 21.01–2; 21.02; 21.04; 21.06; 21.07; 21.07–1; 21.07–2; 21.07–3; 21.11; 21.14; 21.14–2; and 21.58A;

- amend for conformity Insurance Code Articles 3.71; 3.75; 5.13–1; 16.24A; 17.25; 21.21–9; 22.14; and 23.23A; and

- repeal Insurance Code Articles 21.02–1; 21.05; 21.06; 21.07A; 21.15; 21.15–2; 21.15–3; 21.15–4; 21.15–7; and 23.23.

## E. Coordination and Information Sharing among Regulatory Agencies

Paragraph 3.E of the Committees' Letter requested study regarding how best to authorize and require coordination and information sharing among the Agencies' as well as between state and federal banking and functional regulators, including adequate safeguards for shared confidential information.

### 1. Summary of Conclusions and Legislative Recommendations

To maintain and enhance existing functional regulatory cooperation, legislation should be enacted adding a provision to each of the Agencies statutes (in the Finance Code, Insurance Code, and Texas Securities Act) to effectively encourage further development in sharing regulatory information as a means of avoiding duplicative filings, examinations, and other regulatory activities, whether or not the information is confidential. Each provision will vary based on its statutory setting, but should:

- Specifically disclaim and prevent waiver of any privilege or loss of confidentiality applicable to information that might otherwise be waived or lost as a result of sharing the information with another regulatory agency;
- Preserve each Agency's discretion regarding the appropriate use of its confidential regulatory information as well as each Agency's discretionary authority to directly examine or require information filings from a functionally regulated affiliate; and
- Authorize the use of interagency agreements for the purpose of specifying procedures regarding use and handling of shared information, and allowing greater specificity regarding the types of information to be shared and under what circumstances, details that can be developed over time as the Agencies gain experience in cooperatively regulating affiliated entities.

In addition, legislation should be enacted to restore the former status of an insurance company as a "financial institution" for purposes of the exception to public disclosure contained in Government Code §552.112(a) for "information contained in or relating to examination, operating, or condition reports prepared by or for an agency responsible for the regulation of financial institutions or securities, or both."

### 2. The Need Created by GLBA

GLBA authorizes a great deal of coordination and information sharing between federal banking regulators and functional regulators with respect to FHCs and affiliated depository institutions and functionally-regulated subsidiaries. The public policy underlying GLBA encourages each federal banking regulatory agency and each functional regulatory agency, including the Federal Trade Commission ("FTC"), Securities and Exchange Commission ("SEC"), a state securities

regulatory agency, and a state insurance regulatory agency, to exchange useful regulatory information, subject to written agreements that require reasonable efforts to maintain the confidentiality of exchanged information. The purpose of exchanging regulatory information is to facilitate the ability of each participating agency to discharge its regulatory responsibility with respect to an entity within the affiliated group, by permitting the agency to assess the potential impact of the activities and financial condition of the entity's affiliates upon matters within the agency's jurisdiction. Sharing of useful regulatory information can also be expected to benefit regulated industries by enhancing the coordination of regulatory examinations. An agency otherwise empowered to examine an affiliate that is primarily regulated by another agency can coordinate its activities with the other agency, such as by first attempting to obtain needed information from the primary agency that regulates the affiliate before conducting its own examination of the affiliate.

The types of confidential information which should be shared include, for example, examination reports, information on transactions and relationships between a regulated insurer or securities firm and an affiliated depository institution, and information regarding the financial condition, risk management policies, and operations of a FHC that controls an insurer or a securities firm. In addition, prompt forwarding of consumer complaints to the primary regulatory agency can aid the Agencies in coordinating the regulation of multi-financial service providers. For example, a customer of a bank selling securities may call the DOB to complain about a transaction. DOB can promptly forward the complaint to the SSB for expeditious handling to ensure that consumers are protected and receive the prompt and courteous service the Agencies individually strive to achieve.

GLBA addresses functional regulation at the federal level. It necessitates a state-level response to ensure the coordination of state-level functional regulation. The preservation of confidentiality and privilege are important concerns, which must be addressed. Legislation should explicitly prevent waiver of confidentiality laws and legal privileges applicable to shared regulatory information.

### 3. Operation of Existing Law

#### a. Interactions with Other Agencies

The requirement of confidentiality of shared, state-federal information relating to functional regulation is addressed in GLBA. However, the concept is not new to Texas regulatory agencies. GLBA is serving as a catalyst for the state agencies to create a more formalized process.

In general, the appropriate federal banking agencies may not provide any information entitled to confidential treatment under federal regulations or other applicable law to a state functional regulator unless the latter is enabled under law to keep the material confidential and is compelled to take all reasonable steps to preserve the confidentiality of the shared information. The federal banking agencies are also directed to treat any information obtained from a state functional regulator in a reciprocal fashion. Any interagency sharing of information or material between the regulators is

explicitly stated to not constitute a waiver of, or otherwise affect, any privilege to which such information is otherwise subject.

Existing state and federal statutes have for many years addressed information sharing between federal banking regulators and state banking regulators, including the DOB and the TSLD, and between DOB, TSLD, and banking regulators from other states and countries, as well as other Texas regulatory agencies. Existing state statutes validate and protect information sharing between DOB, TSLD, and other state and federal regulatory agencies and also expressly authorize procedural agreements with other regulators regarding the handling and protection of confidential information, including Finance Code §§31.301, 31.303, 89.052, 96.352, 181.301, 181.303, and 201.007.

A number of statutes govern the treatment of regulatory information maintained by TDI. For example, Insurance Code Article 1.15 §9 provides that examination reports, and information obtained during the course of an examination, are confidential by law. Article 1.15 §7 allows the Insurance Commissioner to use information developed during an examination to further any legal or regulatory action considered appropriate in the exercise of discretion. A variety of other statutes relating to TDI's maintenance of information also exist.

Section 28 of the Texas Securities Act protects information received from another law enforcement or regulatory agency, interagency notes, memoranda, reports, or other communications consisting of advice, analyses, opinions, or recommendations, subject to release only pursuant to court order. SSB may, in the exercise of discretion, disclose confidential information to a governmental authority approved by SSB rule, a quasi-governmental authority charged with overseeing securities activities approved by rule, or to a receiver appointed under Section 25–1 of the Texas Securities Act. The SSB has adopted rules, 7 TAC §§131.1 and 131.2, to permit such disclosures to assist in the detection or prevention of violations of law or to further administrative, civil, or criminal action. This authority is sufficient to enable the SSB to provide information to other regulators and obtain information from other regulators while maintaining the confidential nature of any such information.

However, the Agencies are concerned that the separately developed and independent nature of existing statutory enactments governing interagency sharing of confidential information raises uncertainties regarding more global applicability. Other state agencies may need to be included based on future developments or in a specific situation. Determining whether an unidentified Texas agency can protect shared information creates a burden because of the resulting need to independently and thoroughly research the other agency's laws. The Agencies believe that explicit statutory authority attuned to the information needs of state agencies with converging jurisdictions is necessary to eliminate undeterminable and unintended consequences to freely sharing regulatory data.

### b. Application of Public Information Act

Government Code Chapter 552 is popularly known as the "Open Records Act" or the "Public Information Act." While an agency's information made expressly confidential by law is excepted from public release pursuant to the Texas Public Information Act, the statute does not explicitly address the effect on confidentiality of such information when shared among state agencies. The Office of the Attorney General has issued several opinions over the years that conclude confidentiality is not lost as a result of information sharing.[29] The general thrust of these opinions is that transfer of confidential, regulatory information from one state agency to another does not cause the information to lose its confidential status or violate statutory proscriptions on disclosure of confidential information, and creates a duty in the receiving agency to prevent disclosure of confidential information received. However, an Attorney General opinion is subject to reversal by a court that disagrees with its conclusions.[30] Legislation to more firmly establish this principle of law is desirable.

Because Government Code §552.101 specifically incorporates confidentiality provided by other law, the Agencies believe that legislation amending their own laws, *i.e.*, the Finance Code, Insurance Code, and Texas Securities Act, to address confidentiality obligations of recipient agencies, can adequately protect state agencies from forced disclosure of shared confidential information.

### 4. Possible Non–Legislative Solutions

The key to effective regulation in an environment of converging jurisdiction is information sharing and cooperation among regulators to maximize efficiency of the regulatory resources of the state and minimize the burden on regulated entities that might otherwise arise. Each of the four agencies currently has information sharing agreements with federal regulators. Similar arrangements, though less formal, also exist with functional regulators from other states. DOB and TDI have an existing information sharing and cooperative relationship by statute with regard to insurance funded prepaid funeral benefit contracts. A broader and less formal written, information sharing agreement also currently exists among the SSB, DOB, and TDI that provides an effective basis for sharing agency records and information among these agencies. This agreement remains in effect; however, the Agencies believe a more comprehensive interagency agreement is necessary in light of GLBA to address information sharing and confidentiality issues during the interim period until the Texas Legislature can address needed changes to Texas law. The agreement is expected to be finalized shortly and will include all four Agencies.

Under the agreement each agency will designate a person who will act as the agency's primary contact with respect to matters arising under the agreement. The agreement commits each agency to provide any and all information acquired in the performance of their respective regulatory duties that might assist one of the regulators in assessing an entity's compliance with governing law.

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[29] *See, e.g.*, Op. Atty. Gen. Nos. M–713 (1970), H–242 (1974), and H–917 (1976).

[30] *Cf., supra,* note 32.

In addition to information sharing, the agreement outlines agency responsibility for confidentiality of information and records.

In addition, TDI, working through the NAIC, is actively involved in discussions with various federal regulators to implement GLBA directives relating to information sharing between state and federal regulators. For example, TDI serves on the NAIC's Coordinating with Federal Regulators Working Group. TDI is also drafting and/or implementing a number of agreements with various federal, state, and international regulators that govern the exchange of information as contemplated by the GLBA. This work will prove helpful as cross-industry sharing of regulatory information matures through experience and will position Texas as a leader among states regarding innovation in this area. However, the Agencies would prefer a more explicit statutory basis for maintaining confidentiality of shared information.

### 5. Legislative Recommendations

Legislation should be adopted to address:

- The preservation of the confidential nature of information shared among functional regulators,
- The preservation of legal privileges when privileged information is shared, and
- The responsibility of affected Commissioners to exercise appropriate judgement and discretion in determining when regulatory information should be shared.

Such legislation will provide the necessary underpinning to the interagency coordination that is essential to a system of functional regulation.

The Agencies also recommend that this legislation clearly authorize the use of interagency agreements among the Agencies for the purpose of specifying procedures regarding use and handling of shared information and to allow greater specificity regarding the types of information to be shared and under what circumstances, details that will be developed over time as the Agencies gain experience in cooperatively regulating affiliated entities and learn what information collected by other Agencies is truly useful.

With respect to the Public Information Act, the Agencies recommend that an amendment be adopted to specify that an insurance company is a financial institution for purposes of the exception in Government Code §552.112(a), for "information contained in or relating to examination, operating, or condition reports prepared by or for an agency responsible for the regulation of financial institutions or securities, or both." The legislation would codify the longstanding position of the Attorney General that insurance companies are "financial institutions" within the meaning of

§552.112,[31] a position recently overturned by the Austin Court of Appeals.[32] The thrust of GLBA is to incorporate banking, insurance and securities activities into a functional regulatory system applicable to financial institutions. The state should do the same.

[31] Op. Atty. Gen. No. ORD–158 (1977); Op. Atty. Gen. No. MW–411 (1982).

[32] *Birnbaum v. Alliance of American Insurers*, 994 S.W.2d 766 (Tex.App.–Austin, 1999), *review denied* (2000).

## F. Agency Discretion and Flexibility for Adaptation to Future Developments

Paragraph 3.F. of the Committees' Letter requested study and recommendations for the purpose of granting each Commissioner adequate discretion and flexibility to adapt regulatory practices promptly from time to time, as needed, to allow financial institutions to compete in an ever-changing, technology-driven market, to the extent consistent with principles of safety and soundness and applicable federal law.

### 1. Summary of Conclusions and Legislative Recommendations

DOB, TSLD, and SSB have adequate discretion and flexibility to adapt regulatory practices promptly from time to time, as needed, to allow financial institutions to compete in an ever-changing, technology-driven market, to the extent consistent with principles of safety and soundness and applicable federal law. TDI has less flexibility because of limitations in the Insurance Code.

Insurance Code §36 should be amended to ensure that TDI has adequate rulemaking authority to adapt its regulatory practices promptly from time to time to allow financial institutions to compete in an ever-changing, technology-driven market.

### 2. Operation of Existing Law

The Finance Code and the Texas Securities Act each establish a legal framework that generally creates sufficient flexibility to respond to GLBA and adapt to changes in the marketplace. For example, DOB and TSLD have broad regulatory authority to approve new activities for depository institutions within their jurisdiction. The Insurance Code is more limited in flexibility.

Regulatory discretion and flexibility to respond to unforeseen change are increasingly important to effective regulation of financial services. Forces outside the control of legislators and regulatory agencies often govern the pace of change. Recent federal electronic signature legislation, for example, will preempt Texas law requiring hard copy or "wet ink" signatures effective October 1, 2000, and will preempt Texas law requiring paper-based record retention effective April 1, 2001,[33] including requirements in the Texas Insurance Code.[34] A financial regulatory agency must be able to respond to sudden developments in technology or business practices.

The overriding objective of regulatory discretion and flexibility is to enable the regulators to respond to change in a way that, without jeopardizing solvency, safety and soundness, and consumer protection, enables Texas businesses to be competitive and Texas consumers to receive the best possible array of services. Because much of an Agency's discretion and flexibility derive from its ability to adopt rules, an essential attribute of financial regulation in the era of financial services

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[33] Electronic Signatures in Global and National Commerce Act (PL 106–229, 114 Stat. 464, June 30, 2000) (Codified to 15 U.S.C. §§7001 *et seq.*).

[34] 15 U.S.C. §7001(i).

modernization is flexible rulemaking authority for each of DOB, TSLD, SSB, and TDI. However, TDI's general rulemaking authority, as set forth in Insurance Code §36, is limited compared to that of the other Agencies and could hamper TDI's adaptability to respond to fast-paced changes in the insurance regulatory arena.

Banking, insurance, and securities industries are commonly referred to as "regulated industries" because of the complex regulatory environment in which they must operate, and regulations are the single most important tool for defining and communicating the public policy purposes of and reasoning behind the necessary restrictions and limits on business functions. DOB and TSLD both have regulatory provisions that grant their Commissioners the regulatory discretion to approve new activities as discussed elsewhere in this Report.

The Agencies can be more effective in protecting the public and more flexible in assisting regulated businesses to adapt to changes in their competitive environment, when and as they occur, if each has flexible regulatory authority to adopt rules. Both SSB and TDI oversee a significant range of products and markets of enormous importance to Texas, and the list will inevitably expand as financial services modernization pushes ahead. TDI, in particular, must have more flexible authority to promulgate regulations.

Flexible rulemaking authority is not without limits. The Texas Administrative Procedures Act, Government Code Chapter 2000, provides a procedural structure for rulemaking that facilitates and encourages meaningful input from all interest groups, including legislators, industry, and consumers.

### 3. Legislative Recommendations

Insurance Code §36 should be amended to ensure that TDI has sufficiently flexible rulemaking authority, consistent with the other Agencies, to adapt its regulatory practices promptly from time to time to allow financial institutions to compete in an ever-changing, technology-driven market.

## G. Banking Commissioner Authority to Approve New Financial Activities

Paragraph 3.G of the Committees' Letter requested study and recommendations regarding granting the Banking Commissioner authority to approve new financial activities for state-chartered banks and FHCs that are financial in nature or incidental to such financial activity, or complementary to a financial activity, to the extent permissible under federal law, subject to a duty to consult and coordinate with the Agencies and other affected functional regulators in connection with implementation of such approvals.

### 1. Summary of Conclusions and Legislative Recommendations

The Finance Code should be amended to create authority for DOB and TSLD to determine activities to be financial in nature, incidental to a financial activity, and complementary to a financial activity for state bank and state thrift holding companies, respectively, and their subsidiaries. Specifically:

- Finance Code Chapter 202, regarding BHCs, should be amended to add a new section granting authority to the commissioner to determine an activity to be financial in nature or incidental or complementary to a financial activity, based on similar considerations as in federal law; and

- Finance Code Chapter 97, regarding thrift holding companies, should be amended as recommended in Section II–C of this Report.

Proposed legislation should explicitly continue functional regulation as contemplated by GLBA. This concept is strongly endorsed by the Agencies, and should require notification and provide for consultation with an affected functional regulator before implementation. To the extent an approved activity is subject to licensing and regulation by another state or federal agency, a BHC, FHC, or a unitary thrift or other thrift holding company, or a subsidiary of any of them, as the case may be, must apply for and obtain the license and submit to regulation by the other agency before it may engage in the new activity.

### 2. Operation of Existing Law

GLBA Section 103(a) adds Section 4(k) to the BHC Act[35] to provide that a FHC may engage in any activity that the FRB determines, in consultation with the Treasury, to be financial in nature or incidental to such financial activity, or complementary to a financial activity. Section 4(k)(4) specifically lists nine activities that are considered to be "financial in nature" without any further action required by the FRB or Treasury, generally comprising banking, insurance and securities activities, as well as some "complementary" activities.

[35] 12 U.S.C. §1843(k).

For activities proposed outside of specifically listed activities, Section 4(k)(2) provides that the FRB and the Treasury must coordinate in making a determination on whether the activity will be allowed. In doing so, Section 4(k)(3) specifically identifies the factors they must consider: (1) the purposes of the Act; (2) changes or reasonably expected changes in the marketplace in which FHCs compete; (3) changes or reasonably expected changes in the technology for delivering financial services; and (4) whether such activity is necessary or appropriate to allow a FHC and its affiliates to compete effectively, to efficiently deliver information and services that are financial in nature through the use of technological means, and to offer customers any available or emerging technological means for using financial services or for the document imaging of data. Both Treasury and the FRB have the authority to override the other agency's determination that an activity is financial in nature or complementary to a financial activity.

No authority presently exists in Texas law permitting a Texas bank regulator to expand permissible activities of a BHC. State-level authority to determine activities to be financial in nature, incidental to a financial activity, and complementary to a financial activity for FHCs and their subsidiaries could enhance the value of a state charter and provide a means of influencing FRB and Treasury determinations.

State savings banks may be controlled by holding companies which may be BHCs, overseen by DOB, TSLD, and the FRB, or by thrift holding companies, which are overseen by the TSLD and the OTS. Grandfathered unitary thrifts already have authority to engage in virtually any commercial or nonbanking activity, as set forth in the Home Owners' Loan Act.[36] TSLD already has a well-established and smoothly functioning basis for reviewing and examining such activities, to the extent necessary to oversee the safety and soundness of regulated depository institutions and to assure that they are in compliance with applicable legal requirements, but could benefit from having more explicit authority as suggested by DOB.

### 3. Legislative Recommendations

Finance Code Chapter 202, regarding BHCs, should be amended to add a new section granting authority to the Banking Commissioner to determine an activity to be financial in nature or incidental or complementary to a financial activity.

Finance Code Chapter 97, regarding thrift holding companies, should be amended as described in Section II–C of this Report.

Proposed legislation should explicitly continue functional regulation as contemplated by GLBA. This concept is strongly endorsed by the Agencies, and should require notification and provide for consultation with an affected functional regulator before implementation. To the extent an approved activity is subject to licensing and regulation by another state or federal agency, a BHC, FHC, or a unitary thrift or other thrift holding company, or a subsidiary of any of them, as the case

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[36] 12 U.S.C. §§1461 *et seq.*

may be, must apply for and obtain the license and submit to regulation by the other agency before it may engage in the new activity.

TDI and SSB endorse this proposal based on the understanding that the recommended new discretionary authority for Texas banking regulators will be exercised within the system of functional regulation contemplated by GLBA.

# III. COLLECTED QUESTIONS ON GLBA AND TEXAS LAW

***Preliminary Notes:***

1. *Please consult the Glossary on page ii to identify acronyms and other short form references used throughout this Report.*

2. *Questions submitted to the Agencies have been reworded and multi-part questions have been divided as necessary for clarity. The responses are (i) highly condensed summaries relating generally to the topics presented, (ii) not intended as legal advice adequate to any circumstances, and (iii) provided solely for informational purposes. Therefore, the responses should not be relied upon as a complete record for purposes of regulatory compliance. Readers are urged to consult their attorneys, advisors, and appropriate state and federal regulators regarding specific questions they may have.*

3. *Responses have been prepared jointly by staff of the Agencies; however, DOB and TSLD have provided responses involving the Texas Finance Code, TDI has provided responses involving the Texas Insurance Code, and SSB has provided responses involving the Texas Securities Act. In addition, DOB provided responses involving federal banking laws and GLBA as it relates to federal banking law.*

For ease of reference, the questions and responses have been organized under eight general topics of interest:

**A. Financial Holding Company (FHC) Elections**

**B. Depository Institution Financial Subsidiaries**

**C. Banks and Affiliates Conducting Securities Activities**

**D. Insurance Agent Licensing for Depository Institutions and Affiliates**

**E. Regulation of Insurance Activities**

**F. Commissions and Referral Fees from Insurance or Securities Activities**

**G. Merchant Banking**

**H. Miscellaneous Questions**

## A. Financial Holding Company (FHC) Elections

### *A–1. Must a bank holding company (BHC) meet any special qualifications to elect to become a FHC?*

A BHC may become a FHC by submitting a declaration to the FRB electing FHC status, together with a certification that each of the BHC's depository institution subsidiaries is well capitalized and well managed, and has a satisfactory or better Community Reinvestment Act ("CRA") rating. The election will be denied effect if the qualifications stated in the certification are untrue. (12 U.S.C. §§1843(k)(6) and 1843(l)(1); 12 C.F.R. §225.82).

### *A–2. What are the advantages and disadvantages of filing a FHC election?*

The determination of whether to become a FHC is a business decision the board of directors of a BHC should make in consultation with its own counsel. The primary advantage of an election is the increased authority to engage in additional activities, including insurance, securities, and merchant banking. Disadvantages arise from additional enforcement remedies applicable to a FHC that boes not maintain the initial qualifications of a FHC election.

The nonbanking activities of a BHC are limited to activities determined by the FRB "by regulation or order . . . as of the day before the date of the enactment of the Gramm–Leach–Bliley Act, to be so closely related to banking as to be a proper incident thereto. . . ." (12 U.S.C. §1843(c)(8); 12 C.F.R. §225.28(b); *also see* Appendix H).

A FHC may engage in nine listed financial activities (one of which incorporates "closely related to banking" activities by reference) plus any additional activity the FRB determines is "financial in nature or incidental to such financial activity" or that is "complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally." (12 U.S.C. §1843(k)(1) and (4); 12 C.F.R. §225.86). The nine listed activities, which contain some overlap with prior "closely related to banking" determinations, are summarized as follows:

- Lending and related activities;
- Insurance activities, as principal, agent, or broker;
- Financial, investment, or economic advisory services, including as an investment company;
- Issuing or selling instruments representing a pool of assets;
- Underwriting, dealing in, or making a market in securities;
- "Closely related to banking" activities;
- In the United States, engaging in BHC activities that are permissible outside the United States and are usual in connection with banking or other financial operations abroad;
- Merchant banking activities; and
- Owning non-financial firms through insurance or securities affiliates if not directly involved in the management of these firms.

In determining whether an activity is financial in nature or incidental to a financial activity, the FRB must consider:

- the purposes of the BHC Act and GLBA;
- changes or reasonably expected changes in the marketplace in which FHCs compete and in the technology for delivering financial services; and
- whether the activity is necessary or appropriate to allow a FHC and its affiliates to:
  - compete effectively with any company seeking to provide financial services in the United States;
  - efficiently deliver information and services that are financial in nature through the use of technological means, including any application necessary to protect the security or efficacy of systems for the transmission of data or financial transactions; and
  - offer customers any available or emerging technological means for using financial services or for the document imaging of data (12 U.S.C. §1843(k)(3)).

In making a determination regarding a new financial activity, the FRB must consult with Treasury and the Treasury has a veto power (12 U.S.C. §1843(k)(2); 12 C.F.R. §225.88).

### *A–3. Does a BHC that has no specific plans to directly or indirectly engage in an identified financial activity gain any advantage by filing a notice to be treated as an FHC?*

A FHC election by a qualifying BHC becomes effective on the 31st day after the election is received by the FRB (12 C.F.R. §225.82). Generally, a FHC may conduct an activity that is financial in nature or incidental to a financial activity without providing prior notice to or obtaining prior approval from the FRB, subject only to a requirement to file a simple written notice with the FRB Bank in its region within 30 days after commencing the activity or making the acquisition (12 U.S.C. §1843 (k)(6)(A); 12 C.F.R. §§225.85(a)(1) and 225.87(a)). Therefore, electing FHC status before specific plans exist that would require the election could conceivably permit the FHC to take advantage of an opportunity that by its nature or terms would expire within 30 days.

However, electing FHC status before specific plans exist that would require the election will also subject the electing BHC to enhanced remedial provisions if any of its depository institution subsidiaries ceases to be well-capitalized or well-managed, or ceases to maintain a satisfactory or better CRA rating (12 U.S.C. §1843(m); 12 C.F.R. §§225.83 and 225.84). Further, a short-term opportunity to expand beyond traditional lines of business will likely not be conducive to prudent and appropriate analysis and evaluation, thereby creating increased risk of a poor business decision.

The FRB has indicated that a BHC may withdraw an FHC election by letter if the BHC is not engaging in an activity for which the election is required.

***A–4. Must a present or future BHC electing FHC status file a copy of its notice to the FRB with the DOB? Does the answer change if the BHC is filing the notice merely for convenience and has no specific plans to directly or indirectly engage in an identified financial activity?***

A BHC doing business in Texas that submits an application or notice to the FRB under 12 U.S.C. §1843, including a FHC election under 12 U.S.C. §1843(k)(6), must simultaneously file a copy of the notice or application with DOB pursuant to Finance Code §202.004. With respect to a FHC election notice, the DOB has waived the $500 fee that would otherwise be required for a filing under Finance Code §202.004 (7 TAC §15.2(b)(19)). The Texas statutory filing requirement will apply regardless of the substance or pendency of acquisition or activity plans.

A "future" BHC electing FHC status is presumably acquiring a bank or a BHC. The acquiring company is required to file an application with the FRB under 12 U.S.C. §1842(a)(1) and simultaneously file a copy of the application with DOB, accompanied by a $500 filing fee (Finance Code §202.001; 7 TAC §15.2(b)(18)).

***A–5. Must a BHC file a FHC election to engage in insurance agency activities directly or through a nonbank subsidiary?***

The answer depends on both the type of insurance offered and under what circumstances as well as the proposed location of the agency. A BHC's authority to act as an insurance agent or to own a nonbank subsidiary licensed as an insurance agent has been limited by the BHC Act since 1982. Congress, in Title VI of the Garn–St Germain Depository Institutions Deregulation Act of 1982 (PL 97–320, 96 Stat. 1469, §§118(a), 601), amended Section 4(c)(8) of the BHC Act (12 U.S.C. §1843(c)(8)) to provide specifically that insurance activities are not closely related to banking, thereby precluding the FRB from authorizing BHCs to conduct these activities, subject to certain exceptions.

FRB implementation of these restrictions is codified in 12 C.F.R. §225.28(b)(11), which should be consulted in connection with any plan to offer insurance agency services through a BHC or its nonbank subsidiary. These exemptions generally allow a BHC to sell credit-related life, accident and health insurance, and involuntary unemployment insurance; to sell property insurance on collateral securing loans of $10,000 or less ($25,000 or less for manufactured homes) through finance company subsidiaries; to act as general insurance agents only in towns under 5,000 population or if the BHC has less than $50 million in assets; to continue to sell and expand in certain instances insurance agency activities authorized on or before May 1, 1982; and to act as a managing general agent for group insurance for the BHC. Additional and specific conditions apply to each of these exceptions.

If research reveals that the desired insurance agency activity is not permissible for a BHC, the company will need to file a FHC election to engage in the activity. Any entity that is engaged in insurance agency activities in Texas must be appropriately licensed by TDI to do so.

### *A–6. Can a mutual insurance company acquire a bank and qualify as a FHC?*

According to DOB, the FRB has long interpreted the BHC Act to authorize a BHC to exist in mutual form. In connection with authorizing bank and insurer affiliations, GLBA explicitly recognized "mutual bank holding companies" and specified that they are to be regulated on terms comparable to those applicable to any other BHC (12 U.S.C. §1842(g)(2)).

According to TDI, a mutual insurance company may itself be a holding company that owns one or more subsidiary companies engaged in other financial services. Mutual insurers, like other insurers, invest their funds pursuant to laws that list allowable investments (so-called "authorized investment" statutes). Insurers are free to invest in these "authorized investments" without the prior approval of the insurance commissioner. A primary investment statute for most life insurers is Insurance Code Article 3.33. Corresponding statutes for property & casualty insurers can be found at Articles 2.08 and 2.10. These statutes often will limit the amount that may be invested in individual entities and investment types. For example, Article 2.10 allows insurers to invest in a national bank and a Texas state bank whose deposits are insured by the FDIC; however, investments in stock of a state bank are limited to not more than 35% of the outstanding shares of that bank.

Insurance Code Article 21.49–1 also provides additional investment authority for investments in excess of the amounts allowed by other statutes. For example, under Article 21.49–1 §6, an insurer may invest in subsidiaries and affiliates "organized for any lawful purpose," subject to a limit equal to the lesser of 10% of the insurers assets, or 50% of the insurer's net worth. This section also provides, subject to prior approval of the insurance commissioner, that an insurer can invest any amount in a subsidiary or affiliate in certain instances.

Therefore, a Texas mutual insurance company with adequate resources may acquire a bank and qualify as a FHC, subject to required state and federal regulatory approvals. A mutual insurance company acquiring a bank should consult its own counsel with regard to how best to structure the arrangement. One suggested consideration is whether the direct investment by a mutual insurance company in a bank will result in increased regulatory burden as a result of convergent regulatory jurisdictions. A mutual insurance company may wish to consider forming a mutual holding company or otherwise converting to a stock insurance company and forming a holding company as an alternative that would isolate activities regulated by different regulatory agencies.

***A–7. What structures are available to an insurance company interested in purchasing a bank? Must it become a FHC?***

Numerous possibilities exist for structuring such an acquisition. An insurance company interested in purchasing a bank should consult with its own counsel regarding how to structure the acquisition. An insurance company or its affiliates acquiring a bank will by definition become a BHC and must file an application for approval and a FHC election with the FRB under 12 U.S.C. §§1842(a)(1) and §1843(k)(6), and file copies with DOB. Except in the context of a unitary thrift, any situation involving a purchase of a bank by an insurance company will involve election to a FHC, *see* GLBA Section 401(c).

One consideration is the degree to which a direct investment by an insurance company in a bank will result in increased regulatory burden as result of regulation by multiple regulatory agencies. An insurance company may wish to consider forming a holding company to acquire the bank in order to isolate activities regulated by different regulatory agencies.

In any event, direct or indirect acquisition of a bank by an insurance company is subject to both state and federal regulatory approvals. A prospective applicant should consider requesting a joint meeting with the Agencies that will be involved on reviewing the transaction. The Agencies will be responsive to a request for a coordinated meeting.

***A–8. How may an insurance company engage in the business of selling securities and how should the organization be structured? Must it become a FHC?***

Any person or company that wishes to engage in the business of selling securities must become appropriately registered under both state and federal law to the extent the related business conduct is not otherwise exempt. Nothing in GLBA is responsive to the question, in that the FHC regulatory regime created by GLBA is not relevant to an insurance company or securities broker-dealer unless and until it is affiliated with a depository institution. (GLBA does address coordinated regulation and information sharing between the SEC and state insurance regulators in the context of an "Investment Bank Holding Company" (IBHC). An IBHC is not affiliated with a depository institution and may choose the SEC in lieu of the FRB as its primary regulator, *see* GLBA Section 231. However, the question does not seem to contemplate IBHC status and regulation.)

An insurance company that seeks to engage through an affiliate in a regulated financial activity other than insurance should consult with its attorney regarding organizational and structural issues as well as federal and state licensing or registration requirements that may be invoked by its business decisions.

## B. Depository Institution Financial Subsidiaries

### *B–1. What federal notice or prior approval is required for a state bank to control or invest in a financial subsidiary as defined under GLBA?*

As an initial observation, the interim rules adopted separately by the FDIC and FRB, to implement new Section 46 of the FDI Act (12 U.S.C. §1831w), contain differences that likely will be moderated somewhat in final rules prepared in response to comments received. Some differences will validly remain as a result of subtle distinctions in federal law applicable to state member and nonmember banks.

No notice or prior approval is required by the FDIC for a state nonmember bank to acquire control of or invest in a subsidiary engaged only in activities as agent, even if the agency activity is "financial in nature" under 12 U.S.C. §1843(k). State bank subsidiary activities conducted as agent for a customer, conducted in a brokerage, custodial, advisory, or administrative capacity, or conducted as trustee, or in a substantially similar capacity are not subject to FDIC notice and prior approval. For example, acting solely as agent for the sale of insurance, securities, real estate, or travel services is not covered by the rules. Neither is providing safekeeping services or personal financial planning advice.

The interim final rules adopted by the FDIC to govern state nonmember bank financial subsidiary activity establishes conditions and procedures that apply when a subsidiary of a state nonmember bank seeks to engage as principal in financial activities. Currently, the only financial activity in this category is general securities underwriting. To engage in general securities underwriting, an otherwise qualifying state nonmember bank must file a notice to obtain FDIC consent or no objection before it may commence the activity.

The interim final rules adopted by the FRB to govern state member banks take a different approach and directly define the term "financial subsidiary" to be a subsidiary of one or more insured depository institutions seeking to engage in activities other than solely "activities that the state member bank is permitted to engage in directly" (12 C.F.R. §208.77(d)(2)). Thus, a subsidiary conducting solely agency activities will be classified as a "financial subsidiary" only if the state member bank lacked authority to conduct the activities directly. Informal conversations with FRB officials indicate that the FRB considers general securities underwriting to be the only financial activity as principal that a state member bank must conduct through a financial subsidiary. Pursuant to 12 C.F.R. §208.76(a), a state member bank may not control or invest in a financial subsidiary or expand its activities unless it files a notice with the FRB Bank in its region.

### *B–2. Must a bank create a financial subsidiary to engage in insurance agency activities in a community with a population exceeding 5,000?*

A national bank must create a financial subsidiary to engage in insurance agency activities in a community with a population exceeding 5,000; a state bank does not.

