

**BANK CAPITAL MARKETS ASSOCIATION**

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EXECUTIVE DIRECTOR

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Mr. Roger B. Porter  
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Executive Office of the President  
Washington, DC 20500

Dear Mr. Porter:

Two challenging tasks face policymakers who recognize the pressing need for a legal and regulatory restructuring of the American financial services system. One goal is to create competitive franchises for all providers that increase consumer benefits in terms of the availability and price of financial services. The second goal is to provide for systemic safety and soundness and protect the taxpayer from underwriting the operating risks of our financial services delivery system.

Some have argued that the efficiency benefits from deregulation must be balanced against the need to insure safety. The BCMA believes that these two goals are not in conflict and that both can be achieved through a well-designed program of reform.

The attached paper describes BCMA's vision of how we can make our financial system safer and more efficient. Specifically, it calls for the creation of a truly Competitive Bank in a restructured financial and regulatory system.

This paper does not attempt to address the detailed organizational aspects of regulatory restructuring. However, it does point to the importance of two key regulatory concepts that are critical to the achievement of both efficiency and safety and soundness goals. These are functional regulation and early intervention by the banking regulators as the linchpin in dramatically lowering the financial exposure of the deposit insurance funds.

BCMA feels that a decline in the competitiveness of the U.S. banks will increase the risk borne by insurance funds and the U.S. Treasury. If banks are losing markets to less regulated competitors, they will be unable to attract the capital needed to help insulate the funds from losses. The potential for loss will also increase to the extent banks are left with the option of higher risk loans while the more profitable business moves to the securities market.

Other countries have responded to the new market realities by authorizing their banks to offer securities, insurance and other financial services without restrictive firewalls. Unless the U.S. can permit its banks to compete, foreign banks will continue to increase their share of the banking business in international as well as domestic U.S. banking markets.

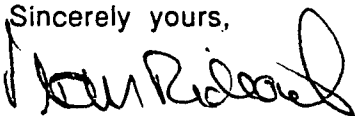
Given these conditions, the BCMA is proposing a six-point program to restore the competitiveness and enhance the safety of the American banking system. The key points in the program are:

1. **Diversified Financial Services.** Expanded products and services offered by banks will lead to better service at lower prices as well as a stronger banking system.
2. **Bank Subsidiaries.** The holding company structure is a needlessly cumbersome method for allowing banks to offer financial services. It is more efficient if banks can offer these services within the bank, or if the needs of functional regulation so require, as subsidiaries of the bank. Subsidiaries actually provide more protection to the deposit insurance funds than do holding company affiliates.
3. **Functional Regulation.** Bank subsidiaries should be made subject to the same degree of regulation by the appropriate state or federal authority as would apply if the company were not owned by a bank.
4. **Minimal Firewalls.** The limited steps the U.S. has taken towards banking reform have been frustrated by excessive firewalls that offset the benefits of offering consolidated financial services. These firewalls have been founded on the erroneous assumption that securities and other financial activities are riskier than traditional banking activities. Ironically, many of these firewalls actually increase risk by discouraging diversification and central coordination. Accordingly, the BCMA recommends that firewalls be limited to those contained in Sections 23A and 23B of the Federal Reserve Act.
5. **Early Intervention.** The safety of the banking system can be further increased through a tough program of early intervention that would halt the growth of capital deficient banks and lead to their closure or sale if the deficiencies cannot be remedied. These regulatory steps should be supplemented with a formal renunciation of the "too big to fail" doctrine in order to bring more market discipline to the banking system.
6. **Two-Way Street.** Just as banks need broader financial powers to be competitive, other financial companies need to combine their financial services with banking products. Accordingly, legal restrictions should be removed to permit any company engaged in financial services to own and operate a bank.

The program for the Competitive Bank recommended by the BCMA will allow all financial companies to provide better service to their customers. The end result will be a healthier and stronger financial system and a more competitive U.S. economy.

Your comments on our proposal are most welcomed.

Sincerely yours,



Thomas P. Rideout

Attachment