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U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON BANKING AND FINANCIAL SERVICES

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March 26, 1997

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The Honorable Robert Rubin
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. ~~Secretary~~ ^{Bob -}:

In the wake of our telephone conversation last night, I thought it might be appropriate to outline where we are on bank modernization legislation.

In the last Congress we basically had grudging support and/or acquiescence from major banks and securities companies on a legislative approach. From my perspective, much of this was undercut by actions of the Department of the Treasury. It appeared from the perspective of the Committee that Treasury wanted to shape things somewhat differently and exert greater control over the process, perhaps with a Democratic Congress. I don't want to belabor this judgment, but I do want to stress that with delay the three affected industry groups have attempted to raise the ante.

The larger banks have generally supported the framework of the bill I introduced this Congress (H.R. 10) which allows for the reintegration of commercial and investment banking and affiliation with insurance companies, but want some nuanced changes. In the last Congress, the securities industry (including Solomon and Goldman) had grudgingly signed off on this basic approach based upon the addition of the wholesale bank ("Woofie") option. Merrill tells me it supports modernization, although it reserves judgment on specific provisions.

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As you know, wholesale banks would have access to the payments system -- a right much wanted by the securities industry and much objected to by the banking industry -- with the additional flexibility of devoting up to 7½ percent of the risk weighted assets of the parent Investment Bank Holding Company to nonconforming commercial investments. The 7½ percent figure was not plucked from thin air; it was based on extensive consultation with affected parties.

The integration of commerce and banking laid on the table principally by large securities companies and one element of the insurance industry is related to, but fundamentally separate from, financial services modernization. I am taking the liberty of enclosing three recent statements on the subject and would particularly draw your attention to the self-explanatory charts which are an addendum to my March 19 speech.

While a group of major banks initially favored mixing commerce and banking, today out of self-interest most have backed off. The vast majority of banks in America (principally smaller banks) want no commerce and banking. Larger banks continue to favor some mixing of commerce and banking, but largely as a one-way rather than a two-way street -- i.e., the smaller the basket, the less vulnerability major banks have to takeover. The statements I have enclosed highlight some of the extraordinary new ramifications for offensive and defensive strategies of various industry groups if basket approaches are adopted as well as the implications for extending the bank safety net and for tilting the economy geographically and structurally.

In terms of legislative strategy, it will be my hope in Committee to repulse full-blown commerce and banking and to keep any breach in this fragile wall to a minimum. If any commerce and banking is approved in the Committee -- the one place in Congress where it has the most potential support -- I could be expected to support approaches on the House floor to restore the separation of commerce and banking.

As for the Senate, I recognize your dismay at the half-dozen Senators who have written you on the subject, but given Senate protocol, stark objections to almost anything by key Senators has

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to be taken seriously, and in this case it can be presumed that if votes are taken, these Senators may not be a minority.

I recognize how strongly some at Treasury feel about certain aspects of this issue, but two points deserve emphasizing: (1) the approach on the table of full integration of banking, securities and insurance represents extraordinarily significant reform with enormously positive implications for American financial services competitiveness in the world; and (2) the prospect of passing critical bank modernization legislation is severely jeopardized by the over-reaching of a few who favor more radical changes.

It is my view that as a public issue there is no particular opposition to commerce and banking until the notion appears to be close to approval, at which point it becomes a "cause celebre" for groups as diverse as the independent bankers, independent insurance agents, small business community, organized labor, every agriculture group and, potentially, many elements of the business community who will see how neutral credit providers can become competitors and how the economic landscape could be fundamentally changed to the advantage of the few.

As you know, H.R. 10 moves beyond where we were last year by incorporating an override of state anti-affiliation statutes and, out of deference to the Comptroller of the Currency, by enshrining in statute the ability of national banks to offer expanded services through operating subsidiaries.

Commerce and banking aside, the principal issue yet to be resolved relates to insurance. The insurance industry has generally accepted that bank modernization is coming, but its bottom line is that state regulation of insurance be maintained. In this regard, a key outstanding issue relates to the banking industry's desire that the Barnett standard, as incorporated in H.R. 10 (state regulation cannot "prevent or significantly interfere with" national bank insurance sales), be strengthened to include an additional tightening, non-discriminating precept, a prohibition against state regulation which discriminates against banks vis-a-vis unaffiliated insurance providers. The banking industry position is in contrast to the insurance agents'

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desire to incorporate greater "consumer" protections in federal law.

The significance of these contrasting views relates to the assumption that at the state level there will be a massive insurance/banking confrontation with insurance agents attempting to proscribe bank insurance activities and the banks attempting to defend their discretion. It is understood that this is one of the issues on which Treasury is likely to express an opinion when it presents its recommendations to Congress.

As a final matter, based on our conversation and recently released OCC memos to the President, it appears that you have been advised that H.R. 10 somehow jeopardizes or undermines CRA. This is not the case. There are no cutbacks of CRA. The OCC view is premised on the dubious argument that if activities are conducted directly in an operating subsidiary of a bank -- rather than in a holding company affiliate -- the profits may be upstreamed to the bank, thus making more money available for CRA activities. The self-serving nature of this argument is patently clear. In fact, the OCC has proposed no requirement that these profits be directed toward CRA, nor is there any current requirement.

Nevertheless, I again reemphasize that H.R. 10 includes a provision, which is strongly opposed by the Federal Reserve, authorizing new financial services activities to be conducted in an operating subsidiary of a bank with the exception of merchant banking, insurance underwriting, and real estate investments, which competitive industries, for good reason, including safety and soundness concerns, insist be conducted in a separate affiliate. As for Woofies, it could be expected that an amendment would be offered to apply CRA to them. The securities industry would strongly object, but as Chairman I would have an open mind on the issue. Here, again, Treasury's views on the merits of such an approach would be appreciated, with the understanding that at issue is not whether CRA will be cut back, but whether it will be expanded.

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In closing, per our conversation, we are tentatively reserving
April 23 and April 24 for your presentation to the Committee.

Sincerely,



JAMES A. LEACH
Chairman

JAL:tcag

Attachments: Statement of March 19, 1997
 Statement of March 22, 1997
 Statement of March 26, 1997