Generally, a depository institution or its affiliate can sell insurance in Texas from any location if appropriately licensed by TDI (*see* Commissioner's Bulletin No. B–0005–00 (Jan. 18, 2000), in Appendix F). The provisions of Insurance Code Article 21.07–1 that purport to geographically limit banks to a community of 5,000 are preempted by GLBA, and will be recommended for repeal.

However, a national bank's ability to act as an insurance agent, either directly or through an operating subsidiary, is limited by federal law to the "community of 5,000." (12 U.S.C. §24a(g)(3); §92; *also see* OCC comments at 65 Fed. Reg. 12905, at 12908 (Mar. 10, 2000)). However, a national bank financial subsidiary can act as insurance agent without regard to the geographic limits of 12 U.S.C. §92. ((12 U.S.C. §§24a(a)(2)(B)(i); 24a(b)(1)(A)(i); and 1843(k)(4)(B); also 12 C.F.R. §5.39(e)(1)(ii)).

Federal law does not require a state bank to form a financial subsidiary with respect to activities as agent. (12 U.S.C. §1831w(a) and 12 C.F.R. §§208.77(d)(1) and 362.16(b)). *See* Response B–1.

## C. Banks and Affiliates Conducting Securities Activities

***C–1. Because GLBA eliminates the exclusion for banks from the definition of dealer, will a bank be required to register with the SEC to provide investment services in the bank lobby where employees are shared between the bank and the dealer?***

No. The current blanket exclusion of banks from the federal definition of "dealer" and "broker" will be replaced on May 12, 2001, with a series of exceptions for banks dealing or engaging in specific products and activities. While GLBA adds a number of narrow exemptions to federal law and eliminates the general exemption, the net effect is to limit the prior exemption, not expand it. One exemption specifically applies to "third party brokerage arrangements" of the sort described in the question, *see* 15 U.S.C. §78c(a)(4)(B)(i).

***C–2. Will the dealer registration requirement for this activity under the Texas Securities Act be retained or does GLBA affect this state requirement?***

The requirement to register as a dealer with the SSB in order to conduct this activity has not changed. Existing dealer registration requirements under the Texas Securities Act (Articles 581–1 *et seq.*, Vernon's Texas Civil Statutes) are not preempted by GLBA and will apply to the offer and sale of securities by any person or entity.

***C–3. What should a bank do when its renewal application and fees are due on December 31, 2000?***

In order to continue this activity on bank premises the following year, the bank must submit its renewal application and fees before the end of the current year.

***C–4. Must bank employees register as dealers to perform clerical services related to the offer and sale of securities on bank premises? Are regulatory guidelines available that describes permissible or impermissible duties or activities for unregistered officers and employees?***

A bank officer or employee may engage in routine clerical and administrative duties without registration if the officer or employee (i) does not receive compensation for referring customers to a registered securities dealer, and (ii) does not communicate with customers regarding the nature of investment vehicles available or otherwise participate in the offer or sale of a security.

Under state securities law as currently applied, a bank officer or employee who receives compensation for referring bank customers to a registered securities dealer that actually performs the securities transactions is required to register with the SSB, although the registration requirements are limited (7 TAC §115.1(b)).

The SSB recently released a proposed rule draft for public comment. If proposed and adopted in current form, the rule would change this limited registration to a registration exemption and require only a notice filing and fee from the bank. Under the proposed exemption, bank employees who make referrals will be able to perform certain clerical functions such as making appointments with customers for the purpose of meeting with the registered dealer, forwarding customer funds or securities, and describing in general terms the types of investment vehicles available from the bank and the registered dealer under their brokerage relationship.

***C–5. Regarding the "de minimis" exemption for 500 securities transactions a year, can a bank use this for transactions that fall outside other exemptions, like private placements, trust department trades, affiliated transactions, and municipal securities underwriting?***

The exemption from broker registration requirements under federal securities law for "de minimis" transactions (up to 500 transactions a year pursuant to 15 U.S.C. §78c(a)(4)(B)(xi)) will be available for transactions that are not exempt under other available exemptions. However, the exemption does not apply to transactions conducted by an employee of the bank who is also an employee of a broker or dealer.

The exemption is not applicable to state securities law and there is no "de minimis" exemption under the Texas Securities Act. However, there are a number of exemptions available to banks in Section 5 and 6 of the Texas Securities Act (Articles 581–5 and 581–6, Vernon's Texas Civil Statutes) and in 7 TAC Chapters 109 and 139.

***C–6. Will the current state securities dealer exemption, for employees of a bank or BHC (Finance Code §31.007), or a trust institution (Finance Code §181.006), with fewer than 500 shareholders, be retained in state law after financial services modernization?***

Nothing in GLBA impacts Finance Code §31.007 or §181.006. The exemptions will continue to exist (*also see* 7 TAC §139.9).

***C–7. In providing securities-related services on bank premises, can a bank sell securities in the bank lobby or is a segregated area required?***

In general terms, with respect to state securities laws and a bank properly registered by the SSB, a segregated area is required unless the bank's options are limited because of confined facilities or limited lobby space. In such a case, the bank should carefully distinguish nondeposit investment product activity from retail deposit activity, such as through use of a room divider or a row of planters to provide visual separation. Sometimes signs to distinguish the different spaces can be helpful.

DOB recommends review of and compliance with the federal Interagency Statement on Retail Sales of Nondeposit Investment Products, *e.g.*, FIL No. 9–94 (FDIC, Feb. 17, 1994), which is consistent with the above advice.

***C–8. What licensing differences apply to a bank that buys a securities dealer as opposed to a bank that contractually associates with a securities dealer?***

Absent an applicable exemption, a person (including a bank) must have an appropriate securities registration under state law to participate in the offer and sale of securities or receive a share of commissions from a securities transaction, whether from an affiliate or nonaffiliate. *See* Responses C–1, C–2, F–1, and F–2.

***C–9. Are a bank's common trust funds subject to registration as an investment company under state or federal securities laws?***

Generally, no. With respect to state law, Section 5.L of the Texas Securities Act exempts securities "issued or guaranteed" by a bank, and also exempts officers and employees of the bank who deal in these securities from dealer registration requirements. Securities of a bank common trust fund are considered issued by the bank.

With respect to federal law, bank common trust funds are presently exempt from regulation under the Investment Company Act of 1940. Effective May 12, 2001, GLBA expands the exemption to include common and collective pooled funds offered by thrift institutions, but also codifies the SEC's interpretation that the exemption is available only for a fund used solely as an aid to the administration of trusts, estates or other accounts maintained by the bank for a fiduciary purpose. Therefore common trust funds may not be generally advertised or marketed. As codified, the exemption for a common trust fund in 12 U.S.C. §80a–3(c)(3) requires a bank to satisfy three conditions:

- the fund must be employed solely as an aid to the administration of trusts, estates or other fiduciary accounts;
- the fund must not be advertised or offered for sale to the general public (except in ordinary advertising of the bank's fiduciary services); and
- fees and expenses charged by the fund must comply with applicable fiduciary principles.

***C–10. Will state law treat banking products the same as federal law? Will state law conform to federal treatment of new hybrid products that SEC (and FRB) determines to be either banking products or securities?***

The federal definition of "banking products" in GLBA Section 206 serves the sole purpose of implementing certain broker-dealer registration exemptions for banks, and does not mean a "banking product" is not a security under federal law for other purposes. Similarly, a "new hybrid product" is a new product not previously regulated by the SEC as a security and not included within the definition of "banking products." Pursuant to 15 U.S.C. §78o(i), the SEC must consult with the FRB before adopting regulations classifying a new hybrid product as a security, but again solely for the purpose of implementing or restricting certain broker-dealer registration exemptions for banks. As discussed in Responses C–1 and C–2, dealer registration requirements under the Texas Securities Act are not affected by GLBA.

## D. Insurance Agent Licensing for Depository Institutions and Affiliates

***D–1. Will new insurance agent licenses be required for depository institutions to accommodate implementation of GLBA? Will the Insurance Commissioner's Bulletin No. B–0005–00 become a final ruling?***

As detailed in Part II–D of this Report, TDI will recommend legislation to restructure and simplify existing insurance agent licensing requirements in the Texas Insurance Code, to achieve the uniformity required by GLBA Title III.

Commissioner's Bulletin No. B–0005–00 (Jan. 18, 2000) (*see* Appendix F), was issued as an interim and temporary measure to address the principal GLBA preemptions affecting agent licensing of depository institutions, and is not intended to be a permanent solution.

***D–2. Does the Texas Insurance Code permit a depository institution to obtain all available insurance agent licenses the same as any other corporation?***

Yes. Interim guidance on agent licensing for depository institutions is available in Commissioner's Bulletin No. B–0005–00 (Jan. 18, 2000) (*see* Appendix F).

***D–3. Must a depository institution become licensed as an insurance agent to permit its licensed affiliate to sell insurance in the depository institution's lobby?***

The answer depends on the actions of the depository institution. Mere affiliation with an insurance agent in a depository institution's lobby will not by itself require the depository institution to become licensed. However, certain actions by the depository institution may trigger a licensing requirement, incuding actions that imply sponsorship, marketing, or other solicitation regarding insurance products. *See, e.g.*, Texas Insurance Code Articles 21.02, 21.07–1, and 21.14, and 28 TAC Chapter 21.

***D–4. What licensing differences apply to a depository institution that buys an insurance agency as opposed to a depository institution that contractually associates with an insurance agency?***

The answer will depend upon the structure chosen for the relationship. Generally, a person (including a bank) must have an appropriate insurance agent license under state law to receive a share of commissions from an insurance transaction, whether from an affiliate or nonaffiliate.

Before banks could be licensed as insurance agents in Texas, a common practice among banks was to lease floor space to an on–premises insurance agency and provide for lease payments expressed as a flat rate or as a percentage of gross receipts. This arrangement permitted the bank to tie its insurance-related revenue to the volume of insurance sales without being required to obtain an

insurance agent license, and is still permissible today. *Solomon v. Greenblat*, 812 S.W.2d 7 (Tex.App.—Dallas, 1991, no writ).

***D–5. Can a bank or its subsidiary obtain a title insurance agent license under the Texas Insurance Code?***

Title insurance is governed by the Texas Title Insurance Act (Texas Insurance Code Chapter 9). Article 9.36 states that a "person, firm, association, or corporation" may be licensed as a title insurance agent. TDI will issue a title insurance agent license to a bank that satisfies the requirements of Texas Insurance Code Article 9.36.

In Opinion No. 00–03 (March 6, 2000), the Texas Department of Banking stated that a Texas state-chartered bank may sell title insurance directly, or through an operating subsidiary, if either is appropriately licensed by the Texas Department of Insurance. Under GLBA Section 303, national banks can sell title insurance as agent if state banks can do so under state law "only in the same manner, to the same extent, and under the same restrictions" as state banks are authorized to conduct the activity (15 U.S.C. §6713(b)(1)). As to the DOB conclusion that these activities can be conducted in an operating subsidiary rather than a financial subsidiary, *see* Response B–2.

A bank should be aware that Article 9.09 of the Insurance Code prohibits a title insurance agent from being licensed to sell any other type of insurance. From a practical perspective, the title insurance business is significantly different from other forms of insurance. In consultation with its own counsel, a bank may conclude that a separate operating subsidiary should hold the title insurance agent license and conduct title agency activities.

***D–6. Can a BHC or its nonbank subsidiary purchase or acquire a title insurance agency?***

Not unless the BHC makes an FHC election and obtains necessary TDI regulatory approvals, *see* Response D–2. Title insurance agency activities as principal, agent, or broker are not "closely related to banking." *See* Response A–5, and the FRB letter and order *re: Independence Bancorp, Inc.* (1989 Fed. Res. Bull. 31).

***D–7. Is a depository institution employee required to be licensed to perform clerical services related to the offer and sale of insurance products on depository institution premises? Are regulatory guidelines available that describes permissible or impermissible duties or activities for unlicensed officers and employees?***

A depository institution employee is not required to be licensed to perform clerical services related to the offer and sale of insurance products on depository institution premises. Insurance Code Article 21.02 sets out the acts of an insurance agent. Provided an employee does not engage in any of these acts, including solicitation, negotiation, procurement, or collection of premiums on an insurance or annuity contract, no insurance agent license will be required.

Regulatory guidelines describing activities which require an agent license are set forth in the Texas Insurance Code and may be supplemented by regulation on an as needed basis.

***D–8. Will Texas promote and participate in an effort to establish uniform or reciprocal licensing standards for insurance agents in a multistate environment?***

Yes. See Part II–D of this Report. Texas is working through the NAIC in recommending changes to insurance agent licensing provisions to promote greater uniformity among various states' licensing requirements. Each state will, however, continue to regulate the activities of insurance agents conducting an insurance business in such state.

***D–9. Will an insurance agency affiliated with depository institution be able to service a former customer that moved to another state?***

The answer depends on the law of the former customer's new state of residence. Generally, a Texas insurance agent will be required to become licensed in the new state before soliciting its customer in that state.

## E. Regulation of Insurance Activities

### *E–1. Does GLBA preempt TDI's insurance advertising regulations applicable to a bank's insurance activities?*

No. GLBA preserves and clarifies current state regulatory authority over insurance sales and market conduct of depository institutions engaging in insurance activities. GLBA generally requires nondiscriminate treatment of depository institutions and affiliates with regard to their insurance activities. However, states may explicitly treat banks conducting insurance activities differently from other insurance agents through enforcement of laws and regulations that are within the 13 so-called "safe harbors," one of which expressly addresses advertising (15 U.S.C. §6701(d)(2)(B)(iii)). In addition to TDI's advertising regulations, located at 28 TAC Chapter 21, Subchapter B, banks are subject to certain statutory advertising restrictions in Insurance Code Article 21.21–9 §3.

### *E–2. Can a bank advertise insurance, deposit, and loan products in a joint advertisement?*

The Finance Code contains no requirements that relate to bank advertising restrictions, prohibitions or allowances, and no consumer compliance statutes enforced by the DOB that address the question. FDIC-insured depository institutions are, however, subject to federal consumer compliance and disclosure laws that impact advertising and are enforced by federal banking regulators (FRB, FDIC, OCC, and OTS) through their examination processes.

Insurance advertisement regulations in 28 TAC Chapter 21, Subchapter B, generally do not prohibit advertising insurance products in conjunction with other financial services. However, as permitted by GLBA, a state may prohibit use of an insurance advertisement or other promotional material (*e.g.*, a "statement stuffer") by a depository institution or its affiliate if the advertisement would cause a reasonable person to mistakenly believe that the federal government or the state "is responsible for the insurance sales activities of, or stands behind the credit of, the institution or affiliate . . . or . . . guarantees any returns on insurance products, or is a source of payment on any insurance obligation of or sold by the institution or affiliate." *See* 15 U.S.C. §6701(d)(2)(B)(iii). Additional disclosure requirements are also applicable as addressed in Response E–3 below.

A key issue regarding joint advertisements, including statement stuffers, is whether an entity whose name appears on the advertisement is appropriately licensed if the reference is suggestive that the entity is engaged in the business of insurance.

To evaluate specific advertising proposals, you may wish to contact TDI's advertising division for assistance and additional information.

***E–3. Does the Texas Insurance Code require specific customer disclosures in an insurance product advertisement on behalf of a bank?***

The disclosure requirements of the Texas Insurance Code vary depending upon the type of insurance involved. The general disclosures required of banks are found in Insurance Code Article 21.21–9 §3, which generally requires promotional materials relating to insurance products distributed to customers and potential customers to clearly disclose that insurance products sold through the bank affiliated agent (i) are not insured by the FDIC; (ii) are not issued, guaranteed, or underwritten by the bank or the FDIC; and (iii) involve investment risk, if appropriate, including potential loss of principal.

Additional disclosures may be required as set out in 28 TAC Chapter 21. To evaluate product-specific disclosure requirements, you may wish to contact TDI's advertising division.

***E–4. What disclosures does the Insurance Code require a depository institution to make to a customer to offer an insurance product in connection with the customer's loan transaction?***

Insurance Code Article 21.21–9 §3(b) currently requires an additional disclosure if the depository institution requires insurance in connection with a loan application, generally for the purpose of informing the customer that the required insurance can but need not be purchased from the depository institution, and furnishing the required insurance from a third party agent will not in any way affect credit terms. For the specific language of required disclosures, see Insurance Code Article 21.21–9 §3(b).

***E–5. New product development is addressed in GLB from the insurance perspective. Does state law need any clarification about who approves what?***

State law does not need any clarification. The business of insurance in Texas is functionally regulated exclusively by TDI. However, if TDI is aware that a particular insurance matter uniquely affects Texas banks or securities firms, TDI intends to coordinate on issues related to new product development with state banking and/or securities regulators.

## F. Commissions and Referral Fees from Insurance or Securities Activities

***F–1. Is a bank still required to obtain a limited dealer's registration in order to receive a percentage of commissions earned by a registered dealer under a third-party brokerage arrangement, or has this been preempted for national banks?***

A bank must file a limited registration as a securities dealer to permit a registered securities dealer to operate on bank premises, regardless of whether the bank receives any income tied to third party securities transactions. The OCC does not possess authority to preempt this requirement. GLBA unequivocally subjects securities activities of a national bank to functional regulation by the SEC and state securities regulators (15 U.S.C. §6701(f)(1)).

***F–2. Is a bank still required to register if its income is derived from dividends received from its registered broker-dealer subsidiary that sells mutual funds in the bank lobby, instead of from commissions?***

Payment of dividends to a bank from its subsidiary is a matter committed to the discretion of the subsidiary's board of directors. Although receipt of commissions is an attribute for which a person should become registered as a securities dealer, the use of the bank's premises and its implied sponsorship of the securities dealer's activities invokes registration requirements, without more.

***F–3. Are regulatory guidelines available with respect to how a bank should calculate and pay noncontingent referral fees to bank employees, for both insurance and securities, as permitted by GLBA?***

GLBA is very clear regarding referral fees except with respect to what constitutes a "nominal" amount for the fee. (12 U.S.C. §1831x(d)(2)(B); 15 U.S.C. §§78c(a)(4)(B)(i)(VI) and §6701(d)(2)(B)(iv)).

With respect to insurance, the federal banking agencies are directed to consult with each other and state insurance regulators to develop joint regulations for the protection of insurance customers of depository institutions (12 U.S.C. §1831x(a)). These regulations must be finalized prior to November 12, 2000. Among other matters, the regulations must set forth standards permitting a bank teller to receive a one-time nominal fee, of a fixed dollar amount, for each referral of a customer to licensed insurance personnel, provided the fee is not dependent on whether the referral results in a transaction (12 U.S.C. §1831x(d)(2)(B)). The impending federal regulations may directly address this issue. Because of the pending federal action, TDI has not yet undertaken to establish the permissible "nominal" amount.

As amended by GLBA, federal securities law explicitly permits bank employees to "receive compensation for the referral of any customer if the compensation is a nominal one-time cash fee of a fixed dollar amount and the payment of the fee is not contingent on whether the referral results in

a transaction" (15 U.S.C. §78c(a)(4)(B)(i)(VI)). The SEC has adequate rulemaking authority to specify define what constitutes a "nominal" fee if it should choose to do so.

GLBA does not alter state securities law requirements with respect to commission sharing. Therefore, a nominal referral fee should not be paid to bank employees unless the bank has obtained a limited registration as a securities dealer from the SSB and the employees are registered as agents. However, as discussed in Response C–4 above, the SSB is proposing a rule to change this limited registration to a registration exemption and require only a notice filing and fee from the bank.

***F–4. Does GLBA permit payment of insurance referral fees to unlicensed persons other than bank tellers, such as to an affiliated depository institution?***

Federal law enacted by GLBA provides that, with respect to "payment or receipt of any commission or brokerage fee or other valuable consideration for services as an insurance agent or broker . . . the term 'services as an insurance agent or broker' does not include a referral by an unlicensed person of a customer or potential customer to a licensed insurance agent or broker that does not include a discussion of specific insurance policy terms and conditions." (15 U.S.C. §6701(d)(2)(B)(iv)). State law to the contrary is preempted.

The state may still prohibit payment of a referral fee to an unlicensed individual if payment is based on the purchase of insurance by the customer (15 U.S.C. §6701(d)(2)(B)(v)).

***F–5. Will state law be enlarged beyond federal law to allow payment of referral fees based on whether the customer purchases an insurance or securities product?***

What state law ultimately provides is a matter reserved to the judgment and action of the Texas Legislature. The Agencies will recommend against permitting unlicensed persons to receive referral fees that are based on resulting purchases of insurance or securities products.

A prohibition on payment of insurance or securities referral fees to unlicensed persons is designed to protect consumers from profit-driven, high pressure sales tactics. An insurance or securities product is particularly prone to misrepresentations. The consumer must often rely on the expertise of the seller, a person that state law requires to be competent, trained, and fully aware of the attendant professional ethics and responsibilities.

Congress determined that a nominal, noncontingent referral fee, for services limited to referring a potential customer to a licensed insurance agent, does not significantly erode the consumer protections inherent in the prohibition on referral fees. A broader exception would raise serious questions regarding adequate protection of the public.

## G. Merchant Banking

***G–1. Can a state bank engage in merchant banking; if so, how should it be structured and what are the investment limitations? Is there a difference between a state member and a nonmember bank with respect to the ability to engage in merchant banking?***

A state bank that wishes to engage in merchant banking activities may pursue two options. The activity may be conducted indirectly through its BHC if the BHC has elected FHC status (12 U.S.C. §1843(k)(4)(H)). Alternatively, the activity may be conducted if approved and in the manner permitted by the FDIC pursuant to its authority under Section 24 of the FDI Act (12 U.S.C. §1831a) to permit state bank activities beyond the authority of national banks. *Also see* 12 C.F.R. Part 362. Currently, no difference exists between member and non-member banks with respect to merchant banking activities.

Under Section 24 of the FDI Act, a state bank or a state bank subsidiary may engage in a state law authorized activity as principal, even though the activity is not permissible for a national bank, if the FDIC upon application determines that the activity poses no significant risk to the federal deposit insurance fund (subject to certain other conditions).

Although merchant banking is identified by GLBA as an activity "financial in nature" (12 U.S.C. §1843(k)(4)(H)), the activity is expressly prohibited in a national bank financial subsidiary (12 U.S.C. §24a(a)(2)(B)(iii)). However, under GLBA Section 122, the FRB and Treasury may by joint rules allow subsidiaries of national banks to conduct merchant banking activities, beginning on or after November 12, 2004, after carefully evaluating the experiences of FHCs with merchant banking activities to that point.

## H. Miscellaneous Questions

***H–1. Will a Texas trust company be treated as a "bank" for state securities and insurance licensing requirements?***

A Texas trust company is a bank as defined in federal securities laws (15 U.S.C. §78c(a)(6)). For purposes of the state securities regulation, a Texas trust company is treated as a bank. Thus, registration is required for dealer activity conducted by a trust company, but there is an exclusion for investment advisory activity pursuant to 7 TAC §107.2(19)(A).

A Texas trust company is not a depository institution as defined in GLBA if it is not engaged in the business of receiving deposits. (12 U.S.C. §1813(c)(1); 15 U.S.C. §6701(g)(3).) A trust company has limited deposit taking authority that is seldom used. Accordingly, unless the trust company is an affiliate of a depository institution, GLBA does not prohibit a state, by statute, regulation, order, interpretation, or other action, from preventing or restricting a trust company or its affiliate from engaging directly or indirectly in an activity authorized or permitted by GLBA for depository institutions or their affiliates.

However, the Texas Securities Act and the Texas Insurance Code (if amended as recommended by TDI) will not prevent or restrict a Texas trust company or its affiliate from engaging in securities and insurance activities if appropriately licensed. *Also see* Response H–3 below.

***H–2. What is the difference between "association" and "corporation" in state licensing laws, particularly insurance? This question relates to banks identified in state law as "associations" that effectively operate as "corporations".***

Most state licensing laws that permit business entity licensing refer to corporations but do not mention "associations." Because a bank or trust company is labeled an "association" and not a "corporation," these Texas licensing statutes may be interpreted to exclude an "association" from the benefits of licensing, although a bank or trust company subsidiary chartered as a corporation may be able to obtain a license. DOB intends to pursue statutory amendments within the Finance Code that will facilitate treatment of state banks and trust companies as corporations. However, DOB also believes existing law can be interpreted to treat banking and trust company associations as corporations (*See* Texas Constitution, Article XVI, §16(a); and Finance Code §§32.007 and 182.009.).

With regard to insurance, TDI will currently license a bank as an insurance agent, whether it is an "association" or "corporation," if the bank satisfies applicable licensing requirements. TDI recommendations for legislation would result in conforming agent licensing requirements to GLBA.

### *H–3. Who examines a bank that has staff with broker/dealer registrations and also has a subsidiary that acts as an insurance agency?*

Examination of the bank will only be conducted by its primary bank regulatory agency and, if it is a state commercial or savings bank, by either the FDIC, if not a member of the FRB System, or the FRB if a member, as was the case in the past. Bank regulatory agencies typically have the discretion to examine the activities of a bank subsidiary in appropriate circumstances, but normally will do so only to address specific concerns.

In connection with the bank's activities as a broker/dealer, its related records are subject to inspection by the SSB, the SEC, and the NASD.

Regarding the insurance agency subsidiary, TDI typically examines or investigates the activities of an insurance agency on an as-needed basis.

### *H–4. Will state agencies attempt to mirror the federal requirement to use plain language in new regulations adopted by the state after January 1, 2000?*

Current Texas law neither requires nor prohibits the use of "plain language" as a style for rule development, although the Agencies strive to draft rules that are easily understandable and support efforts to simplify rulemaking.

For example, in December 1999 the Banking Commissioner directed DOB staff to prepare all new rules promulgated from DOB using plain language, and in each circumstance to consider the viability of using a question and answer format.

### *H–5. Can a bank-affiliated insurance agency or securities dealer name itself after the bank?*

The Interagency Statement on Retail Sales of Nondeposit Investment Products (s*ee*, *e.g.*, FIL No. 9–94 (FDIC, Feb. 17, 1994)) recommends that a bank not use a name that is deceptively similar to the bank's name for investment sales activities. The four federal bank regulatory agencies issued the Interagency Statement to reaffirm the agencies' belief that retail customers must be fully informed regarding risks associated with mutual fund or other nondeposit investment products.

GLBA addresses the retail sale of nondeposit investment products from depository institution premises in several ways that generally are not inconsistent with the Interagency Statement. GLBA does not specifically address bank use of a trade name for securities or insurance activities. The underlying policy of GLBA in this regard does strongly resembles the policy underlying the Interagency Statement, that of ensuring the consumer does not believe the nondeposit investment product is federally insured or guaranteed by the federal or state government or by the bank (*see* 15 U.S.C. 78c(a)(4)(B)(i)(IX), 15 U.S.C. §6701(d)(2)(B)(iii) and (x), and 12 U.S.C. §1831x(c)(1) and (2)).

As a matter of prudent operation, banks should refrain from any actions that might confuse or mislead a customer when selling investment products. Further guidelines from the SEC and the federal banking agencies may address this issue, and more than likely will retain the recommendation to not use a name that is deceptively similar to the bank's name for investment sales activities.

TDI has a rule specifically addressing standards for avoiding misleading names that should be consulted for guidance. *See* 28 TAC §19.902.

# APPENDICES

A Conference Committee Report for the Gramm-Leach-Bliley Act (H.R. 106–434)

B Letter dated March 31, 2000, from the Chairmen of the Senate Economic Development Committee, House Committee on Financial Institutions, and House Committee on Insurance, requesting the Study (Committees' Letter)

C Profile of Regulatory Agencies *(DOB, TDI, TSLD, and SSB)* and Affected Texas Industries

D Listing of GLBA activities involving the Commissioners.

E Commissioners' Letter of May 31, 2000, requesting industry input

F Commissioner's Bulletin No. B-0005-00, "Interim Guidelines Concerning Insurance Agent Licensing in Texas Under the Gramm–Leach–Bliley Act" (Jan. 18, 2000)

G Discussion Papers Regarding Preemption of State Law Under GLBA

(1) *Arthur E. Wilmarth, Jr., George Washington University Law School*
(2) *Gibson, Dunn & Crutcher, LLP*

H Financial Activities: Synopsis of activities financial in nature or incidental to a financial activity under GLBA, emphasizing "closely related to banking" activities

106TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
106–434

## GRAMM-LEACH-BLILEY ACT

NOVEMBER 2, 1999.COrdered to be printed

Mr. LEACH, from the committee of conference,
submitted the following

## CONFERENCE REPORT

[To accompany S. 900]

The committee of conference on the disagreeing votes of the two Houses on the amendments of the House to the bill (S. 900), to enhance competition in the financial services industry by providing a prudential framework for the affiliation of banks, securities firms, insurance companies, and other financial service providers, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its disagreement to the amendment of the House to the text of the bill and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the House amendment, insert the following:

[Text of S. 900 omitted, see the Gramm-Leach-Bliley Act (PL No. 106–102, 113 Stat. 1338 (1999).]

**[[Page 151]]** JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The Managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendments of the House to the bill (S. 900), to enhance competition in the financial services industry by providing a prudential framework for the affiliation of banks, securities firms, insurance companies, and other financial service providers, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The House amendment to the text of the bill struck all of the Senate bill after the enacting clause and inserted a substitute text.

The Senate recedes from its disagreement to the amendment of the House with an amendment that is a substitute for the Senate bill and the House amendment. The differences between the Senate bill, the House amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clerical changes.

### TITLE ICFACILITATING AFFILIATIONS AMONG BANKS, SECURITIES FIRMS, AND INSURANCE COMPANIES

The legislation approved by the Conference Managers eliminates many Federal and State law barriers to affiliations among banks and securities firms, insurance companies, and other financial service providers. The House and Senate bills established an identical statutory framework (except for minor drafting differences) pursuant to which full affiliations can occur between banks and securities firms, insurance companies, and other financial companies. The Conferees adopted this framework. Furthermore, the legislation provides financial organizations with flexibility in structuring these new financial

affiliations through a holding company structure, or a financial subsidiary (with certain prudential limitations on activities and appropriate safeguards). Reflected in the legislation is the determination made by both Houses to preserve the role of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board" or the "Board") as the umbrella supervisor for holding companies, but to incorporate a system of functional regulation designed to utilize the strengths of the various Federal and State financial supervisors. Incorporating provisions found in both the House and Senate bills, the legislation establishes a mechanism for coordination between the Federal Reserve Board and the Secretary of the Treasury ("the Secretary") regarding the approval of new financial activities for both holding companies and national bank financial subsidiaries. The legislation **[[Page 152]]** enhances safety and soundness and improves access to financial services by requiring that banks may not participate in the new financial affiliations unless the banks are well capitalized and well managed. The appropriate regulators are given clear authority to address any failure to maintain these safety and soundness standards in a prompt manner. The legislation also requires that Federal bank regulators prohibit banks from participating in the new financial affiliations if, at the time of certification, any bank affiliate had received a less than "satisfactory" Community Reinvestment Act of 1977 ("CRA") rating as of its most recent examination.

Subtitle ACFinancial Affiliations

*Senate Position:* The Senate bill contains provisions repealing restrictions in the Glass-Steagall Act and the Bank Holding Company Act of 1956 ("BHCA") on affiliations involving securities firms and insurance companies, respectively. The Senate bill establishes a new framework in section 4 of the BHCA for bank holding companies to engage in financial activities. It does not create a separate designation for bank holding companies engaged in the new financial activities but it does require that the subsidiary insured depository institutions of such holding companies be well capitalized and well managed in order to take advantage of the new activities. In the event that a bank holding company's subsidiary depository institutions fall out of compliance, a "cure" procedure is established. The Senate bill authorizes bank holding companies to engage in activities that the Federal Reserve Board has determined to be financial in nature and incidental to such financial activities. It also authorizes qualifying bank holding companies to engage in activities that the Federal Reserve Board determines are complementary to financial activities, or any other service that the Federal Reserve Board determines not to pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. It contains a list of pre-approved activities that includes merchant banking and insurance company portfolio investment activities. There is also a grandfather provision for the commodities activities engaged in by a company as of September 30, 1997, if that company becomes a bank holding company after the date of enactment.

*House Position:* The House bill also repeals the restrictions contained in the Glass-Steagall Act on affiliations between banks and securities firms engaged in underwriting and in the BHCA on affiliations between banks and insurance companies and insurance agents. It creates a new section 6 of the BHCA which authorizes new financial activities for bank holding companies that qualify as "financial holding companies." In order for a bank holding company to qualify as a financial holding company ("FHC"), its subsidiary depository institutions must be well managed, well capitalized, and have received at least a "satisfactory" CRA rating as of their last examination. In the event that an FHC falls out of compliance, a "cure" procedure is established. It authorizes FHCs to engage in activities that the Federal Reserve Board has determined to be financial in nature, incidental to such financial activities or complementary to financial activities to the extent that the amount of such complementary activities remains small. It contains a list of pre- **[[Page 153]]** approved activities that includes investment banking and insurance company portfolio investment activities. The House bill also authorizes FHCs to engage in developing activities to a limited extent. A ten-year grandfather is included for the nonfinancial activities of companies that become bank holding companies after enactment of this legislation and are predominantly financial in nature at the time they become FHCs.

*Conference Substitute:* The Conferees acceded to the Senate by agreeing to amend section 4 of the BHCA to add a series of new subsections that contain the framework for engaging in new financial activities. The Conferees have acceded to the House in designating as FHCs those bank holding companies qualifying to engage in the new financial activities.

New section 4(k) permits bank holding companies that qualify as FHCs to engage in activities, and acquire companies engaged in activities, that are financial in nature or incidental to such financial activities. FHCs are also permitted to engage in activities that are complementary to financial activities if the Federal Reserve Board determines that the activity does not pose a substantial risk to the safety or soundness of depository institutions or the financial system in general.

Permitting banks to affiliate with firms engaged in financial activities represents a significant expansion from the current requirement that bank affiliates may only be engaged in activities that are closely related to banking. The Board has primary jurisdiction for determining what activities are financial in nature, incidental to financial in nature, or complementary. The Board may act by regulation or order. In determining what activities are financial in nature or incidental, the Federal Reserve Board must notify the Secretary of applications or requests to engage in new financial activities. The Federal Reserve Board may not determine that an activity is financial or incidental to a financial activity if the Secretary objects. The Secretary may also propose to the Federal Reserve Board that the Board find that a particular activity is financial in nature or incidental to a financial activity. A similar procedure is included in the legislation with regard to the determination of financial activities and activities that are incidental to financial activities for financial subsidiaries of national banks. The intent of the Conferees is that the Federal Reserve Board and the Secretary of the Treasury will establish a consultative process that will negate the need for either agency to veto a proposal of the other agency. Establishing such a process should bring balance to the determinations regarding the type of activities that are financial and limit regulatory arbitrage.

Section 4(k) contains a list of activities that are considered to be financial in nature. An FHC may engage in the activities on this list without obtaining prior approval from the Federal Reserve Board. Notice must be given to the Federal Reserve Board not later than 30 days after the activity is commenced or a company is acquired. The list includes securities underwriting, dealing, and market making without any revenue limitation such as sponsoring and distributing all types of mutual funds and investment companies. Other activities include insurance underwriting and agency activities, merchant banking, and insurance company portfolio invest- **[[Page 154]]** ments. The reference to "* * * insuring, guaranteeing or indemnifying against * * * illness," is meant to include activities commonly thought of as health insurance, including such activities when provided by companies such as Blue Cross and Blue Shield organizations which are licensed under State laws to provide health insurance benefits in consideration of the payment of premiums or subscriber contributions. Such reference is not meant to include the activity of directly providing health care on a basis other than to the extent that it may be incidental to the business of insurance as defined in section 4(k)(4)(B) of the BHCA.

*Merchant banking*

The authorization of merchant banking activities as provided in new section 4(k)(4)(H) of the BHCA is designed to recognize the essential role that these activities play in modern finance and permits an FHC that has a securities affiliate or an affiliate of an insurance company engaged in underwriting life, accident and health, or property and casualty insurance, or providing and issuing annuities, to conduct such activities. Under this provision, the FHC may directly or indirectly acquire or control any kind of ownership interest (including debt and equity securities, partnership interests, trust certificates, or other instruments representing ownership) in an entity engaged in any kind of trade or business whatsoever. The FHC may make such acquisition whether acting as principal, on behalf of one or more entities (e.g., as adviser to a fund, regardless of whether the FHC is also an investor in the fund), including entities that the FHC controls (other than a depository institution or a subsidiary of a depository institution), or otherwise.

Section 122 provides that after a 5 year period from the date of enactment, the Board and the Secretary may jointly adopt rules permitting financial subsidiaries to engage in the activities under section 4(k)(4)(H) of the BHCA subject to the conditions that the agencies may jointly determine.

*Insurance company portfolio investments*

New section 4(k)(4)(I) of the BHCA recognizes that as part of the ordinary course of business, insurance companies frequently invest funds received from policyholders by acquiring most or all the shares of stock of a company that may not be engaged in a financial activity. These investments are made in the ordinary course of business pursuant to state insurance laws governing investments by insurance companies, and are subject to ongoing review and approval by the applicable state regulator. Section 4(k)(4)(I) permits an insurance company that is affiliated with a depository institution to continue to directly or indirectly acquire or control any kind of ownership interest in any company if certain requirements are met. The shares held by such a company: (i) must not be acquired or held by a depository institution or a subsidiary of a depository institution; (ii) must be acquired and held by an insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty (other than credit-related insurance) or in providing and issuing annuities; and (iii) must represent an investment made in the ordinary course of business of **[[Page 155]]** such insurance company in accordance with relevant state law governing such investments. In addition, during the period such ownership interests are held, the FHC must not routinely manage or operate the portfolio company except as may be necessary or required to obtain a reasonable return on the investment. To the extent an FHC participates in the management or operation of a portfolio company, such participation would ordinarily be for the purpose of safeguarding the investment of the insurance company in accordance with the applicable requirements of state insurance law. This is irrespective of any overlap between board members and officers of the FHC and the portfolio company.

CONDITIONS TO ENGAGE IN NEW ACTIVITIES

New section 4(l) of the BHCA establishes the requirements for permitting a bank holding company to engage in the new financial activities and affiliations. A bank holding company may elect to become a financial holding company if all of its subsidiary banks are well capitalized and well managed. A bank holding company that meets such requirements may file a certification to that effect with the Board and a declaration that the company chooses to be an FHC.

After the filing of such a declaration and certification, an FHC may engage either de novo, or through an acquisition, in any activity that has been determined by the Board to be financial in nature or incidental to such financial activity. FHCs may engage in activities on the preapproved list of financial activities contained in section 4(k) of the BHCA and any other financial activity approved by the Board without prior notice. Complementary activities, however, must be approved by the Board on a case-by-case basis under the notice procedures contained in section 4(j) of the BHCA.

The legislation also amends the CRA to provide that an election of a bank holding company to become an FHC shall not be effective if the Board finds that as of the date of the election not all of the subsidiary insured depository institutions of the holding company had received a “satisfactory” or better CRA rating at their most recent CRA examinations. In addition, the legislation amends the BHCA to require the appropriate Federal banking agency to prohibit an FHC, or a bank through a financial subsidiary, from commencing any new activities or acquiring any companies under sections 4(k) or (n) of the BHCA, section 5136A(a) of the Revised Statutes of the United States, or section 46(a) of the Federal Deposit Insurance Act, in the event that the bank or any of its insured depository institution affiliates or any insured depository institution affiliate of the FHC fails to have at least a “satisfactory” CRA rating at the time of its last examination. It is the most recent rating alone that shall be looked to by the regulator in connection with these provisions. This provision does not authorize any agency to require the divestiture of any company already owned by the FHC prior to the time that the prohibition becomes effective or to limit in any way any activity already engaged in by the FHC prior to that time. The prohibition ceases to apply once all of the insured depository institutions controlled by the FHC or the bank and all of its insured depository institution affiliates have restored their CRA performance rating to at least the “satisfactory” level.

**[[Page 156]]** This provision applies to the ownership and activities of financial subsidiaries of national banks to the same extent as it applies to FHCs. It also applies in the same way to subsidiaries held by insured State banks subject to newly added section 46(a) of the Federal Deposit Insurance Act.

OPERATION OF STATE LAW

*Senate Position:* The Senate bill establishes in section 104 the parameters for the appropriate balance between Federal

and State regulation of the activities and affiliations allowed under this legislation.

*House Position:* The House provision is similar, with parallel provisions contained in sections 104, 301, and 302 of the House bill.

*Conference Substitute:* The House agreed to incorporate its sections 301 and 302 into section 104, and the Senate agreed to adopt the language of the House's section 302. The House discrimination standard was adopted with modifications, and the Conferees agreed to incorporate House provisions protecting the ability of the States to require restoration of an entity's capital, and restricting changes in stock ownership of demutualizing insurers, as modified. The House receded on its provision specifically addressing a North Carolina Blue-Cross Blue-Shield organization, as the State laws governing those types of entities would not be preempted so long as the State laws do not discriminate, as set forth in the legislation.

This section reaffirms the McCarran-Ferguson Act, recognizing the primacy and legal authority of the States to regulate insurance activities of all persons. No persons are permitted to engage in the business of insurance unless they are licensed by the States, as required under State law. States are not allowed to prevent certain affiliations or activities or discriminate against depository institutions in providing such insurance licenses.

In general, States are not allowed to prevent or restrict affiliations permitted under Federal law. With respect to an affiliation by an insurer, States may collect information, and the insurer's State of domicile may take action on the affiliation (including approval or disapproval), but only within 60 days of receiving notice of the affiliation, and only if the actions do not discriminate against the insurer based on an association with a depository institution. An affiliating insurer's State of domicile may require capital restoration to the level required under State law, so long as such request is made within 60 days of notice of the affiliation. Any State, as permitted under State law, may restrict changes in ownership of a demutualizing insurer so long as the restrictions are not discriminatory as set forth in the legislation. Section 104(c)(2)(C) means that State laws and State regulators shall not discriminate against depository institutions or their affiliates with respect to acquiring or otherwise changing the ownership of stock in newly demutualized insurance companies relative to other persons.

Except with respect to insurance, States may not prevent or restrict a depository institution or affiliate thereof from engaging in any activity set forth under the Gramm-Leach-Bliley Act. With respect to insurance sales, solicitations, and cross-marketing, States may not prevent or significantly interfere with the activities of de- **[[Page 157]]** pository institutions or their affiliates, as set forth in *Barnett Bank of Marion County N.A. v. Nelson*, 517 U.S. 25 (1996). However, State restrictions that are substantially the same as but no more burdensome than the thirteen general safe harbors provided are not subject to potential preemption. States are also allowed to continue the regulation of insurance activities other than sales, solicitation, and cross-marketing, and the preemption standard does not apply to such regulation if consistent with the standards set forth in the legislation.

State regulation other than of insurance or securities activities is not preempted even if it does prevent or restrict an activity so long as it does not discriminate. The Conferees adopted the House discrimination standard with respect to insurance activities. The discrimination standard does not apply to State regulations governing insurance sales, solicitations, or cross-marketing activities adopted before September 3, 1998, and does not apply to State regulations that are substantially the same as but no more burdensome than the safe harbors. State securities regulation is not preempted by the "prevent or restrict" standard with regard to a State securities commission's ability to investigate and enforce certain unlawful securities transactions or to require the licensure or registration of securities and securities brokers, dealers, and investment advisors and their associates. State actions of general corporate applicability applying to companies domiciled or incorporated in the State are also protected from the "prevent or restrict" preemption, as well as State laws similar to the antitrust laws, so long as the State actions are not inconsistent with the intent of this Act to permit affiliations. The term "depository institution" is defined as including foreign banks and their domestic affiliates and subsidiaries. The term "affiliate" is defined for section 104 to include any person under common control (including a subsidiary).

Subtitle BCStreamlining Supervision of Bank Holding Companies

Both the House and Senate bills generally adhere to the principle of functional regulation, which holds that similar

activities should be regulated by the same regulator. Different regulators have expertise at supervising different activities. It is inefficient and impractical to expect a regulator to have or develop expertise in regulating all aspects of financial services. Accordingly, the legislation intends to ensure that banking activities are regulated by bank regulators, securities activities are regulated by securities regulators, and insurance activities are regulated by insurance regulators.

In keeping with the Board's role as an umbrella supervisor, the legislation provides that the Board may require any bank holding company or subsidiary thereof to submit reports regarding its financial condition, systems for monitoring and controlling financial and operating risks, transactions with depository institutions, and compliance with the BHCA or other Federal laws that the Board has specific jurisdiction to enforce. The Board is directed to use existing examination reports prepared by other regulators, publicly reported information, and reports filed with other agencies, to the fullest extent possible.

**[[Page 158]]** The Board is authorized to examine each holding company and its subsidiaries. It may examine functionally regulated subsidiaries only if: (1) the Board has reasonable cause to believe that such a subsidiary is engaged in activities that pose a material risk to an affiliate depository institution; (2) it reasonably believes after reviewing the relevant reports that examining the subsidiary is necessary to adequately inform the Board of the systems for monitoring risks; or, (3) based on reports and other available information, the Board has reasonable cause to believe that a subsidiary is not in compliance with the BHCA or other Federal law that the Board has specific jurisdiction to enforce and the Board cannot make such a determination through examination of an affiliated depository institution or the holding company. The Board is directed to use, to the fullest extent possible, examinations made by appropriate Federal and State regulators.

The Board is not authorized to prescribe capital requirements for any functionally regulated subsidiary that is in compliance with applicable capital requirements of another Federal regulatory authority, a State insurance authority, or is a registered investment adviser or licensed insurance agent. The legislation also makes it clear that securities and insurance activities conducted in regulated entities are subject to functional regulation by the relevant State securities authorities, the Securities and Exchange ("SEC"), or State insurance regulators.

The Board is prohibited from requiring a broker-dealer or insurance company that is a bank holding company to infuse funds into a depository institution if the company's functional regulator determines, in writing, such action would have a material adverse effect on the broker-dealer or insurance company. If the functional regulator makes such a determination, the Board may require the holding company to divest its depository institution. All the Federal banking agencies are subject to the same limits on reports, examinations and capital requirements for functionally regulated affiliates which apply to the Board. This ensures that the Office of the Comptroller of the Currency ("OCC"), the Office of Thrift Supervision ("OTS"), and the Federal Deposit Insurance Corporation ("FDIC") will not be able to assume and duplicate the function of being the general supervisor over functionally regulated subsidiaries. The legislation specifically preserves, however, the FDIC's authority to examine a functionally regulated affiliate. This authority, which should be used sparingly, is necessary to protect the deposit insurance funds.

The legislation also specifically addresses indirect action by the Board against functionally regulated affiliates. Consistent with functional regulation, the Board's authority to take indirect action against a functionally regulated affiliate is limited. The Board may not promulgate rules, adopt restrictions, safeguards or any other requirement affecting a functionally regulated affiliate unless the action is necessary to address a "material risk" to the safety and soundness of the depository institution or the domestic or international payments system and it is not possible to guard against such material risk through requirements imposed directly upon the depository institution.

**[[Page 159]]** The Federal banking regulators are empowered to adopt prudential safeguards governing transactions between depository institutions, their subsidiaries and affiliates so as to avoid, among other items, significant risk to the safety and soundness of the institution. The regulators are required to review these safeguards regularly and modify or eliminate those requirements which are no longer necessary.

Bank holding companies may elect to become FHCs by meeting the statutory requirements and filing a declaration and

a certification with the Board. The legislation makes it clear that a duplicative registration statement under section 5 of the BHCA is not required. The integrity of the deposit insurance funds is preserved by prohibiting the use of deposit insurance funds to benefit any shareholder, subsidiary or nondepository affiliate of an FHC. This section ensures that the federal safety net is not extended to persons who are not entitled to Federal deposit insurance coverage.

The savings bank restrictions in the BHCA are repealed. This repeal is designed to conform the regulation of savings bank life insurance to other provisions of Federal banking law.

The Conferees intend that the Board be flexible in its application of holding company consolidated capital standards for the leverage requirement and the timing of the asset calculations to FHCs of which the predominant regulated subsidiary is a broker-dealer. The Conferees intend that, to the extent the Board deems feasible and consistent with the overall financial condition and activities of the holding company, the capital requirements for such holding companies be consistent with the capital standards applied by the SEC to the broker-dealer, which accounts for the predominant amount of assets and activities of the holding company.

Subtitle CCSubsidiaries of National Banks

*Senate Position:* The Senate bill authorizes a national bank to control a subsidiary engaged in financial activities permissible for a bank holding company (but not permissible for a national bank directly) under section 4(k) if the bank has consolidated total assets not exceeding $1 billion, is not affiliated with a bank holding company, is well capitalized, and well managed. For the purpose of determining a parent national bank's regulatory capital, a deduction from assets and tangible equity is required for the amount of outstanding equity investments made in a financial subsidiary. In addition, the assets and liabilities of the financial subsidiary must not be consolidated with those of the parent bank. Equity investments in the operating subsidiary by a parent national bank must not exceed the amount the bank could pay as a dividend without obtaining prior regulatory approval. The Senate bill also clarifies that a national bank may conduct through a subsidiary any activity which the national bank may engage directly and any activity lawfully conducted as of the date of enactment of this legislation.

*House Position:* The House bill authorizes a national bank subsidiary to engage only in activities permissible for national banks to engage in directly, activities otherwise expressly authorized by statute, and activities that are financial in nature or incidental to financial activities. Financial activities are defined as those activities permissible for an FHC or activities that the Secretary of the **[[Page 160]]** Treasury determines to be financial in nature or incidental to financial activities in consultation and coordination with the Federal Reserve Board. Excluded from the list of permissible financial activities are insurance underwriting, insurance company portfolio investments, and real estate investment and development. National bank operating subsidiaries also may engage in developing activities. In order for a national bank operating subsidiary to engage in activities that are financial in nature, its parent bank and all its depository institution affiliates must be well capitalized, well managed, and have a satisfactory CRA rating. A cure procedure is established to address situations where there is a failure to comply with these conditions. It also requires that the aggregate amount of the national bank parent's equity investments in the bank be deducted from the bank's capital including the operating subsidiary's retained earnings. In addition, the assets and liabilities of the subsidiary must not be consolidated with those of its parent bank. Equity investments in the operating subsidiary by a parent national bank must not exceed the amount the bank could pay as a dividend without obtaining prior regulatory approval.

*Conference Substitute:* The Senate receded to the House with an amendment.

Under the amendment, national banks of any size are permitted to engage through a financial subsidiary only in financial activities (with exceptions) authorized by this Act. Section 121 specifically excludes four types of activities for financial subsidiaries: insurance or annuity underwriting, insurance company portfolio investments, real estate investment and development, and merchant banking (subject to section 122). These types of financial activities may only be done in FHC affiliates. The federal banking regulators are prohibited from interpreting these provisions to provide for any expansion of these activities contrary to the express language of this statute. It is the intent of the Conferees that these new statutory

provisionsCand the regulations to be adopted pursuant theretoCsupercede and replace the OCC's Part 5 regulations on operating subsidiaries.

Subtitle DCPreservation of FTC Authority

*Section 131. Amendment to the Bank Holding Company Act of 1956 to modify notification and post-approval waiting period for section 3 transactions.*

*Senate Position:* No provision.

*House Position:* Section 141 of the House amendment amends section 11(b)(1) of the BHCA (12 U.S.C. section 1849(b)(1)) to provide for notice to the Federal Trade Commission ("FTC") when the Board of Governors of the Federal Reserve System approves a transaction under section 3 of the BHCA if that transaction also involves a transaction under section 4 or 6 of the BHCA.

*Conference Substitute:* The Senate receded to the House with an amendment.

Under section 131 of the Conference Report, the modification simply eliminated the reference to section 6 because the new activities for FHCs are now included within section 4 of the BHCA as amended by the Conference Report. The FTC currently has no role **[[Page 161]]** in reviewing pure section 3 transactions, and this amendment does not change that. However, the FTC does perform reviews of certain section 4 transactions. This amendment will simply allow the FTC to coordinate its review with the Board in those cases that also involve a section 3 transaction.

*Section 132. Interagency data sharing*

*Senate Position:* No provision.

*House Position:* Section 142 of the House amendment provided that, except as otherwise prohibited by law, the banking regulators who review mergers or acquisitions (the OCC, the OTS, the FDIC, and Federal Reserve Board) shall make available to the antitrust agencies (the Department of Justice and the Federal Trade Commission ("FTC")) any information in the bank regulators' possession that the antitrust agencies deem necessary for their antitrust review under sections 3, 4, or 6 of the BHCA, section 18(c) of the Federal Deposit Insurance Act, the National Bank Consolidation and Merger Act, section 10 of the Home Owners' Loan Act, or the antitrust laws.

*Conference Substitute:* The Senate receded to the House with an amendment.

Under section 132 of the Conference Report, the modification eliminated the reference to section 6 of the BHCA because the new activities for FHCs are now included within section 4 of the BHCA as amended by the Conference Report. In addition, the modification added new sections 132(b) and 132(c). New section 132(b) requires that any information shared under this provision be kept confidential; that before any information shared under this provision is disclosed to a third party, the agency which shared it must be notified in writing and given a chance to oppose or limit the disclosure; that any sharing under this provision does not affect any claim of privilege with respect to such information; and that nothing in this section shall be construed to limit access to any information by the Congress or the Comptroller General. New section 132(c) simply applies the provisions of new section 132(b) to the sharing of information between Federal banking agencies and State regulators or any other party.

In the past, there have been difficulties with banking agencies sharing bank examination reports with the antitrust agencies because of doubts about whether they had sufficient authority to do so. The reports have generally been shared in the end. However, in cases of failing institutions in which review has been expedited or of institutions taken over by the government, delays in providing these reports have sometimes impeded antitrust review. This language simply allows all of the involved agencies to do their respective tasks in the most expeditious manner possible.

*Section 133. Clarification of status of subsidiaries and affiliates*

*Senate Position:* No provision.

*House Position:* Section 143(a) of the House amendment provided that subsidiaries or affiliates of banks or savings associations which are not themselves banks or savings associations shall not be treated as banks or savings associations for purposes of the FTC Act or any other law enforced by the FTC. Section 143(b) clarified **[[Page 162]]** that nothing in this section shall be construed as restricting the authority of any Federal banking agency.

Section 143(c) amended the existing BHCA exceptions to the Hart-Scott-Rodino ("H-S-R") Act, 15 U.S.C. section 18a(c)(7) and 18a(c)(8). Under current law, transactions subject to approval under section 3 of the BHCA are exempt from H-S-R review. Likewise, assuming certain conditions are met, transactions subject to approval under section 4 are also exempt. The amendments in section 143(c) clarified that when FHCs acquire other FHCs and either of those companies was involved in new activities under section 6 of the BHCA as amended by the House amendment, the portion of the transaction involving those section 6 activities would be subject to H-S-R review. However, the remainder of the transaction will continue to be reviewed under the existing BHCA.

*Conference Substitute:* The Senate receded to the House with modifications.

Under section 133 of the conference report, the modification to section 133(a) clarified that the language applied to any provision of law applied by the FTC under the FTC Act. This clarification makes it clear that the section is limited to laws that the FTC currently enforces and is not intended to provide authority to enforce any new statutes. Under current law, section 5(a)(2) of the FTC Act prohibits the FTC from enforcing the Act against banks or savings associations. The conference report will, however, allow these entities to acquire other kinds of businesses, for example, securities firms, against which the FTC can currently enforce the Act. This provision simply makes it clear that these kinds of businesses do not fall within the bank or savings association exemption because they are owned by such an entity.

There was no modification to the savings provision contained in section 133(b).

The modification to section 133(c) replaced the reference to section 6 of the BHCA as amended by the House amendment with a reference to section 4(k) of the BHCA as amended by the conference report. Under the conference report, section 4(k) now contains the language allowing FHCs to engage in new activities. This amendment to the H-S-R exemptions will allow the antitrust agencies to continue to review mergers between insurance companies, securities firms, and other businesses newly allowed to FHCs as they are today, notwithstanding the ownership interest of the FHC. This clarification for the new FHC structure is consistent with, and does not disturb, existing law and precedents under which mergers involving complex corporate entities, some parts of which are in industries subject to merger review by specialized regulatory agencies and other parts of which are not, are considered according to agency jurisdiction over their respective parts, so that normal H-S-R Act requirements apply to those parts that do not fall within the specialized agency's specific authority. See 16 CFR section 802.6.

*Annual GAO report (section 144 of the House amendment)*

*Senate Position:* No provision.

*House Position:* Section 144 of the House amendment provided for the General Accounting Office to submit an annual report to **[[Page 163]]** Congress on market concentration in the financial services industry for each of the next five years.

*Conference Substitute:* The House receded to the Senate.

Subtitle ECNational Treatment

*Section 141. Foreign Banks that are Financial Holding Companies*

*Senate Position:* The Senate bill, at section 151, permits termination of the financial grandfathering authority granted by the International Banking Act and other statutes to foreign banks to engage in certain financial activities. Foreign banks with grandfathered financial affiliates would be permitted to retain these grandfathered companies on the same terms that domestic banking organizations are permitted to establish them.

*House Position:* The House amendment, at section 151, is similar.

*Conference Substitute:* The Senate receded to the House.

*Section 142. Representative offices*

*Senate Position:* The Senate bill, at section 152, requires prior approval by the Federal Reserve Board for the establishment of representative offices that are subsidiaries of a foreign bank.

*House Position:* The House bill, at section 153, contains the same provision.

*Conference Substitute:* The Senate receded to the House.

Subtitle FCDirect Activities of Banks

*Senate Position:* The Senate bill authorizes national banks to deal in, underwrite, and purchase municipal bonds for their own investment accounts.

*House Position:* The House amendment is identical.

*Conference Substitute:* The House receded to the Senate.

TITLE II

Subtitle ACBrokers and Dealers

*Senate Position:* The Senate bill repeals the exemptions from the definition of broker and dealer under the Federal securities laws that currently apply to banks, generally subjecting banks and their affiliates and subsidiaries to the same regulation as all other providers of securities products. However, the Senate bill replaces the general bank exemption with specific exemptions for certain bank activities.

*House Position:* The House amendment also repeals the general bank exemptions from the definition of broker and dealer under the Federal securities laws but provides more limited exemptions than does the Senate bill.

*Conference Substitute:* Subtitle A of title II of the Gramm-Leach-Bliley Act provides for functional regulation of bank securities activities. The Conferees retained certain limited exemptions to facilitate certain activities in which banks have traditionally engaged. These exceptions relate to third-party networking arrangements, trust activities, traditional banking transactions such as commercial paper and exempted securities, employee and share- **[[Page 164]]** holder benefit plans, sweep accounts, affiliate transactions, private placements, safekeeping and custody services, asset-backed securities, derivatives, and identified banking products.

The Conferees provided for an exception for networking arrangements between banks and brokers. Revisions to Rule 1060 recently approved by the National Association of Securities Dealers ("NASD") are in conflict with this provision. As a consequence, revisions to the rule should be made to exempt banks and their employees from the provisions' coverage.

The Conferees provided that banks that effect transactions in a trustee or fiduciary capacity under certain conditions will be exempt from registration under the Federal securities laws if the bank: (1) is chiefly compensated by means of administration and certain other fees, including a combination of such fees, and (2) does not publicly solicit brokerage business. The Conferees expect that the SEC will not disturb traditional bank trust activities under this provision.

The Conferees also provided that classification of a particular product as an identified banking product shall not be construed as a finding or implication that such product is or is not a security for purposes of the securities laws, or is or is not a transaction for any purpose under the Commodity Exchange Act. The Conferees do not intend in the Gramm-Leach-Bliley Act to express an opinion upon or to address the issue of legal certainty for swap agreements under the securities and commodity exchange laws.

The Conferees also provided that the Commodity Exchange Act is not amended by the Gramm-Leach-Bliley Act, and no transaction or person which is otherwise subject to the jurisdiction of the Commodity Futures Trading Commission pursuant to the Commodity Exchange Act is exempted from such jurisdiction because of the provisions of the Gramm-Leach-Bliley Act.

For new hybrid products, the Conferees codified in the securities laws a process that requires the SEC to act by rulemaking prior to seeking to regulate any bank sales of any such new product. This rulemaking process is designed to give notice to the banking industry in an area that could involve complex new products with many elements.

The process contemplated by the Conferees would work as follows. Prior to seeking to require a bank to register as a broker or dealer with respect to sales of any new hybrid product, the SEC would have to engage in a rulemaking. In its rulemaking, the SEC would need to find that the new product is a security. In addition, the SEC would have to determine that the product is a “new hybrid product.”

A new hybrid product is not one of the products listed in the definition of “identified banking product”. Including a product on the list of identified banking products shall not be construed as a finding or implication that such product is or is not a security, but it would not be a new hybrid product. The Conferees codified the definition of Identified Banking Products as a freestanding provision of law, neither in the securities laws nor in the banking laws.

In addition, during the rulemaking process, the SEC must also make a number of findings. When considering whether such an action is in the public interest, the SEC must also consider whether **[[Page 165]]** the action will promote efficiency, competition and capital formation, as set forth in section 3(f) of the Securities Exchange Act of 1934 (“Exchange Act”). The Conferees note that the SEC’s record in implementing section 3(f) has failed to meet Congressional intent. The Conferees expect that the SEC will improve in this area.

Prior to commencing a rulemaking process, the SEC is required to consult with and seek the concurrence of the Federal Reserve Board concerning the imposition of broker or dealer registration requirements with respect to any new hybrid product. In developing and promulgating rules under this subsection, the SEC shall consider the views of the Board, including views with respect to the nature of the new hybrid product; the history, purpose, extent, and appropriateness of the regulation of the new product under the Federal banking laws; and the impact of the proposed rule on the banking industry.

If the Board seeks review of any final regulation under this section, such review will serve as a stay on the rulemaking until final adjudication of the matter between the SEC and the Board. In considering such an appeal, the United States Court of Appeals for the District of Columbia Circuit shall determine to affirm and enforce or set aside a regulation of the SEC under this subsection, based on the determination of the court as to whether: (1) the subject product is a new hybrid product; (2) the subject product is a security; (3) imposing a requirement to register as a broker or dealer for banks engaging in transactions in such product is appropriate in light of the history, purpose and extent of regulation under the Federal securities laws and under the Federal banking laws, giving deference neither to the views of the SEC nor to the Board.

Subtitle BCBank Investment Company Activities

*Senate Position:* No provision.

*House Position:* The House bill amends the Investment Advisers Act and the Investment Company Act to subject banks that advise mutual funds to the same regulatory scheme as other advisers to mutual funds. It also requires banks to make additional disclosure when a fund is sold or advised by a bank.

*Conference Substitute:* The Senate recedes to the House provision with an amendment.

Subtitle CCSecurities and Exchange Commission Supervision
of Investment Bank Holding Companies

*Senate Position:* No provision.

*House Position:* The House amendment creates a new investment bank holding company structure under the Exchange Act. This subtitle is designed to implement a new concept of SEC supervision of broker/dealer holding companies (that do not control depository institutions with certain exceptions) that voluntarily elect SEC supervision. This provision is designed to assure that the supervision of an investment bank holding company by the SEC is a meaningful option. Non-U.S. financial institutions supervisors, when reviewing regulatory applications or notices submitted by a U.S. financial institution supervised in the United States as an in- **[[Page 166]]** vestment bank holding company by the SEC under section 231, shall treat the SEC as the principal U.S. consolidated home country supervisor of such financial institution on the same basis and terms as if the Federal Reserve Board were the principal U.S. consolidated home country supervisor.

*Conference Substitute:* The Senate recedes with an amendment. The Conferees eliminated the authority of the SEC to regulate investment bank holding company capital.

Subtitle DCBanks and Bank Holding Companies

*Senate Position:* No provision.

*House Position:* The House amendment requires the SEC to consult and coordinate comments with the appropriate Federal banking regulators before any action or rendering any opinion with respect to the manner in which an insured depository institution or insured depository holding company reports loan loss reserves.

*Conference Substitute:* The Senate recedes to the House provision. The Conferees note that the SEC's actions with respect to the reporting of loan loss reserves by certain insured depository institutions did not reflect adequate consultation with the Federal banking agencies with respect to potential implications on the safety and soundness of the Federal deposit insurance fund. The Conferees expect that this provision will facilitate better coordination and decision-making by the SEC in this area.

TITLE IIICINSURANCE

Subtitle ACState Regulation of Insurance

*Senate Position:* The Senate bill contains a number of provisions intended to preserve State regulation of insurance.

*House Position:* The House amendment similarly contains a number of provisions intended to preserve and enhance State regulation of insurance.

*Conference Substitute:* The Senate receded to the House with an amendment.

In general, Subtitle A of Title III reaffirms that States are the regulators for the insurance activities for all persons, including acting as the functional regulator for the insurance activities of federally chartered banks. This functional regulatory power is subject to section 104 of Title I, however, which sets forth the appropriate balance of protections against discriminatory actions. Federally chartered banks and their subsidiaries are prohibited from underwriting insurance, except for authorized products. A rule of construction was added by the Conference Committee to prevent evasion of State insurance regulation by foreign reinsurance subsidiaries or offices of domestic banks, clarifying that providing insurance (including reinsurance) outside of the United States to indemnify an insurance product or company in a State shall be considered to be providing insurance as principal in that State.

Federally chartered banks are prohibited from engaging in any activity involving the underwriting or sale of title insurance, except that national banks may sell title insurance products in any State in which state-chartered banks are authorized to do so (other than **[[Page 167]]** through a "wild card provision"), so long as such sales are undertaken "in the same manner, to the same extent, and under the same restrictions" that apply to such state-chartered banks. Certain currently and lawfully conducted title insurance activities of banks are grandfathered, and existing State laws prohibiting all persons from providing title insurance are protected.

An expedited and equalized dispute resolution mechanism is established to guide the courts in deciding conflicts between Federal and State regulators regarding insurance issues. The "without unequal deference" standard of review does not apply to State regulation of insurance agency activities that were issued before September 3, 1998 (other than those protected by the scope of the safe harbor provision of section 104).

The Federal banking agencies are required to issue final consumer protection regulations within one year, to provide additional safeguards for the sale of insurance by any bank or other depository institution, or by any person at or on behalf of such institution.

State laws that prevent or significantly interfere with the ability of insurers to affiliate, become an FHC, or demutualize, are preempted, except as provided in section 104(c)(2), and with respect to demutualizing insurers for the State of domicile (and as set forth in the Redomestication Subtitle). State laws limiting the investment of an insurer's assets in a depository institution are also preempted, except that an insurer's State of domicile may limit such investment as provided.

The Federal banking agencies and the State insurance regulators are directed to coordinate efforts to supervise companies that control both depository institutions and persons engaged in the business of insurance, and to share, on a confidential basis, supervisory information including financial health and business unit transactions. The agencies are further directed to provide notice and to consult with the State regulators before taking actions which effect any affiliates engaging in insurance activities. A banking regulator is not required to provide confidential information to a State insurance regulator unless such State regulator agrees to keep the information in confidence and make all reasonable efforts to oppose disclosure of such information. Conversely, Federal banking regulators are directed to treat as confidential any information received from a State regulator which is entitled to confidential treatment under State law, and to make similar reasonable efforts to oppose disclosure of the information.

Subtitle BCRedomestication of Mutual Insurers

*Senate Position:* No provision.

*House Position:* The House bill allows mutual insurance companies to redomesticate to another state and reorganize into a mutual holding company or stock company. It only applies to insurers in States which have not established reasonable terms and conditions for allowing mutual insurance companies to reorganize into a mutual holding company. All licenses of the insurer are preserved, and all outstanding policies, contracts, and forms remain in full force. A redomesticating company must provide notice to the state insurance regulators of each State for which the company is li- **[[Page 168]]** censed. A mutual insurance company may only redomesticate under this Subtitle if the State insurance regulator of the new (transferee) domicile affirmatively determines that the company's reorganization plan meets certain reasonable terms and

conditions: the reorganization is approved by a majority of the company's board of directors and voting policyholders, after notice and disclosure of the reorganization and its effects on policyholder contractual rights; the policyholders have equivalent voting rights in the new mutual holding company as compared to the original mutual insurer; any initial public offering of stock shall be in accordance with applicable securities laws and under the supervision of the State insurance regulator of the transferee domicile; the new mutual holding company may not award any stock options or grants to its elected officers or directors for six months; all contractual rights of the policyholders are preserved; and the reorganization is approved as fair and equitable to the policyholders by the insurance regulators of transferee domicile.

*Conference Substitute:* The Senate receded to the House with an amendment.

Subtitle CCNational Association of Registered Agents and Brokers

*Senate Position:* The Senate bill contains a sense of the Congress statement that States should provide for a uniform insurance agent and broker licensing system.

*House Position:* The House bill encourages the States to establish uniform or reciprocal requirements for the licensing of insurance agents. If a majority of the States do not establish uniform or reciprocal licensing provisions within a three-year period (as determined by the National Association of Insurance Commissioners ["NAIC"]), then the National Association of Registered Agents and Brokers (" NARAB") would be established as a private, non-profit entity managed and supervised by the State insurance regulators. State insurance laws and regulations shall not be affected except to the extent that they are inconsistent with a specific requirement of the Subtitle. Membership in NARAB is voluntary and does not affect the rights of a producer under each individual state license. Any state-licensed insurance producer whose license has not been suspended or revoked is eligible to join NARAB. NARAB shall be base membership criteria on the highest levels insurance producer qualification set by the States on standards such as integrity, personal qualification, education, training, and experience. NARAB members shall continue to pay the appropriate fees required by each State in which they are licensed, and shall renew their membership annually. NARAB may inspect members records, and revoke a membership where appropriate. NARAB shall establish an Office of Consumer Complaints, which shall have a toll-free phone number (and Internet website) to receive and investigate consumer complaints and recommend disciplinary actions. The Office shall maintain records of such complaints, which shall be made available to the NAIC and individual State insurance regulators, and shall refer complaints where appropriate to such regulators.

If the NAIC determines that the States have not met the uniformity or reciprocity requirements, then the NAIC has two years **[[Page 169]]** to establish NARAB. The NAIC shall appoint NARAB's board of directors, some of whom must have significant experience with the regulation of commercial insurance lines in the 20 States with the most commercial lines business. If within the time period allotted for NARAB's creation, the NAIC has still not appointed the initial board of directors for NARAB, then the initial directors shall be the State insurance regulators of the seven States with the greatest amount of commercial lines insurance. NARAB's bylaws are required to be filed with the NAIC, taking effect 30 days after filing unless disapproves by the NAIC as being contrary to the public interest or requiring a public hearing. The NAIC may require NARAB to adopt or repeal additional bylaws or rules as it determines appropriate to the public interest. The NAIC is given the responsibility of overseeing NARAB, and is authorized to examine and inspect NARAB's records, and require NARAB to furnish it with any reports.

If at the end of two years after NARAB is required to be established, (1) a majority of the States representing at least 50% of the total commercial-lines insurance premiums in the United States have not established uniform or reciprocal licensing regulations, or (2) the NAIC has not approved NARAB's bylaws or is unable to operate or supervise NARAB (or if NARAB is not conducting its activities under this Act), then NARAB shall be created and supervised by the President, and shall exist without NAIC oversight. The President shall appoint NARAB's board, with the advice and consent of the Senate, from lists of candidates submitted by the NAIC. If the President determines that NARAB's board is not acting in the public interest, the President may replace the entire board with new members (subject to the advice and consent of the Senate). The President may also suspend the effectiveness of any rule or action by NARAB which the President determines is contrary to the public interest. NARAB shall report annually to the President and Congress on its activities.

State laws regulating insurance licensing that discriminate against NARAB members based on non-residency are preempted, as well as State laws and regulations which impose additional licensing requirements on non-resident NARAB members beyond those established by the NARAB board (pursuant to this Subtitle), except that State unfair trade practices and consumer protection laws are protected from preemption, including counter-signature requirements. NARAB is required to coordinate its multistate licensing with the various States. It is also required to coordinate with the States on establishing a central clearinghouse for license issuance and renewal, and for the collection of regulatory information on insurance producer activities. NARAB shall further coordinate with the NASD to facilitate joint membership. Any dispute involving NARAB shall be brought in the appropriate U.S. District Court under federal law, after all administrative remedies through NARAB and the NAIC have been exhausted.

*Conference Substitute:* The Senate receded to the House.

Subtitle DCRental Car Agency Insurance Activities

*Senate Position:* The Senate bill provides that the requirements under section 104 with respect to mandatory licensing do not apply **[[Page 170]]** to persons who offer insurance connected with a short term motor vehicle rental so long as the State does not require such licensing.

*House Position:* The House bill creates a Federal presumption for a three-year period that no State law imposes any licensing, appointment, or education requirements on persons who rent motor vehicles for a period of 90 days or less and sell insurance to customers in connection with the rental transaction. This presumption shall not apply to a State statute, the prospective application of a statutorily-authorized final State regulation or order interpreting a State statute, or the prospective application of a court judgment interpreting or applying a State statute, if such State statute or final State regulation or order specifically and expressly regulates (or exempts from regulation) persons who solicit or sell such short term vehicle rental insurance. This presumption shall apply to the retroactive application of a final State regulation or order interpreting a general State insurance licensing statute, or the retroactive application of a court judgment interpreting or applying a general State insurance licensing statute, with respect to the regulation of persons who solicit or sell such short term vehicle rental insurance.

*Conference Substitute:* The Senate receded to the House.

Subtitle ECConfidentiality

*Senate Position:* No provision.

*House Position:* The House bill requires insurance companies and their affiliates to protect the confidentiality of individually identifiable customer health and medical and genetic information. Such companies may only disclose such information with the consent of the customer or for statutorily specified purposes.

*Conference Substitute:* The House receded to the Senate.

TITLE IVCUNITARY THRIFT HOLDING COMPANY PROVISIONS

*Sec. 401. Prohibition on new unitary savings and loan holding companies*

*Senate Position:* The Senate bill, at section 601(a), amends the Home Owners' Loan Act to prohibit (except for corporate reorganizations) new unitary savings and loan holding companies from engaging in nonfinancial activities or affiliating with nonfinancial entities. The prohibition applies to a company that becomes a unitary savings and loan holding company pursuant to an application filed with the OTS after May 4, 1999. A grandfathered unitary thrift holding company (one in existence or applied for on or before May 4, 1999) retains its authority to engage in nonfinancial activities. The Senate bill, at section 601(b), allows mutual savings and loan holding companies to engage in new financial activities

authorized under the Gramm-Leach-Bliley Act.

*House Position:* The House bill, at section 401(a), prohibits new unitary thrift holding companies after the grandfather date of March 4, 1999, from engaging in nonfinancial activities or from affiliating with a nonfinancial entity. The provision also allows a nonfinancial company to purchase a grandfathered unitary thrift holding company upon approval of an application filed with the OTS and approval or no objection to a notice filed with the Federal Reserve Board. The House bill, at section 401(b), permits a mutual **[[Page 171]]** holding company to engage in activities permissible for multiple stock holding companies and permits unitary mutual savings and loan holding companies to engage in the new financial activities authorized for FHCs.

*Conference Substitute:* The House receded to the Senate.

## TITLE VCPRIVACY

### SUBTITLE ACDISCLOSURE OF NONPUBLIC PERSONAL INFORMATION

*Senate Position:* No provision.

*House Position:* The House bill contained important provisions providing consumers with new protections with respect to the transfer and use of their nonpublic personal information by financial institutions.

Among other things, the House bill directed relevant regulators to establish comprehensive standards for ensuring the security and confidentiality of consumers' personal information maintained by financial institutions; allowed customers of financial institutions to "opt out" of having their personal financial information shared with nonaffiliated third parties, subject to certain exceptions; barred financial institutions from disclosing customer account numbers or similar forms of access codes to nonaffiliated third parties for telemarketing or other direct marketing purposes; and mandated annual disclosureCin clear and conspicuous termsCof a financial institution's policies and procedures for protecting customers' nonpublic personal information.

*Conference Substitute:* The Senate receded to the House with an amendment.

The amendment modified the House position in the following ways:

1. The Federal functional regulators, the Secretary of the Treasury, and the FTC, in consultation with State insurance authorities, are directed to prescribe such regulations as may be necessary to carry out the purposes of the privacy subtitle. The House bill had called for a joint rulemaking. The relevant agencies are required to consult and coordinate with one another in order to assure to the maximum extent possible that the regulations each prescribes are consistent and comparable with those prescribed by the other agencies. It is the hope of the Conferees that State insurance authorities would implement regulations necessary to carry out the purposes of this title and enforce such regulations as provided in this title.

2. To address the concern that the House bill failed to provide a mechanism for enforcing the subtitle's provisions against non-financial institutions, the Conferees agreed to clarify that the FTC's enforcement authority extends to such entities.

3. The Conferees agreed to clarify the relation between Title V's privacy provisions and other consumer protections already in law, by stating that nothing in the title shall be construed to modify, limit, or supersede the operation of the Fair Credit Reporting Act, and no inference shall be drawn on the basis of the provisions of the title regarding whether information is transaction or experience information under section 603 of that Act.

**[[Page 172]]** 4. At the request of the Conferees from the Committee on Agriculture, the Conferees agreed to exclude from the scope of the privacy title any person or entity that is subject to the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act, as well as the Federal Agricultural Mortgage Corporation or any entity chartered and operating under the Farm Credit Act of 1971. The Conferees also excluded from this subtitle institutions chartered by Congress specifically to engage in securitization or secondary market transactions, so long as such institutions do not sell or transfer nonpublic personal information to nonaffiliated third parties. The Conferees granted the exception based on the understanding that the covered entities do not market products directly to consumers.

5. The Conferees agreed to clarify that a financial institution's annual disclosure of its privacy policy to its customers must include a statement of the institution's policies and practices regarding the sharing of nonpublic personal information with affiliated entities, as well as with nonaffiliated third parties.

6. The Conferees agreed to provide that the disclosure of nonpublic personal information contained in a consumer report reported by a consumer reporting agency does not fall within section 502's notice and opt out requirements.

7. The Conferees agreed to modify the statutory definition of "nonpublic personal information" by clarifying that such term does not encompass any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived without using any nonpublic personal information.

8. The Conferees agreed to exclude disclosures to consumer reporting agencies from section 502(d)'s limitations on the sharing of account number information.

9. The Conferees agreed to give the relevant regulatory agencies the authority to prescribe exceptions to subsections (a) through (d) of section 502, rather than just sections 502 (a) and (b), as provided for in the House bill.

10. The Conferees inserted language stating that the privacy provisions in the subtitle do not supersede any State statutes, regulations, orders, or interpretations, except to the extent that such State provisions are inconsistent with the provisions of the subtitle, and then only to the extent of the inconsistency. The amendment provides that a State statute, regulation, order, or interpretation is not inconsistent with the provisions of this subtitle if the protection such statute, regulation, order, or interpretation affords any consumer is greater than the protection provided under this subtitle, as determined by the FTC in consultation with the agency or authority with jurisdiction under section 505(a) over either the person that initiated the complaint or that is the subject of the complaint, on its own motion or upon the petition of any interested party.

11. Section 506 authorizes the Federal banking agencies and the National Credit Union Administration to prescribe joint regulations governing the institutions under their jurisdiction with respect to the Fair Credit Reporting Act; the Conferees agreed to an amendment giving the Board of Governors of the Federal Reserve the authority to prescribe FCRA regulations governing bank holding companies and their affiliates.

**[[Page 173]]** 12. The Conferees agreed to modify section 502(e)(5), to include the Secretary of the Treasury as a "law enforcement agency" for the purposes of the Bank Secrecy Act, to avoid unintended interference with the existing functions of the Treasury's anti-money laundering unit, the Financial Crimes Enforcement Network ("FinCEN").

The Conferees wish to ensure that smaller financial institutions are not placed at a competitive disadvantage by a statutory regime that permits certain information to be shared freely within an affiliate structure while limiting the ability to share that same information with nonaffiliated third parties. Accordingly, in prescribing regulations pursuant to this subtitle, the agencies and authorities described in section 504(a)(1) should take into consideration any adverse competitive effects upon small commercial banks, thrifts, and credit unions. In issuing regulations under section 503, the regulators should take into account the degree of consumer access to disclosure by electronic means.

In exercising their authority under section 504(b), the agencies and authorities described in section 504(a)(1) may consider it consistent with the purposes of this subtitle to permit the disclosure of customer account numbers or similar forms of access numbers or access codes in an encrypted, scrambled, or similarly coded form, where the disclosure is expressly authorized by the customer and is necessary to service or process a transaction expressly requested or authorized by the customer.

The Conferees recognize the need to foster technological innovation in the financial services and related industries. The Conferees believe that the development of new technologies that facilitate consumers' access to the broad range of products and services available through online media should be encouraged, provided that such technologies continue to incorporate safeguards for consumer privacy.

Subtitle BCFraudulent Access to Financial Information

*Senate Position:* The Senate bill contained provisions making it a Federal crimeCpunishable by up to five years in prisonCto obtain or attempt to obtain, or cause to be disclosed or attempt to cause to be disclosed, customer information of a financial institution through fraudulent or deceptive means, such as by misrepresenting the identity of the person requesting the information or otherwise misleading an institution or customer into making unwitting disclosures of such information. In addition, it provided for a private right of action and enforcement by state attorneys general.

*House Position:* Similar provisions, with no private right of action or enforcement by State Attorneys General.

*Conference Substitute:* The Senate receded to the House with an amendment.

The amendment provided that authority for enforcing the subtitle would be placed in the FTC, the Federal banking agencies and the National Credit Union Administration (for enforcement of these provisions with respect to compliance by depository institutions within their jurisdiction).

**[[Page 174]]**

TITLE VICFEDERAL HOME LOAN BANK SYSTEM MODERNIZATION

The Senate and House bills reform the Federal Home Loan Bank ("FHLBank") System in several important ways. Mandatory FHLBank membership for Federal savings associations is eliminated, in order to provide completely voluntary membership. Small bank members are given expanded access to FHLBank advances. Governance of the FHLBanks is decentralized from the Federal Housing Finance Board ("FHFB") to the individual FHLBanks. The Resolution Funding Corporation ("REFCORP") obligation of the FHLBanks, stemming from the savings and loan crisis, is changed from a fixed dollar amount to a fixed percentage of annual net earnings. The Senate bill directs the General Accounting Office to study FHLBank capital and the House bill establishes a new capital structure for the FHLBanks. The conference committee addressed three of these major areas.

*Sec. 604. Advances to members; collateral*

*Senate Position:* The Senate bill authorizes community financial institutions (FDIC-insured depository institutions with assets less than $500 million) to obtain long-term FHLBank advances for lending to small businesses, small farms, and small agri-businesses. Eligible collateral for community financial institutions receiving any FHLBank advances could include secured loans for small business, agriculture, or securities representing a whole interest in such loans.

*House Position:* The House bill authorizes community financial institutions to obtain long-term FHLBank advances for small business, agricultural, rural development, or low-income community development lending. Eligible collateral for community financial institutions receiving any FHLBank advances could include secured loans for small business, agriculture, rural development, or low-income community development, or securities representing a whole interest in such loans. Such advances-funded non-housing loans are treated as qualified thrift investments in determining required FHLBank stock purchases for community financial institutions that are not qualified thrift lenders ("QTLs").

*Conference Substitute:* The House receded to the Senate on the purposes and collateral for advances to community financial institutions. Greater stock purchases required of FHLBank members, that are not QTLs, when they receive advances are eliminated as is the requirement that such members only apply for advances for housing finance purposes. A priority for making advances to QTL members and a 30% limit on total advances to non-QTL members are also removed. Restrictions on obtaining new advances and having to repay advances after three years, applicable to savings associations that are not QTLs, are eliminated.

*Sec. 606. Management of FHLBanks*

*Senate Position:* The Senate bill changed the term of elected FHLBank directors from two to four years to make the term

the same as for appointed directors. It transferred from the FHFB to the individual FHLBanks authority over a number of operational areas. It also gave the FHFB the same enforcement authority over **[[Page 175]]** FHLBanks and their executive officers and directors as the Federal banking agencies and the Office of Federal Housing Enterprise Oversight have under their statutes.

*House Position:* The House bill contained the same provisions. It also empowered the FHFB to address any capital insufficiencies resulting from voluntary membership and eliminated the 20:1 advances to stock ratio limit for a FHLBank member.

*Conference Substitute:* The Conference set terms for both elected and appointed directors at 3 years (staggered with approximately one-third of the terms expiring each year). A FHLBank's board of directors is authorized to elect by majority vote the board's Chairperson and Vice Chairperson. The term of office for the Chairperson and Vice Chairperson is two years. The annual salaries of FHLBank directors may not exceed specified amounts plus reimbursement of expenses. The maximum amounts are: ChairpersonC$25,000; Vice ChairpersonC$20,000; and other directorsC$15,000. FHLBank directors may reside outside the FHLBank district if they are an officer or director of a member institution located in the district. The Senate receded to the House regarding the provisions on capital insufficiencies and the advances to stock ratio limit.

*Sec. 608. Capital structure of the FHLBanks*

*Senate Position:* The Senate bill directs the General Accounting Office to submit to Congress within one year of enactment a study on possible revisions to the FHLBanks' capital structure, including the need for more permanent capital, a statutory leverage ratio, and a risk-based capital structure. GAO would also study the impact such revisions might have on the FHLBanks' operations, including the REFCORP payment obligation.

*House Position:* The House bill establishes a new capital structure for the FHLBanks. The FHLBanks were authorized to issue three classes of stock: Class A (redeemable on 6-months notice), Class B (redeemable on 5-years notice), and Class C (nonredeemable). FHLBanks were required to meet a 5% leverage minimum tied to total capital and a risk-based requirement tied to permanent capital. Permanent capital included Class C stock, retained earnings, and up to 1% of a FHLBank's assets in Class B stock. Total capital included permanent capital plus Class A stock, Class B stock (other than what counted toward permanent capital), and a general allowance for losses. A FHLBank must at all times comply with both the leverage and risk-based capital requirements. In determining compliance with the 5% minimum leverage ratio, Class A stock was counted at paid-in value, Class B stock was weighted at 1.5 times paid-in value, and Class C stock and retained earnings at 2.0 times. The current capital structure of the FHLBanks must be maintained until the new capital requirements are fully implemented. Within one year of enactment, the FHFB must issue implementing regulations. The board of directors of each FHLBank must develop a capital plan, subject to FHFB approval. The FHLBanks have up to three years to carry out their plans.

*Conference Substitute:* The Senate receded to the House with an amendment regarding a new capital structure. Two classes of **[[Page 176]]** stock are authorized: Class A (redeemable on 6-months notice) and Class B (redeemable on 5-years notice). FHLBanks are required to meet a 5% leverage minimum tied to total capital and a risk-based requirement tied to permanent capital. Permanent capital includes Class B stock and retained earnings. Total capital includes permanent capital plus Class A stock, generally. In determining compliance with the 5% minimum leverage ratio, Class A stock is counted at paid-in value and Class B stock and retained earnings are weighted at 1.5 times; however, a FHLBank's total capital, determined without taking into account any multiplier, must not be less than 4% of total assets.

The weighting provision is included to encourage the FHLBanks to build more permanent, longer-term capital. Using the capital multiplier, the paid-in value of outstanding Class A stock plus 1.5 times the paid-in value of outstanding Class B stock and retained earnings must be at least 5% of total assets. Using no weighting factor, total capital must be at least 4% of total assets. For example, a FHLBank with $100 million in assets would comply with $5 million in Class A capital stock or $2 million in Class A capital stock and an unweighted $2 million in Class B capital stock and retained earnings (which

would constitute $3 million on a weighted basis).

A FHLBank's permanent capital, used to measure its compliance with the risk-based capital requirement, consists of the amounts paid by members for Class B stock and the amount of the FHLBank's retained earnings. The amount of retained earnings that may be included in permanent capital must be determined in accordance with generally accepted accounting principles (GAAP), which precludes the use of non-GAAP regulatory accounting standards for measuring retained earnings. The amount of Class B stock that is to be included in permanent capital is the full amount paid by a member to the FHLBank for the purchase of Class B stock.

A FHLBank's total capital, used to measure its compliance with the statutory leverage ratio, consists of permanent capital, the amounts paid by members for Class A stock, any general allowance for losses (consistent with GAAP and subject to FHFB regulation), and any other amounts from sources determined by the FHFB to be available to absorb losses incurred by the FHLBank and appropriate for including as capital. Any loss reserve that is held or established against a specific asset of the FHLBank is expressly prohibited from being included in total capital, as such reserves are not capable of absorbing potential losses on other assets.

In recognition of Congressional concern regarding the Financial Management and Mission Achievement ("FMMA") rule recently proposed by the FHFB, the Chairman of the FHFB sent a letter on October 18, 1999 to the Senate and House Banking Committee Chairmen (inserted below) providing assurances that the proposal would be withdrawn, upon enactment of this legislation. It is the conference committee's understanding and expectation that the FMMA will be withdrawn and that the FHFB will take no action to promulgate proposed or final regulations limiting assets or advances beyond those currently in effect until the statutorily required FHLBank System capital rules are finalized and the statutory period for submission of capital plans by the FHLBanks has **[[Page 177]]** expired. If and when the FHFB develops a new FMMA, or similar rules, we expect that the FHFB will provide ample opportunity for public comment and hearings. It is the desire of the conference committee that the FHFB consult with the Banking Committees regarding both the capital regulations and any financial management and/or mission related rules prior to issuing them in proposed form.

FEDERAL HOUSING FINANCE BOARD, *Washington, DC, October 18, 1999.*

Hon. PHIL GRAMM, *Chairman, Committee on Banking, Housing, and Urban Affairs, Washington, DC.*

Hon. JIM LEACH, Chairman, Committee on Banking and Financial Services, Washington, DC.

DEAR SENATOR GRAMM AND CONGRESSMAN LEACH: As you proceed to consider legislation to modernize the Federal Home Loan Bank System as part of the S. 900/H.R. 10 conference, I am aware that there is substantial concern regarding our proposed Financial Management and Mission Achievement regulation (FMMA). Unfortunately, this legitimate concern regarding a far-reaching regulatory initiative has resulted in a proposal for a statutory moratorium on our regulatory authority. Despite the best efforts of well-meaning advocates, such statutory language can only lead to serious ambiguity and potential litigation over the independent regulatory authority of the Finance Board.

Therefore, this letter is intended to give you and your colleagues on the Committee of Conference solid assurances about our intentions upon final enactment of the statute being drafted in conference. Upon such enactment, the Finance Board will:

1. Withdraw, forthwith, its proposed FMMA.

2. Proceed in accordance with the statutory instructions regarding regulations governing a risk-based capital system and a minimum leverage requirement for the Federal Home Loan Banks.

3. Take no action to promulgate proposed or final regulations limiting assets or advances beyond those currently in effect (except to the extent necessary to protect the safety and soundness of the Federal Home Loan Banks) until such time as the regulations described in number 2 have become final and the statutory period for submission of capital plans by the Banks has expired.

4. Consult with each of you and your colleagues on the Banking Committees of the House and the Senate, regarding the content of both the capital regulations and any regulations on the subjects described in number 3, prior to issuing them in proposed form.

I believe that these commitments cover the areas of concern which have led to a proposal for moratorium legislation. You can rely on this commitment to achieve those legitimate ends sought by moratorium proponents without clouding the necessary regulatory authority of the Finance Board which could result from statutory language.

Thank you for your consideration.

Sincerely,
BRUCE A. MORRISON

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TITLE VIICOTHER PROVISIONS

Subtitle ACATM Fee Reform

*Senate Position:* The Senate bill at Title VII requires automated teller machine (“ATM”) operators who impose a fee for use of an ATM by a noncustomer to post a notice on the machine and on the screen that a fee will be charged and the amount of the fee. This notice must be posted before the consumer is irrevocably committed to completing the transaction. A paper notice issued from the machine may be used in lieu of a posting to the screen. No surcharge may be imposed unless the notices are made and the consumer elects to proceed with the transaction. A notice is required when ATM cards are issued that surcharges may be imposed by other parties when transactions are initiated from ATMs not operated by the card issuer. ATM operators are exempt from liability if properly placed notices on the machines are subsequently removed, damaged, or altered by anyone other than the ATM operator.

*House Position:* Same.

*Conference Substitute:* The House receded to the Senate with an amendment.

The amendment grants a temporary exemption for those older machines that are unable to provide certain of the notices required.

Subtitle BCCommunity Reinvestment

*Sec. 711. CRA sunshine requirements*

*Senate Position:* Section 312 of the Senate bill amends the Federal Deposit Insurance Act by creating a new Section 46, to require full disclosure of agreements entered into between insured depository institutions or their affiliates and nongovernmental entities or persons made pursuant to or in connection with the fulfillment of the CRA. The section does not confer any authority on the Federal banking agencies to enforce the provisions of these agreements.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate, with an amendment.

As recommended by the Conferees, the provision requires full disclosure of agreements, as defined in this section, between an insured depository institution or affiliate and a nongovernmental entity or person where the agreement is made pursuant to or in connection with the CRA, involving funds or other resources of an insured depository institution or affiliate.

The provision is not intended to define as a CRA agreement an individual mortgage loan (although it could apply to agreements involving, for example, parties acting as mortgage intermediaries or facilitators), or other specific contract to an individual, business, farm, or other entity, where funds are loaned at rates not substantially below market rates and if the purpose of the loan or extension of credit does not include any re-lending of borrowed funds to other parties. In addition, the scope of the provision does not extend to an agreement entered into by an insured depository institution or affiliate with a nongovernmental entity or person who has not commented on, testified about, or discussed with the institu- **[[Page 179]]** tion, or otherwise contacted the institution, concerning the CRA. This exception to the coverage could include, for example, service organizations such as civil rights groups, community groups providing housing or other services in low-income neighborhoods, the American Legion, community theater groups, and so forth. The Federal Reserve Board may prescribe regulations to provide further exemptions consistent with the purposes of the provision.

In defining the agreements to which this provision would apply, the legislation assigns to the appropriate Federal banking agency the responsibility to identify a list of factors that the agency determines have a material impact on the agency's decision to approve or disapprove an application for a deposit facility or to assign a rating in an examination under the CRA. It is expected that the regulator will include in such list a full enumeration of the relevant factors that the agency reviews and considers in examining the performance of an insured financial institution in connection with the CRA, including any and all items a regulator would attach importance to in determining the evaluation under the act of the performance of a financial institution.

The Conferees note that while an agency may not give a great deal of weight to a mere agreement to perform certain CRA-related activities, per se, the agency does look carefully at the activities that the institution may have actually performed in fact pursuant to such an agreement. The disclosure and reporting requirements of this section apply to agreements defined in subsection (a) in either event.

As a general rule, the parties are required to disclose fully such agreements and make them available to the public and to the Federal banking agencies.

In addition, parties to each CRA agreement are required to report at least once each year on the use of resources provided pursuant to each agreement. A bank would file its report directly with its Federal regulator. A nongovernmental party is required to file its report with the appropriate Federal banking agency with supervisory responsibility over the insured depository institution that is a party to the agreement, either directly with the agency or via the insured depository institution, which would be required promptly to transmit the report to the Federal banking agency.

The Federal banking agencies are directed, in implementing regulations under this provision, to minimize the regulatory burden on reporting parties. One way in which to accomplish this goal would be wherever possible and appropriate with the purposes of this section, to make use of existing reporting and auditing requirements and practices of reporting parties, and thus avoid unnecessary duplication of effort. The Managers intend that, in issuing regulations under this section, the appropriate Federal supervisory agency may provide that the nongovernmental entity or person that is not an insured depository institution may, where appropriate and in keeping with the provisions of this section, fulfill the requirements of subsection (c) by the submission of its annual audited financial statement or its Federal income tax return.

**[[Page 180]]** *Sec. 712. Small bank regulatory relief*

*Senate Position:* The Senate provision amended the CRA to exempt from the provisions of that Act banks and savings and loan associations with total assets less than $100 million and that are located in nonmetropolitan areas.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate provision with an amendment.

The provision directs that "regulated financial institutions" with aggregate assets not exceeding $250 million will be

subject to routine examinations under the CRA as follows: (i) not more than once every 60 months if the institution received a rating of "outstanding record of meeting community credit needs" at its most recent examination; (ii) not more than once every 48 months if the institution received a rating of "satisfactory record of meeting community credit needs" at its most recent examination; and (iii) as deemed necessary by the appropriate Federal banking agency if the institution received a rating of less than "satisfactory record of meeting community credit needs" at its most recent examination. The provision also states that the Federal banking agencies may subject an institution to more frequent or less frequent examinations for reasonable cause. A regulated financial institution shall remain subject to examination under this title in connection with an application for a deposit facility.

*Sec. 713-715. Federal Reserve Board and Treasury studies, Impact on CRA*

*Senate Position:* No provision.

*House Position:* The House bill at Section 110 requires a study by the Secretary of the Treasury, in consultation with the Federal banking agencies, of the extent to which adequate services are being provided as intended by the CRA, including services in low- and moderate-income neighborhoods and for persons of modest means, as a result of the enactment of the Gramm-Leach-Bliley Act. The report must be submitted to the Congress within two years.

*Conference Substitute:* The Senate receded to the House with an amendment directing, in addition, that the Federal Reserve Board conduct a comprehensive study of the CRA, in consultation with the Chairman and Ranking Member of the House Banking and Financial Services Committee and the Chairman and Ranking Member of the Senate Banking, Housing, and Urban Affairs Committee. The study is to focus on default rates, delinquency rates, and the profitability of loans made in conformity with that Act. The report must be submitted to the House and Senate Banking Committees no later than March 15, 2000. The provision also directs that the report and all of the supporting data be made available at the same time to the public by the Federal Reserve Board, to the extent that the data are not confidential.

The Conferees recommended further amending the House study with an amendment permitting the Secretary of the Treasury to submit to the Congress by March 15, 2000, a baseline report in addition to the final report as required in the House provision. The purpose of the baseline report is to give a set of data against which **[[Page 181]]** the Secretary will be able to measure change by the end of the two-year reporting period.

The Conferees also recommended an amendment to the House language to state that nothing in the Gramm-Leach-Bliley Act shall be construed to repeal any provision of the CRA.

Subtitle CCOther Regulatory Improvements

*Sec. 721. Expanded small bank access to S corporation treatment*

*Senate Position:* The Senate bill at section 302 requires the GAO to study and report to Congress within six months of the date of enactment on certain revisions to S corporation rules permitting greater access by community banks to S corporation treatment.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate.

*Sec. 722. "Plain Language" requirement for Federal banking agency rules*

*Senate Position:* The Senate bill at section 306 directs the Federal banking agencies to use plain language in all proposed and final rule-makings published by the agency in the Federal Register after January 1, 2000, and to report to Congress by no later than March 1, 2001 on how they have complied with the plain language requirement.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate.

*Sec. 723. Retention of "Federal" in name of converted Federal savings associations*

*Senate Position:* The Senate bill at section 307 would permit Federal savings associations that convert to national or state bank charters to keep the word "Federal" in their names.

*House Position:* Same.

*Conference Substitute:* The Senate receded to the House.

*Sec. 724. Control of Bankers' Banks*

*Senate Position:* The Senate bill at section 310 allows one or more thrift institutions to own a state-chartered bank or trust company, whose business is restricted to accepting deposits from thrift institutions or savings banks, deposits arising from the corporate business of the thrift institutions or savings banks that own the bank or trust company, or deposits of public funds.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate.

*Sec. 725. Provision of technical assistance to microenterprises*

*Senate Position:* The Senate bill at section 316 establishes a grant program to fund nonprofit microenterprise development organizations, programs, collaboratives, or intermediaries engaged in (1) providing training and technical assistance to low-income and disadvantaged entrepreneurs interested in starting or expanding their own businesses; (2) building the capacity of organizations that serve low-income and disadvantaged entrepreneurs; and (3) supporting research and development aimed at identifying and pro- **[[Page 182]]** moting training and technical assistance programs that effectively serve low-income and disadvantaged entrepreneurs.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate with an amendment.

While the Senate bill made the new microenterprise program a part of the Treasury Department's Community Development Financial Institutions program, the Conferees chose to have the new program administered by the Small Business Administration.

*Sec. 726. Federal Reserve audits*

*Senate Position:* The Senate bill at section 317 requires annual outside independent accounting firm audits of the Federal Reserve Banks and the Federal Reserve Board. In addition, the bill changes the definitions and rules that apply to the pricing of Federal Reserve System services under the Monetary Control Act.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate with an amendment in the nature of a substitute. The substitute provision requires the Federal Reserve Board to order an annual independent audit of the financial statements of each Federal Reserve Bank and of the Board.

*Sec. 727. Authorization to release reports*

*Senate Position:* No provision.

*House Position:* The House bill at section 132 permits the Federal Reserve Board, at its discretion, to furnish exam reports and other confidential supervisory information concerning State member banks or other entities it examines to any Federal or State authorities with supervisory authority over an examined entity, to officers, directors, or receivers of the entity, or any other person that the Federal Reserve Board determines is proper. In addition, the House bill includes the Commodity Futures Trading Commission under definitions in the Right to Financial Privacy Act.

*Conference Substitute:* The Senate receded to the House with an amendment.

The amendment adds to the provision allowing the disclosure of reports and information by applying certain confidentiality requirements and procedures for disclosure.

*Sec. 728. General Accounting Office study of conflicts of interest*

*Senate Position:* No provision.

*House Position:* The House bill at section 193 requires the Comptroller General of the GAO to study the conflict of interest faced by the Federal Reserve Board between its role as a primary regulator of the banking industry and its role as a vendor of services. Specifically, the GAO should address the conflict between the Board's role as a regulator of the payment system and its role as a competitor with private sector providers of payment services, and how best to resolve that conflict. The study is due one year after enactment of the legislation.

*Conference Substitute:* The Senate receded to the House.

**[[Page 183]]** *Sec. 729. Study and report on adapting existing legislative requirements to on-line banking and lending*

*Senate Position:* No provision.

*House Position:* The House bill at section 195 requires the Federal banking agencies to conduct a study of banking regulations regarding the delivery of financial services, including those regulations that may assume that there will be face-to-face contact, and report their recommendations on adapting those existing requirements to online banking and lending. The report, with any recommended legislative or regulatory action, is due one year after the date of enactment of the legislation.

*Conference Substitute:* The Senate receded to the House with an amendment changing the due date of the study to two years after date of enactment.

*Sec. 730. Clarification of source of strength doctrine*

*Senate Position:* No provision.

*House Position:* The House bill at section 197 enhances the source of strength doctrine by, in certain circumstances, protecting the Federal banking agencies and the deposit insurance funds from claims brought by the bankruptcy trustee of a depository institution holding company or other person for the return of capital infusions.

*Conference Substitute:* The Senate receded to the House with an amendment in the nature of a substitute.

The substitute narrows and clarifies the circumstances under which a Federal banking agency would be protected from a claim. First, it clarifies that the transferred assets must be those of an affiliate or a controlling shareholder of an insured depository institution. The House amendment did not so specify. Second, section 730 provides that the transfer must be to or for the benefit of an insured depository institution and that it must be made by an affiliate or controlling shareholder of such insured depository institution. The House amendment did not include such clarifying language. Third, section 730 specifies that no person may bring a claim against a Federal banking agency for monetary damages, return of assets, or for other legal or equitable relief in connection with such transfer, consistent with certain limitations. The House amendment only referred to claims for monetary damages or for the return of assets or other property. Fourth, section 730 adds a definition of the term "claim." For purposes of this provision, a claim is defined as a cause of action based on Federal or State law providing for the avoidance of preferential or fraudulent transfers or conveyances, or providing for similar remedies. The definition, however, explicitly excepts any claim based on actual intent to hinder, delay or defraud pursuant to such fraudulent transfer or conveyance law.

This section does not limit the right of a depository institution, a controlling stockholder, or a depository institution holding company to seek direct review of an order or directive of a Federal banking agency under the Administrative Procedure Act in accordance with various banking statutes. In addition, the provision does not limit the rights of a claimant to bring suit against the United **[[Page 184]]** States for a breach of contract or a taking under the 5th Amendment to the Constitution.

*Sec. 731. Interest rates and other charges at interstate branches*

*Senate Position:* No provision.

*House Position:* The House bill at section 198 provides loan pricing parity among interstate banks. Specifically, if an interstate bank can charge a particular interest rate, then a local bank in the State into which the interstate bank has branched, may charge a comparable rate.

*Conference Substitute:* The Senate receded to the House.

*Sec. 732. Interstate branches and agencies of foreign banks*

*Senate Position:* The Senate bill at section 313 allows a Federal or State agency of a foreign bank to upgrade to a branch with the approval of the appropriate chartering authority and the Federal Reserve Board.

*House Position:* Same.

*Conference Substitute:* The House receded to the Senate.

*Sec. 733. Fair treatment of women by financial advisers*

*Senate Position:* No provision.

*House Position:* The House bill at section 198B establishes the sense of the Congress that estate planners, trust officers, investment advisers, and other financial planners and advisors should eliminate examples in their training materials which portray women as incapable and foolish, and develop fairer and more balanced presentations that eliminate outmoded and stereotypical examples which lead clients to take actions that are financially detrimental to their wives and daughters.

*Conference Substitute:* The Senate receded to the House with an amendment in the nature of a substitute.

The substitute establishes the sense of the Congress that individuals offering financial advice and products should do so in a nondiscriminatory, nongender-specific manner.

*Sec. 734. Membership of loan guarantee boards*

*Senate Position:* No provision.

*House Position:* No provision.

*Conference Substitute:* The Conferees adopted a provision that would modify the membership of the Emergency Steel Loan Guarantee Board and the Emergency Oil and Gas Loan Guarantee Board. Where under existing law the Chairmen of the Federal Reserve Board and SEC were designated as members, the provision permits both to designate another Member of the Board or another Commissioner as appropriate.

*Sec. 735. Repeal of stock loan limit in Federal Reserve Act*

*Senate Position:* No provision.

*House Position:* The House bill at section 124 repeals the restrictions in section 11(m) of the Federal Reserve Act on loans by Federal Reserve member banks secured by stock or bond collateral. Limitations on loans to one borrower imposed pursuant to other statutory authority are not affected.

**[[Page 185]]** *Conference Substitute:* The Senate receded to the House.

*Sec. 736. Elimination of SAIF and DIF Special Reserves*

*Senate Position:* The Senate bill at section 301 eliminates the need for the establishment of a SAIF “special reserve” which the FDIC was required to establish beginning in 1999. This revision becomes effective on the date of enactment.

*House Position:* Same other than the effective date.

*Conference Substitute:* The House receded to the Senate.

*Sec. 737. Bank officers and directors as officers and directors of public utilities*

*Senate Position:* The Senate bill at section 309 amends the Federal Power Act to permit officers or directors of public utilities to serve as officers or directors of banks, trust companies, or securities firms, if certain safeguards against conflicts of interest are complied with.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate.

*Sec. 738. Approval for purchases of securities*

*Senate Position:* The Senate bill at section 315 authorizes a majority of the entire board of directors of a bank to vote on the purchase of securities from an affiliate, based on a determination that the purchase is a sound investment for the bank. Such a standard does not exist under current law, which simply requires the vote to be taken by a majority of independent directors.

*House Position:* No provision.

*Conference Substitute:* The House receded to the Senate.

*Sec. 739. Optional conversion of Federal savings associations*

*Senate Position:* The Senate bill at section 602 allows a Federal savings association chartered prior to the date of enactment to convert into one or more national banks, subject to the approval of the OCC, each of which may encompass one or more of the branches of the Federal savings association in one or more States.

*House Position:* No provision.

*Conference Substitute:* The House recedes to the Senate with an amendment.

The amendment would allow the conversion to State as well as national banks.

*Sec. 740. Grand jury proceedings*

*Senate Position:* No provision.

*House Position:* No provision.

*Conference Substitute:* The Conferees adopted a provision that would permit U.S. Attorneys offices to seek a court order to provide financial institution regulatory agencies with access to grand jury material, giving State regulatory agencies parity with Federal regulatory agencies.

**[[Page 186-188]]**

**[Identification of Conferees Omitted]**

[*Letterhead of State Senator David Sibley*]

March 31, 2000

Mr. Randall S. James
Banking Commissioner
Banking Department of Texas
2601 North Lamar
Austin, TX 78705

Mr. Jose Montemayor
Commissioner of Insurance
Texas Department of Insurance
P.O. Box 149104
Austin, TX 78714

Ms. Denise Voigt Crawford
Securities Commissioner
State Securities Board
P.O. Box 13167
Austin, TX 78711

Mr. James L. Pledger
Commissioner
Savings and Loan Department of Texas
2601 North Lamar, Suite 201
Austin, TX 78705

Dear Commissioners,

As directed by interim charges from Lt. Governor Rick Perry and Speaker Pete Laney, the Senate Economic Development Committee, House Committee on Financial Institutions and House Committee on Insurance are in the process of studying state law and regulatory structure ramifications of the Gramm-Leach-Bliley Financial Modernization Act ("GLBA").

Effective March 11, 2000, the GLBA allows and encourages the convergence of the banking, insurance and securities industries while maintaining appropriate safety and soundness safeguards. Legal barriers that have historically separated the industries are substantially eliminated from federal law, and in many respects the new federal law will preempt any impending state law.

March 31, 2000
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We appreciate that GLBA also recognizes the vital regulatory interests of this State by endorsing functional regulation of newly authorized bank activities by those regulatory agencies, both state and federal, that are most knowledgeable regarding the need for and public policies underlying regulation of a specific activity. Although state law may not discriminate against banks in licensing or authorizing securities and insurance activities, a state may impose suitable and reasonable licensing and consumer protection requirements consistent with the underlying rationale for regulation.

The vital interests of this State will be best served by empowering the state-chartered bank to fully participate in and adapt to modern banking practices to the extent consistent with safety and soundness and the purpose of functional regulation. We view very positively recent efforts by the Banking Commissioner, the Insurance Commissioner, and the Securities Commissioner of this State to implement financial modernization and coordinate functional regulation of banks, and in particular we are encouraged by the recent promulgation by the Insurance Commissioner of Commissioner's Bulletin B-1005-00 (January 18, 2000). We also believe these efforts must continue, and should further involve the Savings and Loan Commissioner with respect to the impact of GLBA on state savings banks.

To the extent consistent with GLBA and other applicable federal law, our references to state-chartered banks include state savings banks. The Banking Commissioner, the Insurance Commissioner, the Securities Commissioner, and the Savings and Loan Commissioner are collectively referred to as the "Commissioners."

Therefore, we are requesting the Banking Commissioner to perform a study in consultation and cooperation with the aforementioned Commissioners. The continuing efforts of the Commissioners should focus on:

1. cooperative study of the impact of financial modernization on existing Texas statutes and rules, to identify those provisions that are preempted by or inconsistent with the goals and purposes of GLBA and the competitiveness of state-chartered banks, and to assess the continuing effectiveness of existing investor and consumer protection statutes;

2. to the extent possible without legislative action, cooperative authorization and implementation of permissible non-banking activities for insured depository institutions (state or national) as contemplated by GLBA, subject to permissible functional regulation and applicability of investor and consumer protection statutes; and

3. consensus recommendations to the Committees regarding needed legislative changes to State law, including but not limited to recommendations for the purpose of:

    A. eliminating provisions of state law that prevent or restrict an insured depository institution (state or national) from affiliating with insurance or securities firms, or that prevent or significantly interfere with the ability of an insured depository

March 31, 2000
Page Three

institution to engage in the sale, solicitation, or cross marketing of insurance as contemplated by GLBA;

B. expanding the authority of state-chartered banks and their subsidiaries to conduct non-banking activities of the nature contemplated by GLBA, and to conduct activities beyond those allowed for national banks and their subsidiaries to the extent consistent with principles of safety and soundness and applicable federal law;

C. allowing bank holding companies to become financial holding companies and engage in activities that are financial in nature or incidental to such financial activity, or complementary to a financial activity, as determined in the manner provided by GLBA, or to the extent otherwise permissible under federal law;

D. implementing uniform licensing and continuing education requirements for insurance agents and companies as contemplated by GLBA;

E. authorizing and requiring coordination and information sharing among the Commissioners as well as between state and federal banking and functional regulators, including adequate safeguards for shared confidential information;

F. granting each Commissioner adequate discretion and flexibility to promptly adapt regulatory practices from time to time as needed to allow financial institutions to compete in an ever-changing, technology-driven market, to the extent consistent with principles of safety and soundness and applicable federal law; and

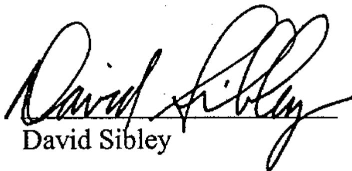
G. granting the Banking Commissioner authority to approve new financial activities for state-chartered banks and financial holding companies that are financial in nature or incidental to such financial activity, or complementary to a financial activity, to the extent permissible under federal law, subject to a duty to consult and coordinate with the Commissioners and other affected functional regulators in connection with implementation of such approvals.

Further, we are of the sense that the Commissioners need not engage in study of or formulate recommendations regarding the financial privacy provisions of GLBA. This is a subject that will be studied and addressed appropriately by our committees and functional regulatory expertise is not required to evaluate the need for state response. For purposes of developing our committee reports, we would greatly appreciate a status report on any findings or recommendations the group might develop on or before August 1, 2000. We recognize that the complexity of this subject may require the group to continue its efforts after this date.

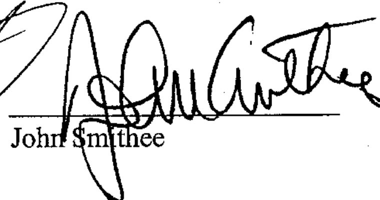
Thank you for your assistance in this matter. As always, we value the work of your respective agencies and look forward to working with you on this very important issue. Please feel free to

contact one of us, Bruce Scott in the Senate Economic Development Committee, Bryan McMath in the House Committee on Financial Institutions, or Bryan Taylor in the House Committee on Insurance.

Yours truly,


David Sibley

Kip Averitt


John Smithee

cc: Lt. Governor Rick Perry
Speaker of the House Pete Laney
Members of the Senate Economic Development Committee
Members of the House Committee on Financial Institutions
Members of the House Committee on Insurance

# APPENDIX – C
# Profile of Regulatory Agencies and Affected Texas Industries

## Texas Department of Banking and its Mission

The agency began its existence in 1905 under the auspice of the Superintendent of Banking that operated under the Commissioner of Agricultural, Insurance, Statistics, and History. The 30th Legislature created the Department of Agriculture and the former agency was renamed the state Department of Insurance and Banking. In 1923, the 38th Legislature created the office of the banking commissioner and the state Department of Banking. In 1943, the 48th Legislature enacted The Texas Banking Code of 1943 and created the Finance Commission of Texas who had responsibility for appointing the banking commissioner. The Banking Department's two sister agencies, Texas Savings and Loan Department and the Office of Regulatory Loan Commissioner, were created in 1963 and also operate under the supervision of the Finance Commission. In 1995, the 74th Legislature enacted the modernized Texas Banking Act and repealed the Texas Banking Code of 1943. This legislation was a dramatic milestone in updating Texas banking law and maintained the agency's status as the primary regulator for state chartered banks. In addition, this legislation abolished the State Banking Board, transferring its chartering authority to the banking commissioner who also received explicit statutory authority to issue interpretive statements and legal opinions, along with expanded ability to investigate unauthorized activities. The basic structure of the Department has changed little since.

Legislation, both state and federal, has indeed shaped the duties and responsibilities of the Department over the last almost 100 years. Three modern events in particular have had a significant impact on the citizens of this state, financial service providers, and the manner in which the Department fulfills its responsibilities. In 1988, restricted bank branching was federally preempted, *Texas v. Clarke*, 690 F. Supp. 573 (W.D. Tex. 1988). Through a series of legal interpretations of judicial and legislative actions, the Finance Commission adopted a rule authorizing statewide branching for state banks. In the wake of an economic crisis of historic proportions, this event laid the foundation for the transfer of control of a significant percentage of the states banking assets to out-of-state institutions. In 1988, 175 Texas banks with assets of $47.3 billion (state and national) failed. This represented about 25% of the states total banking assets for the year ending 1987. In 1998 the trend continued as 134 Texas banks (state and national) with $23.2 billion in assets failed. A significant majority of these financial assets went to banks in Texas that were controlled by out-of-state bank holding companies. Shaken beyond material recovery, this transfer of asset control has not materially abated and continues today.

The second important event is a post-script to the 74th Legislature's decision to prohibit interstate mergers and branching in Texas as an opt-out measure to the federal Reigle-Neal Interstate Banking and Branching Act of 1994. In 1996, the banking commissioner sued Commercial National Bank, Texarkana, Arkansas, and the Office of the Comptroller for allowing a national bank to relocate its main office in Texas and retain branches in Arkansas. Also that year, the banking commissioner sued Sun World National Bank (a subsidiary/affiliate of NationsBank) and the Office of the Comptroller for allowing a national bank to relocate its main office to New Mexico and retain branches in Texas. After a series of judicial decisions and appeals the United States District Court for the Northern District of Texas issued an order denying a preliminary injunction, ruling that the state had not shown a likelihood of prevailing on the merits on its claim that the merger of NationsBank, North Carolina,

and NationsBank was not an "intrastate" merger, because NationsBank, North Carolina, was clearly located in Texas through its El Paso branches (formerly SunWorld branches, acquired through merger). NationsBank, Texas became a branch of NationsBank, North Carolina. In 1998, citing constitutional parity and the federal preemption of Article 489f for its failure to address state savings banks, the banking commissioner announced that the Department would accept applications for interstate merger and branching transactions for state-chartered banks. Although entirely at the other end of the spectrum from the economic bliss of the late 1980's, the new period of economic prosperity in the late 1990's began producing the same effect because of this decision. Out-of-state banks began accelerating their acquisition of Texas banks, and those already under their control began a transition into branches of the out-of-state home offices. The crisis of the 1980's had such a devastating affect upon Texas banks that a return to national significance has not had a chance to fully evolve.

A third piece of historic legislation may very well be the Graham-Leach-Bliley Act of 1999. Again, the likelihood exists that further consolidation will occur as Texas banks are merged or are acquired by insurance companies and securities firms and/or form strategic alliances to offer new products and services. No matter the course, banking in Texas will continue to exist and begin offering new services in the new age of e-commerce. To this end the Department is dedicated toward focusing its supervisory responsibilities to the concept of functional regulation.

The mission of the Texas Department of Banking is brief, *ensure Texas has a safe and sound financial services system.* This simple phrase however, transcends into a complex supervisory framework of laws and regulations that not only address lessons learned from past, but attempts to maneuver around the potential pitfalls of the future.

## The Banking Industry

The Texas Department of Banking occupies an integral part of this regulatory framework in understating its responsibility of supervising state chartered banking organizations. The current field of financial service providers in Texas continues to expand by the hour. Table 1 reflects the banking structure in Texas as it exists today.

Table 1

| Commercial Banking in Texas | No. of Banks | Total Assets (Billions) | Percentage of Texas Assets | Percentage of U.S. Assets |
|---|---|---|---|---|
| State Chartered Banks | 375 | $52.3 | 23.5 | 0.91 |
| Out-of-State State Chartered Banks Branched in Texas[1] | 4 | $7.4 | 3.3 | 0.13 |
| National Chartered Banks | 380 | $128.9 | 57.8 | 2.25 |
| Out-of-State National Chartered Banks Branched in Texas[1] | 6 | $34.3 | 15.4 | 0.60 |
| Total Texas Assets (State and National) | 765 | $222.9 | 100 | 3.89 |
| Total Bank Assets in United States | 8,580 | $5,734.7 | NA | 100 |
| MEMO-Foreign Bank Agencies | 11 | $32.8 | NA | NA |

***Information as of December 31, 1999***

[1]***Data derived from last reporting period (6-30-99) using total deposits.***

Total domestic deposits for all Texas Insured Depository Financial Institutions increased $8 billion from 1998 to 1999 and represents a 3.6% increase. Commercial bank deposits increased $4.7 billion or 2.8%. Mergers, acquisitions, and branch sales have slowed down, but will continue to impact and influence the competitive environment of the financial service providers. Out-of-state holding companies now have 65% of all commercial bank deposits in Texas. In the large metropolitan areas, these holding companies have an even higher market share. Table 2 highlights out-of-state held Texas banks.

Table 2

| | Number of Banks | Total Assets (Billions) | Number of Branches |
|---|---|---|---|
| Out-of-State Held Texas Banks | 46 | $87.4 | 1014 |

***Information as of December 31, 1999***

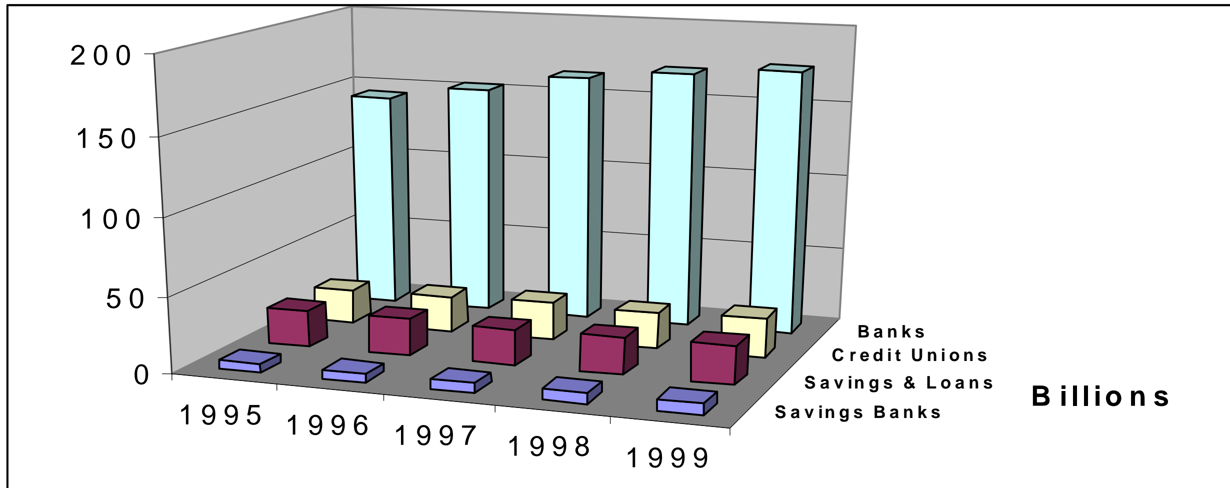
The total market for insured deposits is about $234 billion as of December 31, 1999. This total includes commercial banks, thrifts, savings banks, and credit unions. Table 3 and the accompanying chart show the growth and size of these markets over the last five years.

Table 3

| Institution Type | Total Deposits 1999 | Total Deposits 1998 | Total Deposits 1997 | Total Deposits 1996 | Total Deposits 1995 | Market Share % 1999 |
|---|---|---|---|---|---|---|
| Banks | $175.2 | $170.6 | $164.4 | $153.3 | $144.0 | 74.8 |
| Savings & Loans | 25.4 | 24.3 | 23.5 | 24.7 | 24.0 | 10.9 |
| Savings Banks | 7.1 | 7.0 | 6.4 | 5.8 | 5.5 | 3.0 |
| Credit Unions | 26.4 | 24.3 | 25.1 | 23.8 | 22.5 | 11.3 |
| **Totals** | **$234.2** | **$226.2** | **$219.4** | **$207.7** | **$196.0** | **100** |

***As of June 30, 1999. Deposits in Billions.***

Chart 1




In relation to the United States, Texas is ranked 2nd, 4th, and 5th in the number of bank charters, bank assets, and bank employees, respectively. As a comparison to three of the largest banking institutions in the United States; Bank of America at $585.4 billion, Citibank at $337.9 billion, and Chase Manhattan at $312.2 billion (a New York state charter). The largest Texas national charter is Bank One at $31 billion, and the largest state chartered Texas bank is International Bank of Commerce at $4.6 billion.

## Texas Savings and Loan Department and its Mission

Savings and loan associations have been chartered by the State of Texas since before 1890. The Texas Savings and Loan Department ("TSLD") was separated from the Department of Banking as an independent regulator of state chartered savings and loan associations in 1961. In 1993, the Department's responsibility was expanded to include regulation of state savings banks and again in 1999 to include the licensing of mortgage brokers. Savings and loan associations and state savings banks are generally referred to as thrift institutions; the regulation of these institutions is the only activity of the agency impacted by the Gramm-Leach-Bliley Act ("GLBA").

Savings and loan associations in Texas are subject to the Texas Savings and Loan Act, originally adopted in 1963 and codified as Subtitle B of the Finance Code in 1997. At this time there is only one remaining state savings association. The primary reason for this is the advent of the state savings bank charter that was created with the enactment of the Texas Savings Bank Act in 1993. This law, codified as Subtitle C of the Finance Code in 1997, in many respects led the way for the modernization of the state insured depository institution charter. Authored at a time when many of the issues of financial services modernization in GLBA had just been identified, the legislation creating the state savings bank endowed the charter with very broad powers and utilized a very broad "parity" provision to be sure that the charter would always be able to utilize the broadest possible range of powers, drawing on the lawful powers for state and national banks, state and federal thrifts, and bank holding companies.

Although the charter has very broad powers, historically one of the most attractive features of the state savings bank charter has been that it may be treated as a thrift for holding company purposes. As a result, an entity controlling a state savings bank may, at its election, be either a bank holding company, regulated and overseen by the Board of Governors of the Federal Reserve System ("FRB"), or a thrift holding company, regulated and overseen by the Office of Thrift Supervision (the "OTS"). Nearly all holding companies which own state chartered savings institutions have elected to be treated as thrift holding companies. This holding company election relates directly to the elimination of the barriers between banking and commerce that was a fundamental premise of GLBA.

Since 1956, thrift holding companies have been authorized by law to engage in a far wider range of activities and affiliations than bank holding companies. Prior to GLBA a thrift holding company owning only one thrift, known as a unitary thrift holding company ("UTHC"), could engage in virtually any aspect of commerce. Even though new UTHCs may not be created, as provided for in GLBA, those holding companies in existence when GLBA was enacted were grandfathered and are authorized to continue to engage in an almost unlimited range of financial and other activities. The regulatory bodies which have overseen thrift holding companies, including UTHCs, namely the TSLD and the OTS, have a significant level of experience in supervising insured depository institutions which have affiliations with a wide array of other businesses. They have a longstanding appreciation and support for functional regulation, looking to understand unrelated industries with ties of affiliation only to the extent necessary to understand and manage risks presented to the insured institutions.

The Texas thrift industry is a unique and specialized part of the world of insured depository institutions. Although the two types of Texas-chartered thrifts – the state savings bank and the state savings association – have more or less the same general powers as other types of insured depository institutions, they operate subject to special statutory requirements: compliance with the federal "Qualified Thrift Lender Test" and a local service area investment requirement. These two statutory requirements have the effect of requiring (1) that the majority of thrifts' assets be invested in housing-related assets, such as mortgage loans and mortgage-backed securities, and in government securities and (2) that they invest a significant portion of their deposits (not less than 15%) in specific loans and investments which will benefit their local communities.

These statutory requirements focusing on local finance, particularly on housing-related finance, have historically impacted the manner in which thrifts operate. They tend to have:

- Localized ownership and management;
- Balance sheets with a high level of longer term assets;
- A fairly sophisticated and complex interest rate risk profile employing a variety of tools to mitigate that risk, including a high level of term borrowings from the Federal Home Loan Bank System (the "FHLB") as well as the use of sophisticated hedging techniques; and
- A wide array of complementary activities, including mortgage lending and servicing, insurance products, and real estate management and development. Often these activities are conducted through subsidiaries or other affiliated organizations.

In carrying out its duties to supervise and oversee the safe and sound operation of the state thrift industry, the TSLD conducts full scope examinations of its institutions and their holding companies on an ongoing cyclical basis. Additionally, between examinations regulated institutions are monitored closely through a variety of reports, including specialized reports. Supervisory analysts work closely with the examination staff to stay abreast of the conditions and activities of all supervised institutions on a current basis.

In order to facilitate shared supervisory responsibility and to maximize the efficiency of its workforce, the TSLD examines state savings banks using a cooperative joint examination process, sending teams to conduct examinations with teams from the Federal Deposit Insurance Corporation ("FDIC"). These examination responsibilities are fully shared, with the TSLD and the FDIC relying on each other's staffs and findings based on the allocation of duties at each examination. This has resulted in a very close working relationship with the FDIC.

In addition to the institution-level relationship with the FDIC in supervising and examining savings banks, historically close relationships exist with the OTS in reviewing thrift holding companies and with the FRB in examining bank holding companies.

The examination and monitoring activities that the TSLD conducts, alone and in conjunction with the FDIC, the OTS, and the FRB on various occasions, are directed towards safety and soundness and compliance with state law. The TSLD utilizes the uniform interagency system for the rating of financial institutions (CAMELS – an acronym for capital, asset quality, management, earnings, liquidity, and (interest rate) sensitivity). Transactions with affiliates and related parties are carefully monitored and scrutinized, not only for legal compliance but also for potential risks to supervised institutions. In carrying out its responsibilities to oversee not only the thrift industry but also the mortgage brokerage industry, the TSLD has also established relationships in the mortgage-lending industry, primarily with FNMA, FHLMC, HUD, and GNMA.

The TSLD's approach to the regulation of the thrift industry is based upon the premise that supervised institutions should have:

- The broadest possible powers, under the enabling legislation itself and under parity provisions;
- The maximum flexibility, including the ability to utilize parity provisions in a responsible manner, all subject to careful oversight and review for safety and soundness and for compliance; and
- The ability to service the broadest possible array of needs and interests of the citizens and residents of the State of Texas, supported by regulatory and supervisory receptivity to affiliations and innovations.

This fundamental premise leads to a willingness to say clearly and unambiguously "yes" or "no" to industry initiatives and to remain 100% committed to safety and soundness and compliance while fostering a "leading edge" approach to the providing of financial services.

## The Thrift Industry

The state savings bank charter has been well received. All but one of the state-chartered savings and loan associations have converted to the savings bank charter. Additionally, state and national banks and federal savings associations have converted to the state savings bank charter. The state-chartered thrift industry in Texas has 28 institutions with combined assets of $14.2 billion. The Texas thrift industry, including state and federal thrift charters, includes 53 institutions with combined assets of approximately $59 billion. The state savings bank charter continues to be an attractive alternative to other charters. There are presently five new state savings bank charters in various stages of approval and formation.

## Texas Department of Insurance and its Mission

The Texas Department of Insurance (TDI), with origins dating back to 1876, regulates the Texas insurance market, a market that in 1999 saw Texas consumers pay over $60 billion for insurance premiums. The powers, functions, and duties of TDI are administered by the commissioner of insurance, as chief executive administrative officer, who is appointed by the governor and confirmed by the Senate.

TDI regulates insurers chartered in Texas ("domestic" insurers) and also non-Texas licensed insurers that operate in this State. The number of Texas domestic insurers is substantial; however, the majority of insurers that operate in Texas are out-of-state insurers. Similarly, the amount of premiums sold by Texas based insurers is substantial, but the majority of premiums paid by Texas consumers are paid to out-of-state insurers. (Refer below to Demographics of Regulated Industry for more details.)

TDI coordinates very closely with insurance regulators from other states because of the amount of insurance sold in Texas by out-of-state companies. Much of this coordination is facilitated through the National Association of Insurance Commissioners ("NAIC"), a non-profit corporation whose members include insurance regulators from all 50 states and various US territories.

Texas law requires most insurers and insurance-related businesses to be licensed before selling their products or services. TDI licenses insurance companies, agents, third-party administrators, health maintenance organizations (HMOs), premium finance companies, continuing care retirement communities and insurance adjusters operating in Texas. TDI also issues rules and regulations for the state's insurance industry, enforces the *Texas Insurance Code* and investigates and takes enforcement action against company and agent misconduct.

The Commissioner of Insurance sets price ranges for auto and homeowners insurance sold by rate regulated companies. These companies write about 75 percent of auto and 15 percent of homeowners policies in Texas.

To ensure that insurance companies have the funds to pay claims and expenses, TDI examines the financial condition of companies licensed in Texas, helps problem companies recover financial stability and tries to detect problem insurance companies early enough to reduce chances of insolvency.

TDI investigates insurance fraud. Examples of fraudulent activities include (1) selling insurance without a license, (2) filing illegal claims and (3) misrepresenting insurance policies and coverages for financial gain. TDI refers cases for civil prosecution to the Texas Attorney General and for criminal prosecution to local district attorneys and United States attorneys. The agency may fine or penalize agents and companies that delay payment of claims, misrepresent policies, fail to provide required discounts to policyholders, or engage in other unfair and unlawful practices. TDI reviews most insurance advertising and marketing materials to guard against misrepresentation. Insurance companies and agents engaging in unfair trade practices or deceptive advertising are subject to

warnings, fines, license revocations and other penalties. In some cases, the agency may order premium refunds to consumers. In addition, the agency helps resolve complaints against insurance companies and agents, which leads to consumers receiving millions of dollars in refunds and additional claims' payments each year.

TDI also collects and analyzes statistical data, reviews property and casualty rate filings and reports on rates and markets to assist policy makers and help consumers make insurance-related decisions.

## The Insurance Industry - Demographics

**Insurance Agents.** For fiscal year 1999, the Texas Department of Insurance had 286,146 licenses and certificates under the authority of the Commissioner of Insurance, including 60 licenses issued to banks or bank operating subsidiaries to conduct insurance agency activities in Texas. The licensing program at TDI processed 497,246 filings and responded to 129,611 telephone inquiries.

**Insurance Companies.** The Texas insurance market includes 2,278 insurance companies with combined assets exceeding $4 trillion. Texas consumers purchased in excess of $60 billion of premiums in 1999. To put this into perspective, the Texas market is bigger than that of both Canada and Mexico.

Of the 2,278 insurers operating in Texas, 534 are Texas domestics, while out-of-state insurers represent the remaining 1,744 companies. In 1999, out-of-state insurers sold approximately 64 percent of the total premiums purchased by Texas consumers.

The insurance industry is actually made up of a number of unique sub-industries. Life insurance is vastly different than property & casualty insurance, with each requiring highly specialized expertise. Other unique insurers include health maintenance organizations (HMOs) and title insurers.

Sub-divisions within each of the unique sub-industries exist also. A property & casualty insurer that writes workers' compensation insurance is vastly different than an automobile insurer, while a life insurer that writes annuity business is different than one that writes health insurance.

Tables 4 – 6 summarize by major categories the insurers that operate in Texas *(amounts reported in millions)*:

Table 4

| No. | Texas Domestic Insurers Type of Company | 1999 Texas Premiums | 1999 Total Premiums | 1999 Assets |
|---|---|---|---|---|
| 188 | Life | $5,420.6 | $10,197.4 | $116,920.6 |
| 245 | Property & Casualty | 8,636.8 | 14,172.6 | 24,415.9 |
| 65 | Health Maintenance Organizations | 7,653.4 | 10,483.5 | 2,890.3 |
| 10 | Fraternal | 47.2 | 49.4 | 708.5 |
| 4 | Title | 368.5 | 1,000.9 | 544.8 |
| 22 | Mutual Aid, Burial, Exempt, Pre-Paid Legal | 3.7 | 3.7 | 12.2 |
| **534** | **Total** | **$22,130.3** | **$35,907.5** | **$145,492.3** |

Table 5

| No. | Non-Texas Insurers Type of Company | 1999 Texas Premiums | 1999 Total Premiums | 1999 Assets |
|---|---|---|---|---|
| 613 | Life | $25,526.9 | $243,804.4 | $3,100,871.8 |
| 864 | Property & Casualty | 11,153.9 | 217,776.8 | 795,042.1 |
| 2 | Health Maintenance Organization | 48.0 | 983.2 | 196.5 |
| 26 | Fraternal | 207.9 | 5,024.4 | 60,201.8 |
| 20 | Title | 625.9 | 6,186.6 | 3,868.8 |
| 176 | Surplus Lines | 1,029.2 | * 9,767.7 | * 30,917.7 |
| 43 | Foreign Risk Retention Groups | 51.1 | 617.0 | 1,271.7 |
| **1,744** | **Total** | **$38,642.8** | **$484,160.1** | **$3,992,370.3** |

** Does not include alien surplus lines companies*

Table 6

| No. | Combined Type of Company | 1999 Texas Premiums | 1999 Total Premiums | 1999 Assets |
|---|---|---|---|---|
| 801 | Life | $30,947.5 | $254,001.8 | $3,217,792.5 |
| 1109 | Property & Casualty | 19,790.7 | 231,949.4 | 819,458.0 |
| 67 | Health Maintenance Organization | 7,701.4 | 11,466.7 | 3,086.8 |
| 36 | Fraternal | 255.1 | 5,073.7 | 60,910.3 |
| 24 | Title | 994.4 | 7,187.5 | 4,413.6 |
| 22 | Mutual Aid, Burial, Exempt, Pre-Paid Legal | 3.7 | 3.7 | 12.2 |
| 176 | Surplus Lines | 1,029.2 | * 9,767.7 | * 30,917.7 |
| 43 | Foreign Risk Retention Groups | 51.1 | 617.0 | 1,271.7 |
| **2,278** | **Total** | **$60,773.1** | **$520,067.6** | **$4,137,862.7** |

** Does not include alien surplus lines companies*

*The above schedules do not include certain unique entities subject to TDI's regulation including:*

*19 Continuing care facilities*
*7 Multiple employer welfare arrangements*
*437 Purchasing groups*
*4 Purchasing alliances*
*81 Accredited/trusteed-reinsurers*
*159 Syndicates*

## Texas Domestic Insurers Distinguished by Size of Net Worth

**Insurers with Net Worth Less than $2 Million**. TDI regulates a substantial number of domestic insurers that are relatively small in terms of net worth. (The net worth of an insurer is the amount that remains after all liabilities are subtracted from assets.) In 1999, 183 Texas insurers reported a net worth of $2 million or less.

Although small in size, these insurers sold in excess of $2.4 billion in Texas premiums in 1999. This premium volume was largely attributable to certain property & casualty insurers known as "LLoyds" and "County Mutual" insurers, whose premium rates are essentially unregulated. These insurers typically reinsure (transfer) their insurance obligations to much larger insurers. Approximately 85 percent of Homeowner's insurance sold in Texas is sold by LLoyds insurers. Most sub-standard (high-risk) automobile sold in Texas is insured by county mutual insurers.

**Insurers with Net Worth Less than $50 Million**. TDI regulates 297 domestic insurers whose net worth is greater than $2 million but less than $50 million. These insurers sold in excess of $10.6 billion in Texas premiums in 1999. Total premiums sold by these insurers, including business sold in other states, totaled $12 billion.

**Insurers with Net Worth Greater than $50 Million**. TDI regulates 54 domestic insurers whose net worth is greater than $50 million. These insurers sold in excess of $9 billion in Texas premiums

in 1999. Total premiums sold by these insurers, including business sold in other states, totaled $21 billion. The following tables provide more detail on these Texas domestic insurers:

**Table 7**
**DOMESTIC COMPANIES WITH SURPLUS EQUAL to or LESS than $2,000,000**

| No. | Domestic Type of Company | 1999 Texas Premiums | 1999 Total Premiums | 1999 Assets |
|---|---|---|---|---|
| 73 | Life | $134.3 | $172.2 | $231.8 |
| 60 | Property & Casualty | 2,153.6 | 2,153.6 | 366.4 |
| 24 | Health Maintenance Organizations | 112.8 | 112.8 | 57.9 |
| 5 | Fraternal | .2 | .219.4 | 4.6 |
| 0 | Title | 0 | 0 | 0 |
| 21 | Mutual Aid, Burial, Exempt, Pre-Paid Legal | 3.7 | 3.7 | 9.2 |
| **183** | **Total** | **$2,404.6** | **$2,442.5** | **$669.9** |

**Table 8**
**DOMESTIC COMPANIES WITH SURPLUS**
**GREATER than $2,000,000 but LESS than $50,000,000**

| No. | Domestic Type of Company | 1999 Texas Premiums | 1999 Total Premiums | 1999 Assets |
|---|---|---|---|---|
| 84 | Life | $760.7 | $1,732.7 | $7,412.6 |
| 166 | Property & Casualty | 3,866.7 | 4,412.0 | 3,595.9 |
| 38 | Health Maintenance Organizations | 5,708.8 | 5,708.8 | 1,678.9 |
| 5 | Fraternal | 47.0 | 49.2 | 703.9 |
| 3 | Title | 221.1 | 244.5 | 122.9 |
| 1 | Mutual Aid, Burial, Exempt, Pre-Paid Legal | 0 | 0 | 3.0 |
| **297** | **Total** | **$10,604.4** | **$12,147.1** | **$13,517.2** |

**Table 9**
**DOMESTIC COMPANIES WITH SURPLUS**
**EQUAL to or GREATER than $50,000,000**

| No. | Domestic Type of Company | 1999 Texas Premiums | 1999 Total Premiums | 1999 Assets |
|---|---|---|---|---|
| 31 | Life | $4,525.6 | $8,292.5 | $109,276.2 |
| 19 | Property & Casualty | 2,616.5 | 7,606.9 | 20,453.6 |
| 3 | Health Maintenance Organizations | 1,831.9 | 4,662.0 | 1,153.5 |
| 0 | Fraternal | .0 | 0 | 0 |
| 1 | Title | 147.4 | 756.5 | 422.0 |
| 0 | Mutual Aid, Burial, Exempt, Pre-Paid Legal | 0 | 0 | 0 |
| **54** | **Total** | **$9,121.4** | **$21,317.9** | **$131,305.2** |

## State Securities Board and it Mission

The mission of the State Securities Board ("SSB") is to protect Texas investors. Consistent with that primary mission, the agency seeks to ensure a free and competitive securities market for Texas, increase investor confidence, and thereby encourage the formation of capital and the creation of new jobs.

In 1957, the Texas Securities Act ("TSA"), TEX. REV. CIV. STAT. ANN. art. 581-1 et seq., was passed by the 55th Legislature in Regular Session, creating the SSB. The legislation was the cumulation of four earlier statutes dating back to 1913 adopted in response to a series of securities fraud scandals in Texas. A major overhaul to the TSA was made in 1995.

The agency's duties are to administer the provisions of the TSA and to take such measures and make such investigations as will prevent or detect a violation of the TSA. The TSA sets forth powers to investigate suspected violations of the TSA, initiate administrative enforcement proceedings, refer matters for civil or criminal action, require registration of nonexempt securities sold in Texas, and require registration of firms and individuals who sell securities or render investment advice in the State. For these purposes, the SSB maintains programs for law enforcement, analysis of securities offerings, evaluation of dealer and agent applications, and inspections.

The law enforcement program seeks to detect and prevent violations of the TSA, including fraud committed in connection with the sale of securities, sales of unregistered or nonexempt securities, sales made by unregistered dealers and agents, and investment advice rendered by unregistered investment advisers and investment adviser representatives. The program investigates suspected violations of the TSA and, if appropriate, promptly initiates administrative enforcement proceedings or refers the matter for criminal prosecution or civil action.

The program for analysis of securities offerings includes the review of all applications to register securities for sale in Texas. The primary function of such a review is to ensure investor access to full and fair disclosure of all relevant investment information. The program also processes notice filings for certain offerings in Texas. The program also provides information to entrepreneurs, small businesses, and securities issuers throughout the state regarding the capital formation process and compliance with the TSA.

The program for evaluation of dealer and agent applications examines each application for registration of a dealer or investment adviser, and their agent(s), in accordance with the standards set forth in the TSA and SSB Rules. The program also conducts an ongoing review process by examining each amendment submitted by a registrant. Amendments are filed when an event occurs that causes an answer provided on an original application to change.

The inspection program conducts periodic reviews of the sales practices of certain registrants and inspects their records to ensure that they comply with the requirements of the TSA and SSB Rules. Primary subjects are dealers and investment advisers with offices in Texas who are not regularly inspected by other securities regulatory authorities.

The SSB seeks to maximize its effectiveness in achieving its mission by maintaining information-sharing procedures and closely coordinating activities between programs of the agency as well as with other local, state, and federal regulatory and law enforcement agencies and has undertaken a series of investor education initiatives to assist all Texans in making informed investment decisions that affect their financial future.

In 1996, Congress passed the National Securities Markets Improvement Act (NSMIA), amending federal securities laws to redefine the roles of state and federal regulatory authorities with respect to certain securities offerings and registered firms and individuals. NSMIA vests the U. S. Securities and Exchange Commission (SEC) with exclusive authority for the registration of securities issued by investment companies and jurisdiction over "covered securities." States retain the authority to register other securities offerings, impose notice filing requirements and collect fees for "covered securities" transactions based on the amount of securities sold in the state, and to investigate and bring enforcement actions based on fraud or unlawful conduct.

The other major change affected by the legislation was to create a division of authority between the SEC and the states with respect to investment advisers. Three categories of investment advisers are subject to SEC regulation. The states were given exclusive authority over investment advisers having less than $25 Million in assets and were authorized to require notice filings and fees for advisers registered with the SEC who do business in the state and to investigate and bring enforcement actions against such entities for fraud or deceit.

The Financial Services Modernization Act of 1999 was signed into law on November 12, 1999 and is known as the Gramm-Leach-Bliley Act. Its general purpose is to permit firms in the banking, securities and insurance industries to affiliate with one another and provide a wide range of services "under one roof." The new law establishes the concept of "functional regulation" whereby the existing regulatory experts with respect to each of the functional areas maintain their respective oversight responsibilities.

## The Securities Industry

During fiscal 1999, there were 26,811 securities filings in Texas representing $308 Billion in securities to be sold in this state. That is approximately $74 Billion (32%) more than the $234 Billion that represents total insured deposits in depository institutions in Texas as of December 31, 1999. The $308 Billion figure does not include non-registered securities activity such as, for example, trades of securities listed on the major stock exchanges including the New York Stock Exchange and the national market system of the NASDAQ stock market, among others.

In fiscal 1999, 162,407 individuals and firms were registered to sell securities and/or render investment advice in Texas.

# APPENDIX – D
# Commissioners' Activities Concerning GLBA

The Commissioners of involved Texas Agencies have been active in Financial Services Modernization issues over recent years, both prior to passage of GLBA, and since.

## Commissioner Randall S. James
**(and former Commissioner Catherine A. Ghiglieri):**

- On February 24, 1999, Commissioner Ghiglieri testified before the U.S. Senate Committee on Banking, Housing and Urban Affairs, on financial services modernization, bank powers, and functional regulation issues, speaking as Texas Banking Commissioner and on behalf of the CSBS;

- In January 2000 initiated meetings of the Texas regulatory agencies involved in financial service modernization;

- On March 6, 2000 issued Opinion No. 2000-03 affirming that Texas state-chartered banks and their subsidiaries have the power to engage in the business of title insurance agency, a pre-requisite to a similar power for national banks operating in Texas;

- On March 31, 2000, and upon the request of the involved Texas Legislative Committees, commenced a study of the impact of GLBA on Texas laws in consultation and cooperation with the Commissioners of Insurance, Securities, and Savings and Loans;

- On May 4, 2000, testified before the joint meeting of the House Committees on Financial Institutions and Insurance on Financial Services Modernization issues in Texas;

- On May, elected to the Board of the Conference of State Bank Supervisors ("CSBS"), which is the body of state banking regulators that addresses financial services modernization issues from a state bank regulator perspective;

- On May 31, 2000, issued an invitation letter, from all four involved commissioners, to stakeholders in Texas to submit questions and issues on financial service modernization for response from the commissioners;

- On July 24, 2000, hosted an initial consultation meeting of the four state commissioners involved in financial services modernization, with the SEC's and the four federal banking regulators' key representatives responsible for similar activities in Texas; and

- On line in July, 2000, established a web site (www.finmod.state.tx.us) to provide a central location for research on federal and state regulatory releases, important dates, non-regulatory commentary and a venue for question responses (to the extent that they cab be answered) for a Texas response to financial services modernization;

## Commissioner Jose Montemayor:

- Serves as Vice Chair of the NAIC's Financial Services Modernization Task Force. This Task Force is the primary NAIC body relating to financial services modernization issues; among other things the Task Force serves as a coordinating body for the work performed by the other GLBA related NAIC bodies;

- Serves as the Co-Chair of the NAIC's Financial Services Holding Company Analysis/Examination/Review Working Group. This Working Group is updating general procedures relating to the review of holding company matters, including the codification of "best practices". This Working Group is also focusing on issues relating to holding companies that offer diversified financial services and the impact that such systems may have on the financial condition of insurers;

- Is a member of the NAIC's Privacy Working Group, which is reviewing issues related to ensuring that insurance consumers are protected by appropriate privacy guidelines;

- Is a member of the National Treatment of Insurers Working Group, which among other things is reviewing whether a state-based system can be developed that will provide the functional equivalent of a national charter for insurance companies;

- Is a member of the Coordinating with Federal Regulators Working Group, which is establishing working relationships between state insurance regulators and various federal regulators such as the Federal Reserve, FDIC, OCC, and the OTS;

- Serves on a variety of sub-groups that report to the above NAIC bodies. One notable sub-group is the Troubled Entity Sub-Group of the Coordinating with Federal Regulators Working Group. The Troubled Entity Sub-Group is coordinating with the FRB and the FDIC, etc., to establish lines of communication and general coordination procedures which may be employed should a diversified financial services company become financially troubled;

- On January 18, 2000, issued a bulletin providing interim guidance for the licensing of depository institutions and other affiliated entities as insurance agents in this state. The bulletin was sent to all depository institutions, insurance companies, corporations, exchanges, mutuals, reciprocals, associations, Lloyds, health maintenance organizations or other entities regulated by the Texas Department of Insurance and authorized or eligible to do business in Texas, and to their agents and representatives;

- On May 4, 2000, testified on privacy issues regarding GLBA before a joint meeting of the Texas House Insurance and Financial Institutions Committees at the Capitol;

- On February 16, 2000, submitted written comments on behalf of the TDI to the U.S. Department of Health and Human Services regarding proposed rules entitled "Standards for Privacy of Individually Identifiable Health Information";

- On March 31, 2000, Sara Shiplet Waitt, Senior Associate Commissioner for the Legal and Compliance Program, submitted written comments on privacy issues to the OCC; and

- In the past year, has made more than 40 speeches to industry, business and civic groups across the state with financial services modernization and GLBA being among the chief topics discussed.

## Commissioner Denise Voigt Crawford:

- Testified on June 25, 1999, before the U.S. House Committee on Commerce, Subcommittee on Oversight and Investigations, regarding functional regulation issues of financial services modernization, as Texas Securities Commissioner and on behalf of NASAA;

- Testified on June 25, 1998, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, regarding H.R. 10 and financial services modernization issues, speaking both as Texas Securities Commissioner and as President of the NASAA;

- On May 22, 1997, testified before the U. S. House Committee on Banking and Financial Services regarding H.R. 10, the "Financial Services Competitiveness Act of 1997," a precursor to GLBA, on behalf of NASAA;

- On March 2, 1994, testified before the U.S. House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, regarding "Securities Activities of Banks" on behalf of NASAA;

- Served as President of NASAA from 1997-1998 and represented NASAA on various issues before the U.S. Congress in that capacity;

- Served as Chair of the Securities Activities of Banks Committee of the NASAA from 1993 through 1997;

- On May 4, 2000, testified before the joint hearing of the Texas House Insurance and Financial Institutions Committees regarding privacy issues under GLBA;

- Promotes the involvement of SSB through NASAA project groups, including membership on the Financial Services Modernization Project Group and the Privacy Project Group (formed to study privacy issues springing out of GLBA); and

- Assures the continued involvement of the State Securities Board in securities-related functional regulation issues through NASAA project groups, including membership on

the Financial Services Modernization Project Group and the Privacy Project Group formed to study privacy issues springing out of GLBA.

## Commissioner James L. Pledger:

- Serves as a director and past president of the American Counsel of State Savings Supervisors (ACSSS), the professional organization of state thrift regulators, since 1993;

- Serves as a trustee and past chairman of the Institute for Supervisory Education (ISE), an affiliate of ACSSS, which conducts training programs for state thrift regulators and examiners, since 1991. Both of ACSSS and ISE have conducted numerous programs over the years related to the progress of financial services modernization legislation and the details of the final legislation;

- Serves on Federal Financial Institutions Examination Council (FFIEC) State Liaison Committee from June 1997 to present. The State Liaison Committee advises the FFIEC on state issues related to federal efforts to adopt coordinated regulations among the member agencies: FRB, FDIC, OCC, OTS and the National Credit Union Association. The FFIEC is a key entity in the promulgation of interagency regulations on all aspects of GLBA;

- Testified numerous times before U.S. Congressional committees on financial services modernization legislation as Texas Savings and Loan Commissioner and on behalf of ACSSS, including testimony on:

  - February 25, 1997 before the Subcommittee on Financial Institutions of the U.S. House Banking Committee regarding H.R. 10 and financial services modernization;

  - May 22, 1997 before the full House Banking Committee on H.R. 10 and financial services modernization;

  - June 25, 1998 before the U.S. Senate Committee on Banking, Housing, and Urban Affairs on Senate companion legislation regarding financial services modernization; and

  - February 24, 1999 before the U.S. Senate Committee on Banking, Housing and Urban Affairs on reform of financial services and financial services modernization; and

- Testified on May 4, 2000 before the joint meeting of the House Committees on Financial Institutions and Insurance on financial services modernization in Texas.

# Texas Department of Banking

*Randall S. James*
*Commissioner*

May 26, 2000

To various industry and consumer stakeholders:

The Gramm-Leach-Bliley Act ("GLBA") has created many new opportunities for expanded cooperation and interaction between and among the banking, insurance and securities industries nationwide. This groundbreaking federal law makes it increasingly important for banks, securities firms and insurance companies in Texas to remain leaders in light of these expanding business opportunities.

As directed by interim charges from Lt. Governor Rick Perry and Speaker Pete Laney, The Senate Economic Development Committee, House Committee on Insurance, and House Committee on Financial Institutions are in the process of studying the impact of GLBA on Texas and Texas statutes. I refer you to the enclosed copy of a letter from these three committee chairs dated March 31, 2000, directing a related study by the four undersigned commissioners. Note that a report is due back to the committees by August 1, 2000. We also intend to continue working after that date in response to Legislative direction related to possible legislation for consideration by the 77th Legislature convening on January 9, 2001.

The Commissioners seek your input and recommendations as a vital component of the overall study, including the August 1st report. Your assistance will help ensure the future competitiveness of the financial service industries in Texas and the range of financial services available to Texas citizens. Members of the banking, insurance and securities industries, as well as other interested citizens, can greatly assist the Commissioners in this process, by communicating:

- Questions regarding the meaning or impact of GLBA in Texas;
- Considerations or ideas for statutory or rule changes to enhance and diversify available financial services in the modern financial era; and,
- Suggestions regarding any issue that the Commissioners and the Legislature should consider in implementing financial modernization.

(**NOTE:** The Legislature explicitly excluded the subject of financial privacy from the scope of the Commissioners' study to enable the Commissioners to focus on financial institution structure and powers. Financial privacy is extremely important, but the issues involved will not be considered in the context of this study.)

You should identify (and limit) your questions or issues to: a) those that are required by GLBA; b) those that are arguably required by GLBA; and, c) those that are not required but desirable to keep Texas in the forefront of financial modernization.

2601 N. Lamar Boulevard, Austin, Texas 78705-4294 (512) 475-1300 / www.banking.state.tx.us

We request that interested parties submit questions, considerations or suggestions that follow the direction of the March 31st letter to:

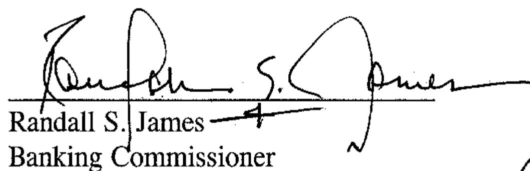
> Ms. Karen Neeley
> Long, Burner, Parks, McClellan, and DeLargy
> 515 Congress, Suite 1500
> Austin, Texas 78701

Ms. Neeley has graciously consented to act as a collecting point for all questions and other input, and will prepare a compilation of all submissions to each commissioner. You may direct questions on anonymous submissions, should you choose to submit one in this fashion, to Ms. Neeley at (512) 474-1587.

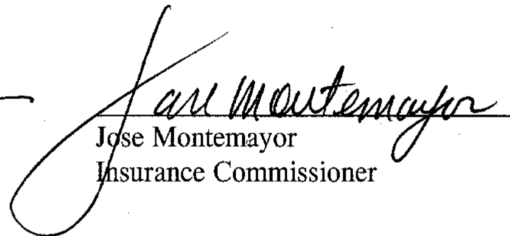
The Commissioners tentatively propose to host a public meeting in Austin during the month of June to address the questions received and issues raised by commenters, all of whom will be invited to participate. That meeting date has not yet been set. At a minimum, the commissioners will include the questions received and our responses in the August Report.

On the following page you will find some example questions. If you have any questions on this process or request, please feel free to contact Ms. Neeley, or any of us.

Sincerely,

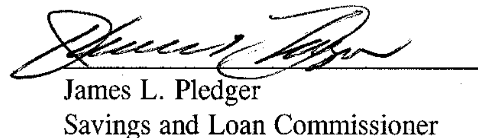


Randall S. James
Banking Commissioner



Jose Montemayor
Insurance Commissioner

Denise Voigt Crawford
Securities Commissioner



James L. Pledger
Savings and Loan Commissioner

enclosure

cc: Senator Sibley
Representative Averitt
Representative Smithee

Financial Modernization Stakeholders
May 26, 2000
Page 3

***Sample Questions***:

❑ Can a bank (bank subsidiary) now sell insurance in Texas from any location, or is the bank (bank subsidiary) still restricted to a community of 5,000 or less in population?

❑ Does a Mutual (Insurance) Association qualify as a financial services holding company; can it own a bank; and what is the process for accomplishing this?

❑ Can a state bank engage in merchant banking; is so, how should it be structured; and what are the investment limitations?

❑ How does my insurance company go about getting into the business of selling securities and how should the organization be structured?

❑ Are there any qualifying factors in becoming a financial service holding company, and what are the advantages and disadvantages of such a move?

## Commissioner's Bulletin No. B-0005-00

January 18, 2000

TO: ALL DEPOSITORY INSTITUTIONS, INSURANCE COMPANIES, CORPORATIONS, EXCHANGES, MUTUALS, RECIPROCALS, ASSOCIATIONS, LLOYDS, HEALTH MAINTENANCE ORGANIZATIONS OR OTHER ENTITIES REGULATED BY THE TEXAS DEPARTMENT OF INSURANCE AND AUTHORIZED OR ELIGIBLE TO DO BUSINESS IN TEXAS; AND TO THEIR AGENTS AND REPRESENTATIVES AND THE PUBLIC GENERALLY

Re: Interim Guidelines Concerning Insurance Agent Licensing in Texas Under the Gramm-Leach-Bliley Act

On November 12, 1999, the President signed into law an act which makes significant changes to the delivery of financial services in the U.S. Based on the provisions of the new law, several provisions of the Texas Insurance Code are preempted as applied to depository institutions and other affiliated entities who wish to exercise powers granted under federal law to engage in the business of insurance in Texas.

Because I must continue to carry out my responsibility to regulate the sale of insurance in Texas and the Legislature may not have the chance to act on these issues for several months, I believe it is in the public interest to provide interim guidance for the licensing of depository institutions and other affiliated entities as insurance agents in this state.

The Texas Insurance Code as it currently exists does not contemplate that depository institutions may engage in the business of insurance to the extent provided in the new federal law. As a result, the Gramm-Leach-Bliley Act creates a statutory preemption of several licensing provisions in the Texas Insurance Code. In response to a spate of recent inquiries from the Texas insurance industry concerning the new legislation, I believe it prudent to provide an outline of licensing guidelines which reflect the new federal framework. These guidelines are intended to assist the Texas insurance industry in making informed business decisions under the new federal law until the Texas Legislature can consider appropriate statutory changes.

The purpose of this bulletin is to outline the Department's **interim** guidelines for the licensing of depository institutions and other affiliated entities as insurance agents in Texas in compliance with the provisions of the Gramm-Leach-Bliley Act. The bulletin does not attempt to answer all questions that may arise as activities are expanded in this arena. The Department of Insurance will address other questions on an individual basis.

**These guidelines are interim only. These guidelines are not intended to and do not create a class of licensees whose status must be "grandfathered" into any statutory scheme that may be adopted by the Texas Legislature. Neither the existence of nor compliance with the interim guidelines confers any property or other rights on licensed entities other than the right to conduct the business of insurance in accordance with these interim guidelines until they are superceded or terminated.**

**Preemption of Certain State Laws**

**Definition of Bank**

The Texas Insurance Code definition of "bank" is preempted by §104(d)(2) of the Gramm-Leach-Bliley Act to the extent that the Insurance Code does not contemplate that a savings association," as defined in 12 U.S.C. §1813, may be licensed as an insurance agent in Texas. As a result of this preemption, a "savings association" may obtain an insurance agent's license under the same laws and regulations that apply to the licensing of a "bank."

As of March 12, 2000, the Texas Insurance Code definition of "bank" is preempted by §104(d)(2) of the Gramm-Leach-Bliley Act to the extent that the Insurance Code does not contemplate that a "financial holding company," as defined in section 2 of the Bank Holding Company Act of 1956, as amended by the Gramm-Leach-Bliley Act, or a "financial subsidiary," as defined in section 121 of the Gramm-Leach-Bliley Act, may be licensed as an insurance agent in Texas. As a result of this preemption, a financial holding company or a financial subsidiary may obtain an insurance agent's license under the same laws and regulations that apply to the licensing of a "bank."

The Texas Insurance Code definition of "bank" is preempted by §104(d)(2) of the Gramm-Leach-Bliley Act to the extent that the Insurance Code does not authorize the issuance of an agent's license to a "state bank," as defined in 12 U.S.C. §1813, organized under the laws of a state other than Texas. As a result of this preemption, a "non-resident state bank" may obtain an insurance agent's license under the same laws and regulations that apply to the licensing of a "bank."

The place of 5,000 restriction in the Texas Insurance Code is preempted by §104(e) of the Gramm-Leach-Bliley Act. The place of 5,000 restriction as a state law licensing requirement is preempted because it discriminates against a depository institution by adversely impacting the depository institution when compared to other persons providing the same products and services that are not depository institutions. As a result of this preemption, a depository institution, as defined in 12 U.S.C. §1813, "financial holding company," "financial subsidiary," or "operating subsidiary" of a depository institution may obtain an insurance agent's license in Texas without regard to the geographical location of its business operations in this state.

**Ownership of a Managing General Agency**

Texas Insurance Code Article 21.07-3 is preempted by §104(d)(2) of the Gramm-Leach-Bliley Act to the extent that the Insurance Code does not contemplate that a depository institution, financial holding company, financial subsidiary or operating subsidiary of a depository institution may be licensed as a managing general agent in Texas. As a result of this preemption, any of these entities may obtain a managing general agent's license by complying with the statutory requirements outlined below.

The provision of Texas Insurance Code Article 21.07-3 §4(a) requiring each applicant for a managing general agent's license to be a resident of Texas is preempted as applicable to a depository institution, financial holding company, financial subsidiary or operating subsidiary of a depository institution. The preemption results from §104(e)(3) of the Gramm-Leach-Bliley Act which provides that no state law may effectively prevent a depository institution or affiliate from engaging in insurance activities authorized by the Act. As a result of this preemption, a depository institution, financial holding company, financial subsidiary, or operating subsidiary of a depository institution may obtain a managing general agent's license in

accordance with these guidelines without regard to the Texas residency requirement in Article 21.07-3 of the Texas Insurance Code.

The provision of Texas Insurance Code Article 21.07-3 §5(h) prohibiting a bank, bank holding company, or a subsidiary of either entity from owning a managing general agency is preempted by §104(e) of the Gramm-Leach-Bliley Act. This ownership prohibition is preempted because it discriminates against a depository institution by adversely impacting the depository institution when compared to other persons providing the same products and services that are not depository institutions.

As a result of this preemption, a depository institution, financial subsidiary, or operating subsidiary of a depository institution that is properly licensed in Texas as a managing general agent may own a licensed managing general agency. The managing general agency owned in whole or in part by such entity must be licensed according to the requirements set out in the Texas Insurance Code except that the residency requirement in Article 21.07-3 is preempted with respect to the depository institution, financial subsidiary, or operating subsidiary that is a shareholder, member, or partner of the managing general agency.

**Interim Guidelines for Issuance of a License to a Depository Institution or Operating Subsidiary of a Depository Institution to Act as an Insurance Agent in Texas**

**Life, Accident & Health Insurance**

A depository institution, as defined in 12 U.S.C. §1813, or an operating subsidiary of a depository institution, as defined in section 2 of the Bank Holding Company Act of 1956, may be licensed as a Life, Accident & Health insurance agent in this state under the requirements set out in Texas Insurance Code Article 21.07-1 §4(f) except the following shall not apply as a result of the federal preemption:

1. The definition of "bank" in Article 21.07-1 §1C;
2. The provision in Article 21.07-1 §4(f) that prohibits a bank licensed as an agent from operating additional offices from which the business of insurance is conducted in a place with a population exceeding 5,000; and
3. The provision in Article 21.07-1 §1C that prohibits a bank operating subsidiary from owning a licensed corporate agent located in a place with a population exceeding 5,000.

**Life, Health, Accident, Miscellaneous License (Group II)**

A depository institution, as defined in 12 U.S.C. §1813, or an operating subsidiary of a depository institution, as defined in section 2 of the Bank Holding Company Act of 1956, may be licensed as a Life, Accident & Health insurance agent in this state under the requirements set out in Texas Insurance Code Article 21.07 §2(e) except the following shall not apply as a result of the federal preemption:

1. The definition of "bank" in Article 21.07 §1C(a);
2. The provision in Article 21.07 §2(e) that prohibits a bank licensed as an agent from operating additional offices from which the business of insurance is conducted in a place with a population exceeding 5,000; and

3. The provision in Article 21.07 §1C(b) that prohibits a bank operating subsidiary from owning a licensed corporate agent located in a place with a population exceeding 5,000.

**Property & Casualty Insurance**

A depository institution, as defined in 12 U.S.C. §1813, or an operating subsidiary of a depository institution, as defined in section 2 of the Bank Holding Company Act of 1956, may be licensed as a property & casualty insurance agent in this state under the requirements set out in Texas Insurance Code Article 21.14 §3(d) and associated regulations except the following shall not apply as a result of the federal preemption:

1. The requirements set out in Article 21.14 §3(d)(1);

2. The provision in Article 21.14 §3 that prohibits a bank licensed as an agent from operating additional offices from which the business of insurance is conducted in a place with a population exceeding 5,000;

3. The definition of "bank" set out in Article 21.14 §3(g); and

4. The provision in Article 21.14 §3(g) that prohibits a bank operating subsidiary from owning a licensed corporate agent located in a place with a population exceeding 5,000.

**Managing General Agent License**

As a result of the federal preemption, a depository institution, as defined in 12 U.S.C. §1813, or an operating subsidiary of a depository institution, as defined in section 2 of the Bank Holding Company Act of 1956, may be licensed as a managing general agent in this state by satisfying the licensing requirements in Article 21.14 which apply to the licensing of a depository institution as a property & casualty agent.

**Other License Types**

A depository institution, as defined in 12 U.S.C. §1813, or an operating subsidiary of a depository institution, as defined in section 2 of the Bank Holding Company Act of 1956, may become a licensed insurance agent in Texas by complying with all applicable licensing requirements set out in the Texas Insurance Code except the following shall not apply as a result of the federal preemption:

1. the currently required statutory organization;

2. the Texas residency requirement; and

3. the individual licensing of all officers, directors, shareholders, members, managers, and partners.

### Operating Subsidiary

As a result of the federal preemption, an insurance agency owned in whole or in part by a depository institution must be licensed according to the requirements set out in the Texas Insurance Code except the Texas residency requirement will not apply to a depository institution or operating subsidiary of a depository institution.

As with all other licensed insurance agents, a depository institution or operating subsidiary of a depository institution and their employees who are engaged in the business of insurance must hold the appropriate license for each line of insurance being offered.

### Interim Guidelines for Issuance of a License to a Financial Holding Company or Financial Subsidiary of a Depository Institution to Act as an Insurance Agent in Texas

As of March 12, 2000, a "financial holding company," as defined in section 2 of the Bank Holding Company Act of 1956 as amended by the Gramm-Leach-Bliley Act, or a "financial subsidiary" of a depository institution, as defined in section 121 of the Gramm-Leach-Bliley Act, may become a licensed insurance agent in Texas by complying with the licensing requirements set out in the Texas Insurance Code applicable to a "bank."

### Agency Ownership by a Financial Holding Company

Under the provisions of Section 103 of the Gramm-Leach-Bliley Act, a "financial holding company" may own a licensed insurance agency. The insurance agency owned in whole or in part by a financial holding company must be licensed according to all requirements set out in the Texas Insurance Code except the requirement that all shareholders must be individually licensed is preempted with respect to a financial holding company.

### Consumer Protections

Financial holding companies, depository institutions, financial subsidiaries and operating subsidiaries of depository institutions that are licensed and selling insurance in Texas under authority provided by the Gramm-Leach-Bliley Act are subject to all consumer protection requirements imposed by Texas law, including Articles 21.21, 21.21-9, and 21.48A of the Texas Insurance Code and the regulations enacted thereunder. Many of the measures required to protect against possible consumer abuses and unfair competition by a lender who is also selling insurance are included in the federal anti-tying provisions of 12 U.S.C. §1972, and the disclosure provisions of the February 15, 1994, Interagency Statement on Retail Sales of Nondeposit Investment Products, issued jointly by federal bank regulatory agencies. Adherence to these standards will not provide an exemption from compliance with state laws and regulations applicable to insurance agents.

All entities addressed in these interim guidelines are encouraged to carefully review the federal and state laws governing the business of insurance to ensure compliance with all applicable federal and state requirements.

### To Contact the Department of Insurance

To obtain agent license applications, call (512) 322-3503 or visit the Department's web site at www.tdi.state.tx.us.

To notify the Department of Insurance of a change in ownership of an agency, write to:

Texas Department of Insurance
Licensing Division
P. O. Box 149104
Mail Code 107-1A
Austin, Texas 78714-9104

To notify consumers of how to file a complaint with the Department of Insurance, include the following information:

Texas Department of Insurance
Consumer Protection Program (111-1A)
P.O. Box 149091
Austin, Texas 78714-9091
Phone: 1-800-252-3439 In Austin, call 463-6515
Fax: 512-475-1771

___________________________________
Jose Montemayor
Commissioner of Insurance

Arthur E. Wilmarth, Jr.
Associate Professor of Law
George Washington University Law School
Washington, D.C.

June 30, 2000

### Preemption of State Law under the Gramm-Leach-Bliley Act

I. Preemption Issues under Section 104: Section 104 of the Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338, 1352 (1999) (the "GLB Act"), preempts two general types of state law: (1) state laws that prevent or restrict *affiliations* between banks and other financial companies (*e.g.*, securities firms and insurance companies) that are authorized or permitted by the Act, and (2) state laws that prevent or restrict *financial activities* that are authorized or permitted by the Act. As described below, these two general areas of preemption are qualified by a number of important exceptions.

   A. Preemption of State Laws Restricting Affiliations: In general, Section 104(c)(1) of the GLB Act, 12 U.S.C. § 6701(c)(1), preempts state laws that "prevent or restrict" depository institutions from entering into affiliations or associations with other persons that are "authorized or permitted by this Act or any other provision of Federal law."

      1. The scope of preemption with respect to affiliations that are "authorized or permitted by this Act" is primarily directed at the newly-authorized combinations among depository institutions, securities firms and insurance companies. However, neither the GLB Act nor any of the committee reports contains a detailed description of the extent of preemption that is created by Section 104(c)(1)'s reference to "any other provision of Federal law." *See, e.g.*, H.R. Rep. No. 434, 106th Cong., 1st Sess. 156 (1999) (Conf. Rep.) ("In general, States are not allowed to prevent or restrict affiliations permitted under Federal law"); H.R. Rep. No. 74 (pt. 1), 106th Cong., 1st Sess. 127 (1999) ("Section 104(a), in general, pre-empts a state's ability to prevent or restrict affiliations between financial entities").

      2. The states have a long-established authority to regulate bank holding companies and their subsidiaries in a manner that is more restrictive than federal law, pursuant to Section 7 of the Bank Holding Company Act ("BHC Act"), 12 U.S.C. § 1846. *See Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 48-49 (1980); *Security Nat'l Bank & Trust Co. v. First W. Va. Bancorp*, 277 S.E.2d 613 (W.Va. 1981), *appeal dism'd*, 454 U.S. 1131 (1982). Because Section 7 of the BHC Act is a federal statute, a strong argument can be made that Section 104(c)(1) of the GLB Act does *not* preempt state laws which are authorized by Section 7, *except* for state laws that *directly* conflict with a specific provision of the GLB Act.

a. Section 104(c)(1) does not amend or repeal Section 7 or make any explicit reference to Section 7. To the extent that a state law restricts depository institution affiliations in a manner authorized by Section 7 and does not conflict with a specific provision of the GLB Act, it can be argued that the relevant affiliations are *not* permitted by "any other provision of Federal law."

b. It appears unlikely that the courts would conclude that Section 104(c)(1) was intended to repeal Section 7 of the BHC Act by implication. *See, e.g., Watt v. Alaska*, 451 U.S. 259, 267 (1981) (holding that repeals of federal statutes by implication are *not* favored and will *not* be upheld in the absence of clearly expressed congressional intent); *Morton v. Mancari*, 417 U.S. 535, 549, 551 (1974) (same).

3. In a provision related to insurers that is parallel to Section 104(c)(1), Section 306 of the GLB Act, 15 U.S.C. § 6715, preempts state laws that (i) prevent or significantly interfere with the ability of an insurer or any of its affiliates to acquire control of a depository institution or become a financial holding company, or (ii) limit the amount of an insurer's assets that can be invested in the voting securities of a depository institution or its holding company (except that the insurer's state of domicile may limit the insurer's investment in such securities to an amount that is not less than 5% of its assets).

B. Exceptions to Section 104's Preemption of State Laws Restricting Affiliations: The preemption of state anti-affiliation laws under Section 104(c)(1) is subject to the following important exceptions:

1. Section 104(a) states that the McCarran-Ferguson Act "remains the law of the United States." Under that Act (codified at 15 U.S.C. §§ 1101 *et seq.*), each state retains the right to regulate "the business of insurance" *unless* a state insurance regulation conflicts with a federal statute (such as Section 104) that "specifically relates" to insurance. Section 104(a) thus maintains the traditional role of the states as primary regulators of the business of insurance, and the GLB Act does not preempt state regulation of insurance *except* to the extent that the Act's provisions *expressly* mandate that result. Put another way, the practical impact of Section 104(a) is to preclude any argument that the GLB Act has preempted state insurance laws *by implication*.

2. Section 104(c)(2) provides that, as long as a state's conduct does not have the effect of discriminating against a depository institution or its affiliates or associates, a state may (i) review and approve or disapprove any application relating to a proposed acquisition or change of control of an insurer domiciled in that state ("domestic insurer"), or (ii) require any person that acquires control of a domestic insurer to maintain or restore the capital of the insurer in accordance with general state requirements, or (iii) restrict

a change in the ownership of a domestic insurer's stock after a mutual-to-stock conversion has occurred.

3. In addition, Section 104(f) preserves the applicability of the following categories of state law to depository institutions and their affiliates and associates:

    a. State securities laws that (i) authorize state agencies to investigate and bring enforcement actions with respect to securities fraud and similar unlawful conduct, to the extent permitted under Section 18(c) of the Securities Act of 1933, or (ii) require the registration of securities or the licensing or registration of securities brokers, dealers and investment advisers, to the extent permitted by other applicable federal laws;

    b. State laws relating to the governance of corporations, partnerships and other state-chartered business organizations, and

    c. State antitrust laws that are not inconsistent with the purpose of the GLB Act to permit affiliations among depository institutions, securities firms and insurance companies. For example, state "deposit cap" laws would presumably be treated as valid state antitrust laws under Section 104(f). *See* 12 U.S.C. § 1831u(b)(2)(C) (indicating the validity of nondiscriminatory state "deposit cap" laws).

C. Preemption of State Laws Restricting Financial Activities: In general, Section 104(d)(1) of the Act preempts state laws that "prevent or restrict" depository institutions or their affiliates from engaging in activities that are "authorized or permitted under this Act and the amendments made by this Act." Unlike the preemption of state anti-affiliation laws set forth in Section 104(c)(1), the preemption of state laws contained in Section 104(d)(1) refers *only* to activities that are permitted by the GLB Act and does *not* refer to activities allowed by "any other provision of Federal law." In addition, the general scope of preemption defined by Section 104(d)(1) is subject to the following important exceptions:

1. As noted above, Section 104(a) preserves the general applicability of state laws regulating insurance under the McCarran-Ferguson Act, *except* to the extent that state insurance regulations conflict with a *specific* provision of the GLB Act.

2. Section 104(d)(2) sets forth special rules governing the preemption of state laws regulating insurance sales.

    a. In general, as set forth in Section 104(d)(2)(A), state laws regulating insurance sales are preempted if they "prevent or significantly interfere with" the ability of a depository institution or its affiliate to engage in insurance sales, solicitation or cross-marketing activities. This standard expressly incorporates the preemption test applied by the Supreme Court in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996).

b. Notwithstanding the general rule stated above, Section 104(d)(2)(B) creates "safe harbors" for 13 specified categories of state laws regulating insurance sales. A state regulation that falls within one of the specified "safe harbors" will not be preempted under the Act.

c. Section 104(d)(2)(C) establishes a special standard for state laws regulating insurance sales that do *not* fall within one of the 13 "safe harbors," and that are adopted *after* September 2, 1998. These "new" state insurance regulations must satisfy the *Barnett* preemption test and must also satisfy the nondiscrimination rules contained in Section 104(e). In addition, these "new" state insurance regulations will be subject to judicial review under the "equal deference" rule contained in Section 304(e), 15 U.S.C. § 6714(e), which requires a court to decide preemption issues related to insurance matters "without unequal deference" to either federal or state regulators.

d. Under Section 104(d)(2)(C), a state insurance regulation that does *not* fall within one of the 13 "safe harbors," and that was adopted *before* September 3, 1998, must meet the *Barnett* preemption test. Such an "old" state insurance regulation is *not* required to satisfy the nondiscrimination rules contained in Section 104(e). However, in any judicial proceeding, the question of whether an "old" state insurance regulation has been preempted by the GLB Act *will* be subject to traditional rules under which the courts typically give substantial deference to the views of federal regulators in accordance with *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 834 (1984).

3. The Office of the Comptroller of the Currency ("OCC") has recently published notice of a request by the West Virginia Bankers Association ("WVBA") for a determination that the GLB Act preempts seven West Virginia statutes that regulate insurance sales by financial institutions. *See* OCC Notice of Request for Preemption Determination, 65 Fed. Reg. 35,420 (2000). The WVBA claims that the seven state statutes violate the general preemption standard set forth in Section 104(d)(2)(A) because they "prevent or significantly interfere with" the ability of banks and their affiliates to engage in insurance sales, solicitations and cross-marketing activities. In addition, for the following reasons, the WVBA contends that none of the seven statutes fall within the "safe harbors" under Section 104(d)(2)(B):

a. The first W. Va. law prohibits financial institution employees with lending responsibilities from soliciting customers for insurance sales. The WVBA claims that none of the "safe harbors" authorizes a similar restriction on insurance sales by loan officers.

b. The second W. Va. law prohibits a financial institution from offering insurance products in combination with other products unless all products are available

separately from the institution. The WVBA asserts that this restriction goes further than the "safe harbor" for anti-tying regulations under Section 104(d)(2)(B)(viii).

c. The third W. Va. law requires (i) disclosures regarding the lack of FDIC insurance to be included in every advertisement or other promotional document used by financial institutions in soliciting the sale of insurance, and (ii) customer acknowledgment of such disclosures on a document that is separate from any application for insurance. The WVBA argues that these requirements go beyond the "safe harbors" under Section 104(d)(2)(B)(iii) and (x) for state laws regulating advertising and customer disclosures.

d. The fourth W. Va. law prohibits a financial institution from making an insurance-related solicitation or referral with respect to a borrower until *after* the borrower has received notice of his loan approval, *unless* the bank *requires* the borrower to obtain insurance in conjunction with his loan. The WVBA contends that this state prohibition is not consistent with any of the "safe harbors."

e. If a financial institution requires a borrower to purchase insurance as a condition for obtaining a loan, the fifth W. Va. law compels the institution to complete the loan and insurance transactions "independently and through separate documents." The WVBA maintains that this law goes beyond the "safe harbor" under Section 104(d)(2)(B)(xiii) for state regulations requiring financial institutions to maintain "separate and distinct books and records relating to insurance transactions." The OCC notice does not mention the "safe harbor" under Section 104(d)(2)(B)(xi), which validates state laws requiring "separate documents" for loan and insurance transactions. However, the latter "safe harbor" may not help the W. Va. law because it does not apply to the purchase of "credit insurance or flood insurance."

f. If a financial institution requires a borrower to provide insurance information in connection with a loan application, the sixth W. Va. law prohibits the institution or any affiliated insurance agent or broker from using that information to offer insurance to the borrower unless the borrower has previously consented to such use in a separate document. The WVBA contends that this law goes beyond the "safe harbor" under Section 104(d)(2)(B)(vi) for state regulations which bar the disclosure of insurance information to *non-affiliated* persons without the customer's express consent. However, the OCC notice fails to ask whether the W. Va. law could qualify as a non-preempted state protection of customer privacy under Section 507(b) of the GLB Act, discussed in Part II(F), below.

g. The seventh W. Va. law mandates that sales of insurance by a financial institution must take place in an office that is "clearly and conspicuously signed so as to be readily distinguishable by the public as separate and distinct from the financial institution's lending and deposit-taking activities," unless the institution has "small physical facilities" and receives a waiver from state regulators. The WVBA argues

that this requirement of physical separation for insurance activities is not protected by any of the "safe harbors."

h. The OCC notice does not ask whether the W. Va. laws could be defended as "insurance customer protection regulations" that are more rigorous than federal law and, therefore, are protected from preemption under Section 305(g)(2) of the GLB Act, discussed below in Part II(C). The OCC and WVBA would probably argue that Section 305(g)(2) does not qualify the preemption standards of Section 104 and *only* protects state insurance laws from preemption by the federal rules that will be promulgated under Section 305.

i. The terms and legislative history of the GLB Act do not clearly explain the relationship and potential interaction between Sections 104 and 305 insofar as they both apply to the preemption of state insurance regulations. The absence of such an explanation is likely to create a difficult interpretive question for the courts, particularly since Sections 104 and 305 both deal with the same general subject matter. *See, e.g.*, S. Rep. No. 44, 106th Cong., 1st Sess. 12-17, 21-24, 30-31 (1999). *See especially id.* at 14 ("[I]t is the Committee's intent that courts apply the various preemption standards applicable to State insurance sales, solicitation, and cross marketing laws so as to give effect to each of the standards. In other words, the standards are intended to be complementary alternatives. One standard is not intended to limit or reduce the scope of another").

4. Under Section 104(d)(3), state laws regulating insurance activities *other than* sales, solicitation and cross-marketing are *not* preempted if they (i) fall within the states' authority to regulate the business of insurance under the McCarran-Ferguson Act, (ii) do *not* apply directly to depository institutions (except for savings banks that underwrite life insurance), and (iii) satisfy the nondiscrimination rules contained in Section 104(e).

5. Under Section 104(d)(4), state laws regulating activities *other than* insurance operations are *not* preempted if they (i) do not prevent affiliations or activities that are "authorized or permitted by this Act or any other provision of Federal law," and (ii) do not discriminate against depository institutions or their affiliates.

6. As described above, Section 104(f) generally preserves the applicability of (i) state securities investigation, enforcement and licensing laws, (ii) state corporate governance laws, and (iii) state antitrust laws.

II. <u>Preemption Issues Arising under Other Sections of the GLB Act</u>: Several other provisions of the GLB Act deal with the interaction of federal and state laws in regulating financial holding companies and their affiliates.

A. Capital Infusions by Insurance Companies into Troubled Bank Affiliates: Under Section 112(a) of the GLB Act, codified at 12 U.S.C. § 1844(g), a state insurance regulator can refuse to allow an insurer to make a capital infusion into a troubled bank affiliate in spite of a capital directive issued by the Federal Reserve Board (the "FRB"). In order to refuse such permission, the insurance regulator must determine that the requested capital infusion would have a material adverse effect on the insurer's financial condition. In that event, the FRB can order the bank holding company to divest the troubled bank subsidiary and may impose limits on the bank's operations (including restrictions or prohibitions on any transactions between the bank and its affiliates) until such divestiture occurs.

B. Permitted Activities for State Bank Subsidiaries: Section 121(d) of the GLB Act adds a new Section 46 to the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1831w. Section 46 generally requires financial subsidiaries of FDIC-insured state banks to limit their "as principal" activities to those that would be permitted to financial subsidiaries of national banks under Section 121(a) of the GLB Act, 12 U.S.C. § 24a. However, Section 46 contains two important exceptions to this general requirement:

   1. Preservation of powers exercised by grandfathered subsidiaries: Subsidiaries that were lawfully controlled or acquired by state banks *prior* to the enactment of the GLB Act on Nov. 12, 1999, may be retained and may continue to engage in any activities that such subsidiaries lawfully conducted as of that date. *See* Section 46(b).

   2. Preservation of FDIC's Authority to Permit New Powers for Operating Subsidiaries under Section 24(d) of the FDI Act: Operating subsidiaries of state banks may engage in new "as principal" activities that would not be permissible for financial subsidiaries of national banks, if (i) such activities are authorized by state law, and (ii) the FDIC determines, under Section 24(d) of the FDI Act, 12 U.S.C. § 183la(d), that those activities pose "no significant risk to the appropriate deposit insurance fund." *See* Section 46(d)(1).

   3. Recent Proposal for a New Capital Charge on Nonfinancial Investments: The FRB has recently proposed a significantly higher capital requirement for "nonfinancial investments" made by bank holding companies and their subsidiaries. The proposed new capital charge would be equal to 50% of all equity investments made by bank holding companies and their subsidiaries under (i) the GLB's new merchant banking provisions, (ii) Sections 4(c)(6) and 4(c)(7) of the BHC Act, (iii) small business investment company authorizations, and (iv) Section 24 of the FDI Act. *See* FRB Proposed Rule, 65 Fed. Reg. 16,480 (2000). This new capital charge would obviously create a strong disincentive for equity investments made by state banks and their subsidiaries under Section 24. However, it is not clear whether the FRB will adopt the capital charge as proposed, because the FRB's proposal has triggered strong opposition from banking industry representatives and several members of Congress. *See* Eileen Canning, "Senators Come Down Hard on Fed, Treasury For Merchant Banking Capital Requirements," 74 BNA's Banking Rep. 1082 (2000); Rob Blackwell,

"Industry Rips Interim Rules Limiting Merchant Banking," Am. Banker, June 14, 2000, at 4.

C. State Consumer Protection Laws related to Insurance Sales: Section 305 of the GLB Act adds a new Section 47 to the FDI Act, 12 U.S.C. § 1831x. Section 47 requires the federal banking agencies to adopt joint rules to protect consumers from misleading or abusive practices in retail sales of insurance products by depository institutions or their agents.

1. In particular, Section 47 directs the federal bank regulators to adopt joint rules that (i) require disclosures of investment risks and lack of deposit insurance for insurance products, (ii) prohibit misrepresentations or unlawful tying in connection with insurance sales, (iii) mandate physical segregation of insurance sales from areas in which retail deposits are accepted, and (iv) bar the sale of insurance by unlicensed individuals.

2. Section 47(g)(2) provides that the new federal rules will *not* apply in any state whose laws provide *greater* protection to consumers. If the federal banking agencies jointly determine that a state provides *less* protection to consumers with respect to a particular area of regulation, the agencies can preempt that state's laws by sending a written preemption notice to the state. Such preemption will remain in force *unless* the state adopts legislation, within 3 years after the notice, that overrides the notice's preemptive effect.

3. Section 47(g)(2) thus operates as an anti-preemption clause for state laws protecting consumers in insurance sales, at least with respect to the new federal regulations to be issued under Section 47. As noted above, it is not entirely clear whether Section 47(g)(2) would provide the states with any argument against preemption under Section 104 of the GLB Act.

D. State Laws Regulating Mutual-to-Stock Conversions of Insurance Companies: Title III of the GLB Act contains several provisions that restrict the authority of states to regulate mutual-to-stock conversions of insurance companies.

1. Section 306(3) prohibits any state, *except* for an insurer's state of domicile, from preventing, significantly interfering with, reviewing, approving or disapproving the insurer's proposal to convert from mutual to stock form.

2. If a state has *not* enacted a law that establishes "reasonable terms and conditions" for a mutual insurer to convert into a mutual holding company with a stock subsidiary, Sections 311 and 312 provide that a mutual insurer domiciled in that state (the "transferor domicile") may transfer its domicile to another state that has enacted such a law.

a. In order to transfer its domicile under Section 312, a mutual insurer must comply with the procedural requirements set forth in Section 312(f), which are designed to protect policyholder rights. All licenses and certificates of authority held by a redomesticating mutual insurer in any state are expressly preserved under Section 312(c), as long as the insurer remains duly qualified to transact business in that state.

b. Section 313 preempts (i) any state laws of a transferor domicile that conflict with the provisions of Section 312, (ii) any laws of another state that would treat a redomesticating insurer differently from other similarly situated insurers, and (iii) any actions of another state that would interfere with the lawful authority of a redomesticating insurer to operate in that state on the same basis, and subject to the same conditions, as other out-of-state insurers.

E. Multistate Licensing of Insurance Agents and Brokers: Subtitle C of Title III of the GLB Act (Sections 321-36, codified at 15 U.S.C. §§ 6751-66) includes provisions that (i) encourage the states to adopt uniform or reciprocal laws governing the licensing of insurance agents and brokers, and (ii) mandate the establishment of a National Association of Registered Agents and Brokers ("NARAB"). Section 333 preempts state laws that conflict with certain specified provisions of Subtitle C, including state laws that interfere with the operation of NARAB. Except to the extent specifically provided in Section 333(a) or (b), state laws regulating unfair trade practices and establishing consumer protections will not be preempted and will remain in force pursuant to Section 333(c).

F. State Laws Designed to Protect Customer Privacy: Title V of the GLB Act, 15 U.S.C. § 6801 *et seq.*, contains provisions intended to protect the privacy of confidential information held by financial institutions with respect to their customers and other consumers. In general, Title V, and the regulations adopted thereunder by federal banking agencies, prohibit financial institutions from disclosing confidential consumer information to any non-affiliated person unless the consumer has previously been given notice of his privacy rights and the opportunity to "opt out" of such disclosure. *See* Joint Final Rule, Privacy of Consumer Financial Information, 65 Fed. Reg.35,162 (2000).

1. Sections 507 and 524 of the GLB Act preempt state laws which provide *less* protection to consumers than the new federal privacy rules under Title V and the implementing regulations. However, Sections 507(b) and 524(b) expressly preserve the right of each state to provide *greater* protection to customers than the safeguards included in the federal privacy rules. The Federal Trade Commission is responsible for determining, after consultation with the appropriate federal banking agency, whether particular state privacy laws provide greater protection than federal safeguards and, therefore, are protected from preemption.

2. The joint privacy rules issued by the federal banking agencies expressly recognize the right of each state to adopt and enforce more rigorous privacy protections in

accordance with Sections 507(b) and 524(b). *See* 12 C.F.R. § 40.17 (OCC rule); *id.* § 216.17 (FRB rule); *id.* § 332.17 (FDIC rule); *id.* § 573.17 (OTS rule).

3. Several state legislatures have considered bills to adopt stricter privacy measures. Some of these proposed bills would prohibit financial institutions from sharing confidential customer information with either affiliates or non-affiliates unless the customer "opts in" to such disclosure by giving prior written consent. *See* A. Mazumdar, "State Legislatures Make Moves to Strengthen Privacy Protections While Congress Hesitates," 68 U.S.L.W. 2620 (2000). However, these state bills have encountered strong opposition from financial industry representatives. *See, e.g.*, Laura Mahoney, "Last Pending Financial Privacy Bill In California Felled by Committee Vote," 74 BNA's Banking Rep. 913 (2000).

4. The potential impact of stricter state privacy laws is shown by a settlement agreement announced by Chase Manhattan Corp. and the New York State Attorney General's office in January 2000. According to one news report, Chase agreed to stop selling all nonpublic customer information to unaffiliated third parties, except for customer names, addresses and telephone numbers. Thus, Chase reportedly gave up its potential right under Title V of the GLB Act to sell additional nonpublic information to non-affiliates with respect to customers who failed to "opt out" of such selling arrangements. *See* Lisa Fickenscher, "Chase Pact in N.Y. Shows How States Could Set Privacy Rules," Am. Banker, Jan. 27, 2000, at 1.

5. The Clinton Administration has recently proposed federal legislation that would provide stronger privacy protections for confidential consumer financial and medical information. The Clinton bill would (i) permit consumers to "opt out" of disclosure of their confidential financial information to either affiliates or non-affiliates of financial institutions, and (ii) require consumers to "opt in" to any disclosure of "especially sensitive information" related to their medical history or personal spending habits.

   a. Some sponsors of the Clinton bill have indicated that they would be willing to add a provision preempting state privacy laws if such a provision is needed to persuade the financial services industry to support the bill's passage.

   b. Prospects for enactment of the Clinton bill are unclear. Consumer groups have expressed enthusiastic support for the bill while financial industry representatives are strongly opposed. Republican members of Congress have sought to head off action on the Clinton proposal by offering a narrower bill, which would provide consumers with "opt in" privacy rights only with respect to confidential medical and health information. For discussion of these developments, *see, e.g.*, Eileen Canning, "President's Proposal to Expand Consumer Financial Privacy Introduced in Congress," 68 U.S.L.W. 2678 (2000); Eileen Canning, "House Banking Supports Medical Privacy Bill; Democrats Push for Administration Proposal," 74 BNA's Banking Rep. 1080 (2000).

Note: The information in this outline includes developments through June 30, 2000.

A.E.W., Jr.

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GIBSON, DUNN & CRUTCHER LLP

November 30, 1999

# NEW FEDERAL PREEMPTION RULES

# CONCERNING INSURANCE AND OTHER AFFILIATES OF DEPOSITORY INSTITUTIONS: Section 104 of the Gramm-Leach-Bliley Act

***Robert C. Eager and Cantwell F. Muckenfuss III***
Gibson, Dunn & Crutcher LLP, Washington, D.C.

When Section 104 of the Gramm-Leach-Bliley Act ("the Act") became law on November 12, it immediately made a wide range of state laws subject to federal preemption if they impede or disadvantage either the creation of affiliations with depository institutions or the activities of such affiliates. These provisions apply to any type of affiliation with any depository institution, not just the financial holding companies ("FHCs") authorized in Section 103 of the new Act. Section 104 is multi-faceted and complex, and it assigns no single regulator primary responsibility for interpreting its provisions. Accordingly, it will take the actions of banking and insurance regulators and probably litigation to develop the meaning and effects of these preemption provisions.

Section 104 addresses a number of substantively and politically sensitive issues. Banks and diversified financial companies sought federal preemption of state laws intended to prevent bank-insurance affiliations or place burdens on sales and cross-marketing of insurance by depository institutions and their affiliates. Insurance commissioners and many insurance trade groups wanted to preserve state regulation of insurance. They further sought to limit the ability of the Comptroller of the Currency ("OCC") to expand insurance activities of national banks and the judicial deference given OCC decisions when challenged in the courts. Insurance agent groups particularly wanted to preserve existing state insurance provisions regarded as favorable to independent agents. Extended negotiations produced the complicated Section 104 rules concerning preemption of state insurance provisions. The rules governing insurance marketing and sales are especially complex and apply different tests and standards to various parts of state law, depending upon the date of enactment and subject matter.

We hope you find the following memorandum helpful in understanding these important new rules. We welcome comments and questions. Please direct them to:

Chuck Muckenfuss - 202-955-8514; cmuckenfuss@gdclaw.com; or
Bob Eager - 202-955-8544; reager@gdclaw.com; 202-530-9545 (fax).

## *HIGHLIGHTS OF SECTION 104*

• ***Already effective.*** The Act specifies that Section 104 is effective on the date of enactment – *i.e.,* when signed by the President on November 12.

• ***Broad preemption to allow affiliations with depository institutions.*** It uses broad preemptive language intended to override any state law that would stand in the way of the creation of any affiliation "permitted" by the new Act or any other provision of federal law, with particular provisions addressing state insurance law and state review of acquisitions of insurers.

• ***Broad definition of depository institution and affiliated persons.*** It applies to affiliates of any bank or savings institution, or of any foreign bank with a U.S. branch, agency, or commercial lending company. An affiliate is any person or entity controlling, controlled by, or under common control with the institution. The affiliate preemption also reaches any entity or person "associated" with a depository institution.

• ***Broad definition of "insurer."*** Its definition of "insurer" for purposes of the affiliations preemption is equally broad, including "any person engaged in the business of insurance," *i.e.,* underwriters, brokers, agents, or any other person engaged in insurance as defined under state or federal law, whether a business entity or an individual.

• ***Broad nondiscrimination tests applicable to state insurance sales laws***. Subject to "old law" and "safe harbor" exceptions, state rules concerning the conduct of financial activities, including insurance sales and cross-marketing by any depository institution or any affiliate, will be preempted if they either "prevent or significantly restrict" such activities or are discriminatory under any one of four relatively stringent tests.

• ***Special rule for pre-9/3/98 state sales laws ("Old Law")***. State insurance sales rules or actions as of September 3, 1998, are subject only to a "prevent or significantly restrict" test in accordance with the U. S. Supreme Court decision in the case of *Barnett Bank v. Nelson (1996)* ("*Barnett*"), with judicial deference to federal banking agency interpretations in any litigation.

• ***Double-edged "safe harbor" tests.*** State insurance sales rules that fall into thirteen so-called "safe harbor" categories are not subject to either the "prevent or significantly restrict" test or the nondiscrimination tests, but only if they are "no more burdensome or restrictive" than what is expressly permitted in the Act.

• **Barnett** ***preserved.*** The effect of *Barnett* is expanded by allowing other banking regulators to apply its preemption standards and by applying it beyond the provision of the National Bank Act at issue in that case. The applicability of the *Barnett* decision itself to state law other than "safe harbor" provisions is preserved.

• ***Broad nondiscrimination tests applicable to state insurance nonsales laws and laws affecting all other depository affiliations.*** The four nondiscrimination tests also apply to state rules or actions governing nonsales activities of insurance companies, other nonsales insurance activities, or any other activity of a depository institution or any affiliate.

• ***Expedited dispute resolution.*** The expedited dispute resolution procedure in the federal courts set forth in Section 304 can be used by any state or federal regulator (but not a private party) that questions a preemption determination under Section 104, and (except in Old Law cases) the courts shall review regulatory preemption determinations "without unequal deference."

## I. MCCARRAN-FERGUSON REAFFIRMED

The Gramm-Leach-Bliley Act generally and Section 104 specifically attempt to follow a "functional regulation" approach . The Act opens the way to full financial affiliations and affirms the roles of banking, insurance, and securities regulators in their respective spheres.

Accordingly, Section 104(a) states that the McCarran-Ferguson Act "remains the law of the United States." Under that Act, the "business of insurance" is subject to state regulation, except to the extent that a federal statute (such as Section 104 of the Act) "specifically relates" to insurance. 15 U.S.C. § 1011 et seq. Section 104(b) provides that, subject to Section 104(c), (d) and (e), no person or entity may provide insurance as principal or agent in a state unless licensed "as required by the appropriate insurance regulator of such State in accordance with relevant State insurance laws." These two brief provisions, originally added to Title III of the House bill (H.R. 10) by the House Commerce Committee in 1998 and moved to the beginning of Section 104 in the Senate bill (S. 900), respond to the insurance industry view that the Comptroller of the Currency had intruded into state regulation of insurance.

It should be noted that for purposes of Section 104 the term "insurer" means "any person engaged in the business of insurance" and "State" includes not only the fifty states and the District of Columbia, but also the U.S. territories -- Puerto Rico, Guam, the Virgin Islands, American Samoa, the Northern Mariana Islands, and the Pacific Island trust territory.

## II. PREEMPTION OF RESTRICTIONS ON AFFILIATIONS

Section 104(c) of the Act generally preempts any state law restricting the establishment of affiliations with depository institutions. Although developed with a focus on insurance anti-affiliation laws, this provision is not limited to insurance, but by its terms reaches any state law that adversely affects affiliations with a depository institution.

### A. Broad Preemption for Affiliations with Depository Institutions

In general, under Section 104(c)(1) "no state" may "prevent or restrict" the affiliations authorized or permitted by the Act, or any other provision of federal law. That any affiliation "permitted" under any federal law may be reached indicates the potential, if undefined, scope of this preemption. This preemption reaches all forms of state action, including any statute,

regulation, order, interpretation or "other action" that would prevent or restrict directly or indirectly covered affiliations or associations.

The preemption provisions cover not only depository institutions in a FHC, but all insured depository institutions, foreign banks with a U.S. branch, agency, or commercial lending company, and all affiliations with depository institutions of the type permitted under the Act. It reaches persons or entities "associated" with a depository institution or FHC, but does not define "associate." In context that term would appear to cover joint venture, contractual, or other relationships among individuals, companies, or other persons engaged in financial or other activities covered by this subsection. Any person or entity "engaged in the business of insurance" is an "insurer" for purposes of these affiliation provisions.

### B. Exceptions for State Insurance Regulators

The authority of state insurance regulators to review and approve acquisitions of insurers and state laws protecting demutualized insurers are preserved from preemption as long as they are not discriminatory in practice.

#### 1. State Review of Insurance Affiliations

Unlike the 1998 version of H.R. 10 which preempted the ability of a state insurance regulator to review or disapprove acquisition of an insurer by a depository organization, the Act adopts the Senate bill (S. 900) approach, permitting state review of such acquisitions on a non-discriminatory basis and subject to time limits. With respect to insurers domiciled in a state, Section 104(c)(2) states that paragraph (c)(1) does not prohibit that state from collecting, reviewing, and taking actions on required applications and other documents concerning acquisitions or changes in control. The final bill also preserves the ability of state insurance regulators to collect information concerning any acquisition or change in control of any insurer engaged in insurance in the state or regulated by the state. Both of these permitted state actions must take place during the 60-day period before the effective date of the proposed acquisition or change in control.

Such state action may not "have the effect of discriminating, intentionally or unintentionally, against a depository institution or an affiliate thereof, or against any other person based upon an association of such person with a depository institution." This provision does not define or characterize discrimination that might invalidate otherwise protected state action. This broad language suggests that any state rule or action concerning a proposed affiliation with a depository institution that has a discriminatory effect, even if unintended, on a depository organization may be found preempted. (The breadth of this language may be contrasted with the four non-discrimination tests of Section 104(d)(4) and (e).) This potentially sweeping effects test suggests that any denial of an acquisition of an insurer by a depository organization may be litigated.

### 2. Preservation of State Laws Limiting Takeovers of Demutualized Insurers

Section 104(c)(2)(C) preserves state laws preventing the unfriendly takeover of insurers that have converted from mutual to stock form. It provides that a state may restrict a change in the stock ownership of an insurer, or of a company formed for the purpose of controlling an insurer, after the conversion of such company from mutual to stock form, "so long as such restriction does not have the effect of discriminating, intentionally or unintentionally, against a depository institution or an affiliate thereof, or against any other person based upon an association of such person with a depository institution." As with the general protection for state approval of insurer acquisitions, this provision means that any state action having a discriminatory effect, even if unintended, may be challenged, and thus does not provide absolute protection for demutualized insurers. Although most state laws protect demutualized companies for a specified period of time (*e.g.,* three years or five years), this federal provision includes no time limit.

A parallel provision is found in Section 306. It provides that no state, other than the insurer's state of domicile, may prevent or significantly interfere with, or possess the authority to review, approve or disapprove an insurer's reorganization from mutual to stock form, including as a subsidiary of a mutual insurance holding company.

### 3. Capital Requirements

Under Section 104(c)(2)(B), the general (c)(2) preemption does not prevent a state from requiring an acquirer of an insurer to "maintain or restore the capital requirements" of the insurance business being acquired to the minimum level prescribed under capital regulations of "general applicability." This minimum level is described as the level required to avoid having to file a capital restoration plan under state insurance law. The state must make a capital deficiency determination within 60 days from the time that the acquiring party files notice and accompanying information with the state insurance regulator, as required by state law preserved under Section 104(c)(2)(A).

## C. Partial Preemption of State Laws Governing Affiliations and Investments by Insurers under Section 306

Section 306 also addresses the concerns of insurance companies, particularly mutual companies, that investment restrictions or other limits in state law may effectively prevent such a company from operating as a FHC. It provides in effect a minimal uniform federal standard by preempting state investment or other laws that might in practical effect prevent such an insurer from having a depository institution affiliate. This section is expressly made subject to Section 104(c)(2) and its broad nondiscrimination requirement.

In addition to the demutualization provision discussed above, Section 306 addresses:

1. ***Insurer-depository affiliations*** - no state may prevent or significantly interfere with the ability of any insurer or its affiliate to become a financial holding company or to acquire control of a depository institution.

2. ***Downstream investment in depository institutions*** - states are prevented from limiting the amount of an insurer's assets that may be invested in the stock of a depository institution, except that the insurer's state of domicile can limit such investments to not less than 5% of the insurer's assets.

### D. Insurer Redomestication Preemption Under Title III

The insurance mutual holding company redomestication provisions contained in Title III generally permit an insurer located in a state that as a practical matter does not permit a domiciled insurer to reorganize into a mutual holding company structure to relocate its state of domicile to a state that permits such a structure.

## III. AN OVERVIEW OF FEDERAL PREEMPTION OF STATE LAW CONCERNING INSURANCE AND OTHER ACTIVITIES

Section 104(d) establishes a preemption framework governing state rules or actions affecting activities of depository institutions and their affiliates, including detailed provisions specifically addressing insurance sales and other insurance activities. These provisions will often require a multi-step analysis to determine the effect of state law.

At the threshold, Section 104(d)(1) appears to state a broad federal preemption rule, but as a practical matter it is superseded by the different tests set forth in paragraphs (d)(2) - (4) specifically applicable to insurance sales, insurance activities other than sales (*i.e.*, underwriting and other insurance company activities), and all other activities of depository institution affiliates. On its face, the (d)(1) rule parallels the broad Section 104 (c)(1) language and reaches any state law or action that would "prevent or restrict" an insured depository institution, or affiliate thereof, from "engaging directly or indirectly, either by itself or in conjunction with an affiliate, or any other person" in any activity authorized or permitted under the Act or the amendments made by the Act. (Unlike (c)(1), this language reaches only all activities permitted under the Act; the (c)(1) preemption is broader, also reaching any affiliation permitted under any provision of federal law.) The net result is that the (d)(1) language appears to have no operative significance, except perhaps in connection with non-insurance law addressed in Section 104(d)(4).

The paragraph (d)(2) provisions governing insurance sales are especially complicated: they include a multi-part general rule and two significant exceptions. The general rule is that insurance sales rules and actions are subject to both a "prevent or significantly restrict" test "in accordance with" *Barnett* and a strong four-part nondiscrimination test (in Section 104(e)), with disputes

litigated under the Section 304 procedures and the "without unequal deference" standard of review.

However, insurance groups were concerned that the new nondiscrimination test would invalidate existing laws that (they believed) could survive scrutiny under the *Barnett* case standards. The result was a compromise in which Old Law (statutes, rules, or actions in force on September 3, 1998) is made subject only to the "prevent or significantly restrict" test of the general rule, but not the subsection (e) nondiscrimination test, with the proviso that in cases involving Old Law the courts would continue to accord deference to the OCC and other federal banking agencies under the *Barnett* and *Chevron v. Natural Resources Defense Council* [467 U.S. 837 (1984)] cases. A second, so-called "safe harbor" exception was made for thirteen specified types of state rules that are protected from preemption under the general rule as long as they conform to detailed federal standards in Section 104 (d)(2)(B).

Under paragraph (d)(3), nonsales insurance provisions are also subjected to the subsection (e) nondiscrimination test. State law or actions concerning activities other than insurance are subject to a parallel four-part nondiscrimination test in paragraph (d)(4). Finally, under Section 104(f) state law concerning corporate governance, antitrust, and securities registration and antifraud enforcement are expressly protected from preemption under Section 104.

## IV. INSURANCE SALES

State rules or actions concerning insurance sales, solicitation, or cross-marketing are subject to the detailed, and at times ambiguous, provisions of section 104(d)(2). These provisions evolved in 1998 in a series of negotiations between banking and insurance interests. For banks, the starting point was the preemption analysis followed by the U.S. Supreme Court in a series of cases over many decades, most recently the 1996 *Barnett* case. That case stated (1) that a state law would be preempted by the National Bank Act if it impeded, prevented, or significantly interfered with the conduct of activities permitted to national banks and (2) that under the standards of *Chevron*, the Court of Appeals had appropriately accorded deference to the interpretations by the OCC, the responsible federal administrative agency.

Insurance groups generally responded to *Barnett* by arguing that all insurance activities should be regulated under state law under the McCarran-Ferguson Act, and that the OCC should not be able to separately regulate insurance sales activities of national banks under *Barnett.* They also asserted that *Chevron* deference to the OCC gave national banks an unfair advantage in litigation challenging state rules regarding insurance activities of such banks and their affiliates. In addition, insurance agent groups sought to preserve state insurance laws governing insurance sales by bank affiliates, some of which were enacted in the wake of *Barnett*.

### A. General rule

Subparagraph (d)(2)(A) states that no state may "prevent or significantly interfere" with the ability of an insured depository institution, or affiliate thereof, to engage directly or indirectly, either by itself or in conjunction with an affiliate or any other entity or person in insurance sales,

solicitation, or cross-marketing activities. This provision is to be interpreted "in accordance with" the legal standards for preemption set forth in the *Barnett* case. As long as an entity engaged in insurance sales has a depository institution affiliate, state rules applicable to the insurance sales activities of that entity "by itself" may be preempted under the paragraph (d)(2)(A) standard. This standard applies to state statutes, regulations, orders, interpretations, or other action regarding insurance sales, marketing, or cross-marketing, except those described in the Safe Harbor.

In addition, subject to the Old Law and Safe Harbor exceptions, state insurance sales rules and actions are subject to the four-part nondiscrimination test in Section 104(e), described below.

Disputes between regulators with respect to possible preemption of sales rules and actions (except for Old Law provisions) are governed by the expedited dispute resolution provisions in Section 304 ( discussed below). In brief, under that provision, a dispute between a state insurance regulator and a federal banking agency over an insurance-related issue is to be determined by the courts "without unequal deference."

### B. "Old Law"

Section 104(d)(2)(C) embodies a compromise with respect to preemption standards applicable to Old Law -- a state insurance sales "statute, regulation, order, interpretation or other action . . . that was issued, adopted, or enacted before September 3,1998," the date chosen when the insurance compromise was reached. It leaves Old Law subject to the (d)(2) "prevent or significantly interfere" test. However, it provides in clause (i) that any state insurance sales, solicitation or cross-marketing regulation adopted prior to September 3, 1998, and outside the Safe Harbor, will not be subject to the special "no unequal deference" rule of Section 304. This means that judicial deference to federal banking agency positions under *Chevron* is retained for Old Law cases. Clause (ii) states that Old Law will not be subject to the nondiscrimination standards set forth in Section 104(e).

The use of a "bright line" date to characterize Old Law may not be as clear as first it might appear. Questions may still be raised about whether a specific provision or action is subject to the general rule or the Old Law exception. For example, how are statutes or rules *re*-enacted or amended after this date to be treated, or interpretations or "other actions" issued after that date that are based upon prior interpretations but not identical.

### C. *Barnett* preserved.

Further ambiguities may be presented by clause (iii)(I) of Section 104(d)(2)(C), which expressly preserves the *Barnett* case. It states that "[n]othing in this paragraph [(d)(2)]shall be construed . . . to limit the applicability" of the *Barnett* decision to any state statute, regulation, order, interpretation, or other action not described in the Safe Harbor. This may be read to suggest that because the *Barnett* case concerned the interpretation of the National Bank Act that this provision applies only in cases involving interpretation of that Act. It should be remembered that the general (d)(2) standard, which applies to all insurance sales activities of depository

institution affiliates, is by its terms to be applied "in accordance with" *Barnett*'s legal standards for preemption.

### D. "Safe Harbor"

Subparagraph (2)(B) provides a "safe harbor" that provides protection from potential federal preemption for thirteen specified types of state laws (whether adopted before or after September 3, 1998). However, at the same time, these provisions represent a federal standard against which state rules in these thirteen areas must be measured. Disputes between regulators over the application of the safe harbor are governed by the Section 304 procedures and standard of review.

The Section 104(d)(2)(B) "safe harbor" provisions allow states to impose restrictions that fall into thirteen enumerated categories so long as the restrictions "are substantially the same as but no more burdensome or restrictive" than the provisions of this paragraph. "Safe harbor" is thus at least a partial misnomer because state restrictions in these thirteen areas that are more burdensome or restrictive are not protected, and the specific terms of the thirteen enumerated items do not appear to leave much room for mischief. In addition, this paragraph does not include a severability clause, and the lack of such a clause should mean that those state rules or actions that exceed the bounds of a Safe Harbor provision may fail in their entirety, not just to the extent they exceed what is permissible under this paragraph.

- ***Protection for unassociated insurance issuers or underwriters (i)***: If an insurance policy is required in connection with a loan or extension of credit, states may prevent insured depository institutions, or affiliates thereof, from rejecting a policy solely on the basis that a person not associated with that institution issued or had underwritten the policy.

- ***One fee for insurance services (ii):*** When insurance is required in connection with a loan or extension of credit or other traditional banking product, states may prohibit insured depository institutions or affiliates thereof, from charging a "debtor, insurer, insurance agent or broker" a separate fee, unless such fee would be required when the institution or an affiliate serves as the insurance agent or broker providing the insurance.

- ***Advertising restrictions (iii):*** States may restrict insured depository institutions, or affiliates thereof, from using any advertisements or distributing other "insurance promotional material" that would cause a reasonable person to believe mistakenly that a state or the Federal Government stands behind the credit of the institution or affiliate, is responsible for the insurance sales activities, guarantees any returns on insurance products or pays any insurance benefits.

- ***State licensing requirements (iv)*****:** The state may require any person who receives any commission or brokerage fee for "services as an insurance agent or broker" to hold a valid state license for the applicable class of insurance, but such services do

not include a referral by an unlicensed person that does not include a discussion of "specific insurance policy terms and conditions."

- ***Referral fee restrictions (v)*****:** States may prohibit insurance companies from paying referral fees "based on the purchase of insurance by the customer" for referrals by an unlicensed person to a licensed person of customers who seek to purchase, or who seek opinion or advice on, an insurance product.

- ***Privacy requirements for policyholder information (vi) and (vii)*****:** States may prohibit the release of customer insurance information to persons other than an employee, agent or affiliate of a depository institution for the purpose of "soliciting or selling insurance" without the express consent of the customer. The information covered includes information about the policy itself, such as premiums, terms and the conditions of coverage and customer claims contained in the records of an insured depository institution or affiliate thereof. This restriction on information sharing does not apply to any officer, director, employee, agent, subsidiary or affiliate of an insured depository institution. States also cannot prohibit the provision of information (i) in connection with the transfer of insurance in force on existing insureds of an insured depository institution or affiliate thereof, to an unaffiliated insurance company, agent or broker, (ii) in connection with a merger with or acquisition of such an unaffiliated company, agent or broker, or (iii) where the release of information is authorized by state or federal law. States may prohibit the release of health information derived from a customer's insurance records for any purpose other than for the activities of a licensed agent or broker, unless the insuring institution receives the customer's permission. Title V, which was added subsequent to the Section 104 compromise, of course contains more detailed privacy provisions.

- ***Separations between credit approval and insurance (viii) and (ix)*****:** States may prohibit the extension of credit or any equivalent product to a customer, or varying the consideration for any product, on "the condition or requirement that the customer obtain insurance" from an insured depository institution or affiliate thereof or any other particular insurer, agent, or broker, subject to exceptions noted below. Although such institutions may impose "reasonable requirements" on the credit-worthiness of any insurance provider or on the scope of coverage that a customer may choose, where insurance is offered or required in connection with a pending loan application, states can require that the customer be informed in writing that his or her "choice of an insurance provider" will not affect the credit decision or credit terms. States may not prohibit an insured depository institution or affiliate thereof, from informing a customer that obtaining a loan requires insurance, that approval is contingent on procuring acceptable insurance, or that the institution where they are applying for credit provides that insurance. Nor may states prohibit any insured depository institution or affiliate from engaging in any activity

permissible under the antitying provisions of the Bank Holding Company ("BHC") Act Amendments of 1970.

- ***Disclosure of insurance risks (x)*****:** When a customer buys an insurance policy from an insured depository institution or an affiliate, states may require the bank to clearly and conspicuously disclose, in writing "when practicable," to its customer that the policy is not a deposit, is not insured by the FDIC, is not guaranteed by the institution (or any affiliate or person soliciting or selling insurance on the premises thereof) and "where appropriate, involves investment risk, including potential loss of principal." The federal consumer protection rules required under Section 305 also require this disclosure.

- ***Separation of credit and insurance transactions (xi) and (xii)*****:** States may require an insured depository institution or an affiliate thereof, or any person soliciting the purchase of or selling insurance on the premises of these institutions, to use separate credit and insurance transaction documents (other than for credit or flood insurance). States may also prevent insured depository institutions, or subsidiaries or affiliates thereof, or any person soliciting the purchase of or selling insurance on the premises thereof, from including customers insurance premiums (other than for credit or flood insurance) in the primary credit transaction without the express written consent of the customer.

- ***Requirement of maintaining separate books for insurance transactions (xiii)*****:** Banking institutions may be required to maintain "separate and distinct books and records relating to insurance transactions," including customer complaints. Such books and records may be required to be made available for inspection by the state insurance regulator.

### E. "No Inferences"

Clause (iii)(II) provides that nothing in paragraph (d)(2) "shall be construed . . . to create any inference" with respect to any state provision or action not referred to or described in that paragraph.

### F. Nondiscrimination

Under Section 104(e), nondiscrimination standards apply to any state law or action applicable to the insurance activities of any affiliate of a depository institution, whether structured as a FHC, a savings and loan holding company, a free-standing bank or thrift with an affiliated insurance agency, or a third-party sales or marketing arrangement. These nondiscrimination standards apply to all state insurance regulations except for sales regulations that were enacted prior to September 3, 1998, or that are within the Section 104 "safe harbor." There are four separate nondiscrimination tests.

Under these provisions, no state may regulate the insurance activities permitted under this Act or "any other provision of Federal law" of insured depository institutions or affiliates thereof to the extent that such rule or action:

1. "distinguishes by its terms" between such institutions or affiliated entities and other persons or entities engaged in insurance activities "in a manner that is in any way adverse" to such depository institution or affiliated entity;

2. "as interpreted or applied, has or will have an impact" on such depository institutions and affiliated entities that is "substantially more adverse" than its impact on other persons or entities (that are not such depository institutions or affiliated entities) providing the same products and services or engaged in the same activities;

3. "effectively prevents" such a depository institution or affiliated entity from engaging in any insurance activity permitted by this Act or any other provision of federal law; or

4. "conflicts with the intent of this Act" and the amendments made by this Act to allow affiliations permitted by this Act or other federal law.

A state insurance sales law, except for Old Law and Safe Harbor provisions, found wanting under any of these tests is preempted.

## V. STATE LAW GOVERNING INSURANCE ACTIVITIES OTHER THAN SALES

Section 104 (d)(3) provides the preemption rule for state insurance laws governing all insurance activities other than sales, solicitation and cross-marketing, such as underwriting, investment and other activities of insurance companies. It uses a double-negative construction that supersedes not only the (d)(1) "prevent or restrict" language, but also the (d)(2)(A) "prevent or significantly restrict" test. The net effect of this provision is to preserve state regulation of insurance underwriters and other providers of insurance as long as state regulation is nondiscriminatory under the standards of Section 104(e).

The paragraph (d)(3) language specifically provides that state statutes, regulations, interpretations, orders or other actions shall not be preempted to the extent that they meet four tests. To be protected from preemption, a state law or action must be--

- "insurance" regulation--it must "relate to," or be enacted "for the purpose of regulating the business of insurance" in accordance with the McCarran-Ferguson Act ;
- not apply to a depository institution--it may apply only to persons or entities that are not insured depository institutions, but are directly engaged in the business of insurance (including subsidiaries or affiliates of depository institutions and the savings bank life insurance underwriting activities of banks);
- not regulate sales--it must not relate to or directly or indirectly regulate insurance sales, solicitations or cross-marketing activities (which are addressed in Section 104(d)(2)); and
- not be discriminatory--it must not be prohibited under the nondiscrimination standards of Section 104(e).

Taken together, these provisions mean that any person or entity (other than a depository institution) engaged in the "business of insurance" other than insurance sales, solicitation or cross-marketing will be subject to any state law that meets the nondiscrimination test. Insurance subsidiaries or affiliates of depository institutions thus are subject to the same rules as all other insurance providers. The exception for insurance activities conducted directly by depository institutions is relatively narrow because banks have generally not been authorized to engage directly in nonsales "insurance" activities; state banks have been limited since 1991 under Section 24 of the Federal Deposit Insurance Act, and Title III of the Act expressly bars new insurance activities as principal by national banks.

## VI. STATE LAW GOVERNING ACTIVITIES OTHER THAN INSURANCE

Parallel to paragraph (d)(3), Section 104(d)(4) addresses state laws or actions that regulate activities other than insurance. This provision subjects *any* state statute, regulation, order, interpretation or "other action" affecting any depository institution or any affiliate thereof to several nondiscrimination tests. Because of the breadth of this preemption provision, the subsection (f) exclusion for certain state corporate, antitrust, and securities provisions was added. This exclusion serves to underscore the broad range of state laws that remain subject to review under these (d)(4) standards.

Paragraph (d)(4) employs the same double negative structure as the paragraph (d)(3) provisions and similarly applies nondiscrimination tests to other state laws that may adversely affect depository institutions or any affiliate.

This provision first excludes state law addressed elsewhere in Section 104: insurance sales, solicitations or cross-marketing activities covered under paragraph (d)(2); insurance activities other than sales, solicitations, or cross marketing activities, covered under paragraph (d)(3); or securities investigations or enforcement actions referred to in paragraph (f)(1).

State laws and actions not subject to these exclusions must meet four nondiscrimination tests to avoid preemption. The effect of this subparagraph is to preserve a state law or action that may prevent or restrict an activity (other than insurance) of a depository institution, or any affiliate, if it meets all four of the nondiscrimination tests.

The (d)(4) nondiscrimination tests are substantively the same as the ones in subsection (e). Such "other" state law is subject to preemption to the extent that it:

1. "distinguishes by its terms" between such institutions or affiliated entities and other persons or entities engaged in the activity at issue and other persons engaged in that activity "in a manner that is in any way adverse" to such depository institution or affiliated entity;

2. "as interpreted or applied, has or will have an impact" on such depository institutions and affiliated entities that is "substantially more adverse" than its impact on other persons or entities (that are not such depository institutions or affiliated entities) providing the same products and services or engaged in the same activities;

3. "effectively prevents" such a depository institution or affiliated entity from engaging in any activity permitted by this Act or any other provision of federal law; or

4. "conflicts with the intent of this Act" to allow affiliations permitted by this Act or other federal law.

## VII. PRESERVATION OF STATE SECURITIES, CORPORATE GOVERNANCE, AND ANTITRUST LAWS

An across-the-board exemption from Section 104 preemption is provided for certain state laws to avoid unintended consequences.

### A. Jurisdiction of State Securities Regulators to Enforce State Antifraud Laws

Section 104(f)(1) provides that subsections 104(c) and (d) shall not be construed to affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any state, under the laws of such state, to investigate and bring enforcement actions, consistent with Section 18(c) of the Securities Act of 1933, with respect to fraud or deceit or unlawful conduct by any person in connection with securities or securities transactions. State laws

governing registration of broker-dealers, investment advisers, or associated persons (that are consistent with the federal securities laws) are also preserved.

### B. Corporate Governance and Antitrust Laws

In response to the concern that provisions of state corporate or antitrust laws might be found to "prevent or restrict" affiliations among financial firms, Section 104 includes express protection for such state laws. Section 104(f)(2) states that Section 104(c) and (d) are not to be construed to affect state laws, regulations, orders, interpretations or other actions of general applicability relating to the governance of corporations, partnerships, limited liability companies or other business associations incorporated or formed under the state's laws or domiciled in that state provided they are "not inconsistent with the purposes of this Act" to permit financial affiliations.

This provision also preserves the applicability of the antitrust laws of any state or any state law that is similar to antitrust laws. Section 104(g)(2) defines "antitrust laws" to have the same meaning as in Section 1(a) of the Clayton Act (15 U.S.C. § 12), and Section 5 of the Federal Trade Commission Act (15 U.S.C. § 45) to the extent that the latter relates to unfair methods of competition.

## VIII. EXPEDITED DISPUTE RESOLUTION

The Section 104 provisions are free-standing and do not amend any existing federal banking or other statute. In addition, no administrative agency is given regulatory authority to administer or interpret Section 104. This structure means that in the first instance state insurance regulators and the federal banking agencies each might interpret Section 104, but it also means that the courts will be called upon to provide more definitive interpretation. The expedited dispute resolution procedure of Section 304 can be used by any state or federal regulator that questions a preemption determination under Section 104. However, nothing in Section 304 indicates that any of its provisions apply to private party litigation in which Section 104 preemption issues may rise.

### A. Appellate Review

In Section 304, the Act addresses the concern that *Chevron* deference unfairly advantaged the OCC and banking groups in litigation over determinations by the OCC that national banks could engage in insurance sales activities despite a state law that would appear to restrict such activity. Section 304 provides expedited and equalized judicial review by a U.S. Court of Appeals of disputes between a federal banking regulator and a state insurance regulator regarding insurance issues, including whether federal law preempts a state insurance provision. Such disputes may involve the Federal Reserve Board, OCC, Office of Thrift Supervision or Federal Deposit Insurance Corporation with respect to any insured bank or thrift. In such a case, the court must render its judgment within 60 days of the filing of the petition for review, unless the parties agree to an extension. Supreme Court review of such a decision shall be sought "as soon as practicable" after the Appeals Court judgment is issued.

### B. Deference

This section also specifies a standard of judicial review for any case filed under this provision. It states that the court shall make its decision "based on its review on the merits of all questions presented under State and Federal law, including the nature of the product or activity and the history and purpose of its regulation under State and federal law, without unequal deference." The deference issue was highly controversial and symbolic among banking and insurance organizations and this compromise was important to the legislative process. However, the Act generally implements a functional regulation approach to banking and insurance activities, reaffirming the McCarran-Ferguson policy committing regulation of the "business of insurance" to the states. Accordingly, state action within the McCarran delegation and federal banking agency interpretations of banking laws should each be given weight by federal courts under any standard of review. It thus remains to be seen whether the inclusion of the Section 304 "without unequal deference" standard will prove to have been more important for its symbolism than its practical effect. Moreover, because Section 304 by its terms applies only to cases brought by a regulator, it does not address the standard of review a court would apply in a case brought by private litigants in which a regulatory determination is at issue.

### C. Statute of Limitations

Consistent with expedited review and a desire for resolution of issues, the Act contains a relatively short statute of limitations provision. No action under this provision may be filed after the later of the end of (i) the 12-month period dating from the first public notice of the final form of the order, ruling, or determination, or (ii) six months from the effective date of such regulatory action.

# APPENDIX – H
# FINANCIAL ACTIVITIES

A FHC may engage in nine listed activities that are "financial in nature" plus any additional activity the FRB determines is "financial in nature or incidental to such financial activity" or that is "complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally." (12 U.S.C. §1843(k)(1) and (4); 12 C.F.R. §225.86). The nine listed activities are summarized as follows, and in two instances expanded further below as indicated:

- Lending and related activities (12 U.S.C. §1843(k)(4)(A));

- Insurance activities, as principal, agent, or broker (12 U.S.C. §1843(k)(4)(B));

- Financial, investment, or economic advisory services, including as an investment company (12 U.S.C. §1843(k)(4)(C));

- Issuing or selling instruments representing a pool of assets (12 U.S.C. §1843(k)(4)(D));

- Underwriting, dealing in, or making a market in securities (12 U.S.C. §1843(k)(4)(E));

- "Closely related to banking" activities (12 U.S.C. §1843(k)(4)(F))
  **(Detailed description of "closely related to banking" activities appears in Part A below)**;

- In the United States, engaging in BHC activities that are permissible outside the United States and are usual in connection with banking or other financial operations abroad (12 U.S.C. §1843(k)(4)(G))
  **(Detailed description of "BHC foreign" activities appears in Part B below)**;

- Merchant banking activities (12 U.S.C. §1843(k)(4)(H)); and

- Owning non-financial firms through insurance or securities affiliates if not directly involved in the management of these firms (12 U.S.C. §1843(k)(4)(I)).

## EXPANDED DESCRIPTIONS OF "CLOSELY RELATED TO BANKING" AND "BHC FOREIGN" ACTIVITIES


A. "Closely Related To Banking" Activities ........ H-2
   1. "By Regulation" ........ H-2
   2. "By Order" ........ H-6
B. "BHC Foreign" Activities ........ H-7

## EXPANDED DESCRIPTIONS OF "CLOSELY RELATED TO BANKING" AND "BHC FOREIGN" ACTIVITIES

**A. "Closely Related To Banking" Activities.** Specifically, 12 U.S.C. §1843(k)(4)(F) identifies as financial in nature "any activity that the [FRB] has determined, by order or regulation that is in effect on [November 12, 1999], to be so closely related to banking or managing or controlling banks as to be a proper incident thereto (subject to the same terms and conditions contained in such order or regulation, unless modified by the [FRB])."

This category is very broad, in essence incorporating most of the nonbanking activities permitted to a BHC. Many of these activities are also subsumed in other listed financial activities, creating some overlap and duplication. However, the category is important in a number of contexts and is expanded here.

Part A.1 below details closely related to banking activities "by regulation" and Part A.2 below details closely related to banking activities "by order."

**1. "By Regulation."** Any activity that the FRB has previously determined, by regulation in effect on November 12, 1999, to be so closely related to banking as to be a proper incident thereto. These activities are listed in 12 CFR §225.28(b). The numbered list below corresponds with the numbered paragraphs in §225.28(b):

(1) Extending credit and servicing loans: Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters or credit, and accepting drafts) for the company's account or the account of others

(2) Activities related to extending credit:

- (a) Appraising
  - (1) Real estate appraising
  - (2) Personal property appraising
- (b) Arranging commercial real estate equity financing
- (c) Check-guaranty services
- (d) Collection agency services
- (e) Credit bureau services
- (f) Asset management servicing and collection activities
- (g) Acquiring debt in default
- (h) Real estate settlement servicing

(3) Leasing personal or real property or acting as agent, broker, or adviser in leasing such property

(4) Operating nonbank depository institutions:

(a) Owning, controlling, or operating an industrial bank, Morris Plan bank, or industrial loan company so long as the institution is not a bank
(b) Owning, controlling, or operating a savings association, if the savings association engages in deposit-taking activities, lending, and other activities that are permissible for bank holding companies

(5) Trust company functions or activities

(6) Financial and investment advisory activities: acting as an investment adviser or financial adviser to any person, including (without limiting these activities in any way)—

(a) Serving as an investment adviser to an investment company registered under the Investment Company Act of 1940, including sponsoring, organizing, and managing a closed-end investment company
(b) Furnishing general economic information and advice, general economic statistical forecasting services, and industry studies
(c) Providing advice in connection with mergers, acquisitions, divestitures, investments, joint ventures, leveraged buyouts, reorganizations, recapitalizations, capital structurings, financing transactions, and similar transactions, and conducting financial feasibility studies
(d) Providing information, statistical forecasting, and advice with respect to any transactions in foreign exchange, swaps and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments, *e.g.*:
- Financial futures and options on futures
- Providing financial advice to:
  - state and local governments and
  - foreign governments; including foreign municipalities and agencies of foreign governments, such as with respect to the issuance of their securities
- Inclusion of any investment or financial advisory activity without restriction
- Discretionary investment advice to be provided to any person (includes investment advice regarding derivative transactions to institutional or retail customers as an investment, commodity trading, or other adviser) regarding contracts related to financial or nonfinancial assets (such advice is no longer restricted to institutional customers)
- Financial and investment advice (or any permissible nonbanking activity) can be provided in any combination of permissible nonbanking activities listed in Part A.1 of this Appendix E.

(e) Providing educational courses and instructional materials to consumers on individual financial management matters
(f) Providing tax-planning and tax-preparation services

(7) Agency transactional services for customer investments (principal positions)

(a) Securities brokerage services (including securities clearing and/or securities execution services on an exchange) for the account of customers and does not include securities underwriting or dealing
(1) Securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or
(2) In combination with advisory services and incidental activities (including related securities credit activities and custodial services)
(b) Riskless-principal transactions
(c) Private-placement services
(d) Futures commission merchant activities (a nonbanking subsidiary may act as an FCM with respect to any exchange-traded futures contract and options on a futures contract based on a financial or nonfinancial commodity)
(e) Other transactional services such as providing to customers as agent transactional services with respect to the following:
(1) Swaps and similar transactions
(2) Investment transactions as principal
(3) Transactions permissible for a state member bank
(4) Any other transaction involving a forward contract, an option, futures an option on a future or a similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange

(8) Investment transactions as principal

(a) Underwriting and dealing in government obligations and money market instruments
(b) Investing and trading activities. Engaging as principal in the following:
(1) Foreign exchange
(2) Forward contracts, options, futures, options on futures, swaps, and similar contracts, based on any rate, price, financial asset (such as gold, silver, platinum, palladium, copper, or any other metal approved by the Board) or any other nonfinancial asset of group of assets, other than a bank-ineligible security
(3) Forward contract, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate or price, or the value of any financial asset, nonfinancial asset, or group of assets, other than a bank-ineligible security, if the contract requires cash settlement

(9) Management consulting and counseling activities

(a) Providing management consulting advice on any matter (financial, economic, accounting, or audit) to any other company, including unaffiliated banks (depository institutions), nonbank depository institutions, other unaffiliated depository institutions, or other companies

(b) Employee benefits consulting services
(c) Career counseling services

(10) Support services

(a) Courier services
(b) Printing and selling MICR-encoded checks and related documents

(11) Insurance agency and underwriting

(a) Credit insurance: acting as principal, agent, or broker for insurance (including home mortgage redemption insurance), including acting as insurance agent or broker primarily in connection with credit extensions, and underwriting credit life and credit accident and health insurance related to an extension of credit
(b) Finance company subsidiary: insurance agent or broker for extension or credit by finance company subsidiary
(c) Insurance agency activities in small towns
(d) Insurance agency activities conducted on May 1, 1982
(e) Supervision of retail insurance agents
(f) Insurance agency activities by small bank holding companies
(g) Insurance agency activities conducted before 1971

(12) Community development

(a) Financing and investment in community development activities
(b) Advisory and related services designed to promote community welfare

(13) Issuance and sale of payment instruments

(a) Issuance and sale of retail money orders
(b) Sale of savings bonds
(c) Issuance and sale of traveler's checks

(14) Data processing

(a) Providing data processing and data transmission services; facilities (including data processing and data transmission hardware, software documentation, or operating personnel); databases; advice; and access to services, facilities, or databases by any technological means. This category includes providing bookkeeping services, and providing data processing and transmission advice to anyone on processing and transmitting banking, financial, and economic data
(b) Conducting data processing and data transmission activities that are not described in (a) that are *not* financial, banking, or economic in nature

2. **"By Order."** Any activity that the FRB has determined by order in effect on November 12, 1999, to be so closely related to banking as to be a proper incident thereto. These activities include:

    a. Operating "a pool-reserve plan" for the pooling of loss reserves of banks with respect to loans to small businesses (1971 Fed. Res. Bull. 1037).

    b. Operating an article XII New York investment company (1977 Fed. Res. Bull. 595).

    c. Underwriting and dealing in commercial paper to a limited extent (1987 Fed. Res. Bull. 367).

    d. Underwriting and dealing in, to a limited extent, municipal revenue bonds, mortgage-related securities, and commercial paper (1987 Fed. Res. Bull. 473).

    e. Underwriting and dealing in, to a limited extent, municipal revenue bonds, mortgage-related securities, consumer receivable-related securities, and commercial paper (1987 Fed. Res. Bull. 731).

    f. Issuing and selling mortgage-related securities backed by the guarantees of the Government National Mortgage Association (1988 Fed. Res. Bull. 573).

    g. Engaging in title insurance agency activities (approved under exemption G of the Garn-St Germain Depository Institutions Act of 1982) (1989 Fed. Res. Bull. 31).

    h. Underwriting and dealing in, to a limited extent, corporate debt and equity securities (1989 Fed. Res. Bull. 192, 196-197).

    i. Acting as a sales-tax agent (1990 Fed. Res. Bull. 860).

    j. Providing real estate settlement activities through a permissible title insurance agency (1990 Fed. Res. Bull. 1058) (generally, only for companies already engaged in insurance agency activities prior to 1971).

    k. Providing administrative and certain other services to mutual funds (1993 Fed. Res. Bull. 626).

    l. Acting as a dealer-manager in connection with cash-tender and exchange-offer transactions (1994 Fed. Res. Bull. 49).

    m. Privately placing limited partnership interests (1994 Fed. Res. Bull. 736).

    n. Engaging in real estate title abstracting (1995 Fed. Res. Bull. 805).

    o. Providing employment histories to third parties (1995 Fed. Res. Bull. 732).

p. Underwriting "private ownership" industrial development bonds by a section 20 company (1995 Fed. Res. Bull. 1116).

q. Servicing as a commodity pool operator of investment funds engaged in purchasing and selling futures and options on futures on certain financial and nonfinancial commodities (1996 Fed. Res. Bull. 569).

r. Development of broader marketing plans and advertising, sales literature, and marketing materials for mutual funds (1997 Fed. Res. Bull. 679).

s. Sale of government services involving postage stamps and postage-paid envelopes, public transportation tickets and tokens, vehicle registration services (including the sale and distribution of license plates and license tags for motor vehicles), and notary public services (1998 Fed. Res. Bull. 481).

t. Operating a securities exchange (2000 Fed. Res. Bull. 61).

u. Acting as a certification authority for digital signatures (2000 Fed. Res. Bull. 56).

**B. "BHC Foreign" Activities.** Specifically, 12 U.S.C. §1843(k)(4)(G) identifies as financial in nature, and permits a FHC to conduct in the United States, "any activity that (i) a [BHC] may engage in outside of the United States; and (ii) the [FRB] has determined, under regulations prescribed or interpretations issued pursuant to [12 U.S.C. §1843(c)(13) as in effect on November 11, 1999] to be usual in connection with the transaction of banking or other financial operations abroad."

Some overlap and duplication exists between these activities and other financial activities identified in GLBA. These activities are listed in 12 CFR §211.5(d). The numbered list below corresponds with the numbered paragraphs in §211.5(d):

(1) Providing management consulting services, including to any person with respect to nonfinancial matters, so long as the management consulting services are advisory and do not allow the financial holding company to control the person to which the services are provided;

(2) Operating a travel agency in connection with financial services offered by the financial holding company; and

(3) Organizing, sponsoring, and managing a mutual fund so long as the fund does not exercise managerial control over the entities in which the fund invests and the financial holding company reduces its ownership in the fund, if any, to less than 25 percent of the equity of the fund within one year of sponsoring the fund or additional period if the Federal Reserve Board permits.