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Strategic Planning for Financial Institutions in a New Legal and Economic Environment

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PANEL I: STRATEGIC PLANNING FOR
FINANCIAL INSTITUTIONS IN A NEW LEGAL
AND ECONOMIC ENVIRONMENT

Moderator
Carl Felsenfeld^{*}

Panelists
William T. Lifland^{**}
Ernest T. Patrikis^{***}
Frank Scifo^{****}
William J. Sweet, Jr.^{*****}

PROFESSOR FELSENFELD: My name is Carl Felsenfeld. I am a professor here at Fordham Law School.

We will now move into our next aspect of the program, which is a panel. We will talk about the perspectives on the future business planning and strategies for the future of Gramm-Leach-Bliley¹ in practice.

I will assume that we all have a certain fundamental knowledge of what Gramm-Leach-Bliley² is about. Congressman Leach brought us into the fold, if we weren't there. Essentially, it creates some coordination among banking law, insurance law, and securities law.

We should not forget, along the way other kinds of institutions and other kinds of financial activities that might pop up and be part

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1. See, e.g., Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

2. *Id.*

of this mix. One is a little diffident about saying what they are. It occurs to me, however, that we do have in the United States entities such as finance companies, small-loan companies and other types of financial institutions that, depending upon the shape of the future, might turn out to be dominant players. I will introduce the panelists as they come up.

Our first speaker is Ernie Patrikis. I have known Ernie forever. In banking law circles in New York, he is one of the best-known banking lawyers around. He had been General Counsel of the Federal Reserve Bank of New York. He ended his career at the Federal Reserve Bank in 1998 as First Vice President, which is the number two position at the Federal Reserve Bank of New York. He went on from there to the American International Group (AIG), which is one of the largest financial companies in the world. He is now Senior Vice President and General Counsel of the AIG holding company.

Ernie always has a somewhat different and original view on what is going on. I am very interested in hearing what you have to say this morning, Ernie.

MR. PATRIKIS: Thank you, Carl.

I thought I would start off by comparing the insurance and banking industries a bit in terms of my perspective of the two industries. I characterize them both as being subject to a high level of competition. What that means is there are too many banks and there are too many insurance companies. We now have, approximately, 9,000 banks and 6,000 insurance companies in the United States.³

What does that mean? It means there is too much capital chasing too little good business. So in banking, it means the spreads on loans are probably not adequate to cover the risk. In insurance, it means the premiums charged in the general insurance business are not adequate to cover the risk. Over the long term, that means either failure or merger. That is nature's way. That is very healthy.

There are two types of mergers when you do antitrust analysis, or rather two types of ways of looking at mergers in antitrust

3. U.S. Census Bureau, *STATISTICAL ABSTRACT OF THE UNITED STATES: NATIONAL DATA BOOK 520* (119th ed. 1999).

analysis. One is geographic. That is, the area that the business is in, in terms of looking for where the competition is. The other type is in terms of the product market.

So I ask myself, "If a banking organization buys an insurance company or an insurance organization buys a bank, is there reduction in capacity?" If you accept my view that we have too much capacity in banking and in insurance, we have not reduced it at all. We probably do not have a whole lot of synergies. We do not have many economies in terms of the back office. The world will stay on its course, which means that if nature has its way we will see either failures or more mergers down the road.

On the securities industry side, I think we do see something unique. There are the "bulge bracket"⁴ firms, and it is very, very hard to break into that group. Firms like J.P. Morgan are really trying, and are perhaps almost there. We see a number of foreign banks really retreating. Union Bank of Switzerland tried retreating, it said, "Well, we can't really make it in New York. We are going to focus on our business in London." I think in the securities industry, while there are many smaller firms, in terms of the major players, it is a fairly small group.

But in banking it has started when we have transactions like Manufacturers Hanover coming into Chemical Bank⁵ and Chase Manhattan Bank coming into Chemical Bank,⁶ so that we now have the "new" Chase. That takes capacity out when we have those kinds of in-market mergers.

In the insurance industry, what we see is a little different. Firms will exit lines of business. That does not happen in banking. So an insurance company might bid on a whole line of business of

4. See *J.P. Morgan's Uncertain Future*, *ECONOMIST*, February 14, 1998, at 71 (characterizing "'bulge-bracket' [firms as] a small group of investment banks — made up of Merrill Lynch, Goldman Sachs and Morgan Stanley Dean Witter, Discover — that earn much bigger profits than [other investment banks]").

5. See Michael Quint, *Big Bank Merger to Join Chemical, Manufacturers*, *N.Y. TIMES*, July 16, 1991, at A1 (reporting on the merger between Chemical Bank and Manufacturers Hanover).

6. See Saul Hansell, *Banking's New Giant: The Deal; Chase and Chemical Agree to Merge in \$10 Billion Deal Creating Largest U.S. Bank*, *N.Y. TIMES*, Aug. 29, 1995, at A1 (reporting on the merger between Chemical Banking Corporation and Chase Manhattan Corporation).

another firm that has just said that it cannot make it in that business and that it will shut down that line. In banking, there are mergers and acquisitions. Banking firms do not, however, typically sell a whole line of business to their competitors.

Banks deliver their products pretty directly. Branch banking is still the way to do business. The e-commerce banks or the dot-commerce banks are not very successful. If they do succeed, it is only by paying up on rates; however, that is not going to be sufficient in the long run.

The tellers, for the most part, really are not a sophisticated sales force. In insurance, however, there is a professional cadre comprised of brokers and insurance agents, who substantially outrank the tellers in sophistication.

We now see a change. I was on jury duty recently here in New York, and there was a young woman on the jury employed by a bank. She asked the judge to excuse her. He said, "Why? Your employer is paying you." What the judge did not know, however, is that she made a commission if she sold products across her window. That is a change in commercial banking.

I look at the Internet and think it is not banking and insurance nirvana — at least not yet. The reason why is that the products being sold over the Internet are commodities. They are commodity-like products. Take auto insurance for example. Let's say your auto policy is a six-month policy. If you surf the Internet regularly, you look for the lowest rate once every six months. The only thing you look at is rate. Now, some will disagree with me and try to say, "No, there are unique aspects to the policies. There are all different parts to the policies that are very meaningful." I don't believe that. Well, what does that mean? If someone keeps moving on every six months, it means companies are going to have trouble covering their fixed costs when they are dealing in a commodity like auto insurance.

And then, there are other products, like annuities. These products are sold; they are not bought. Someone surfing the Internet is not going to buy an annuity. There has to be a salesperson. There really needs to be a sales force, and that part of it is different.

Investment banks are going through the same problem as insurance companies regarding the impact of the Internet. I don't

know if it was Allstate that said it would share with its agents some of the income that was brought in by the Internet because of its huge agent force.⁷ If you look at Merrill Lynch, it is experiencing the same problem. What do you do with all your brokers when you have the Internet? The struggles that must be going on within Merrill Lynch in terms of this problem are fairly significant.

One of the supposedly motivating forces for the legislation⁸ is the need for a level playing field. I just do not see it. A guarantee and surety, a standby letter of credit, and a credit derivative, all serve the same purpose. That does not mean that they should be supervised or regulated in the same manner or treated the same way. The reasons for this may be in terms of capital, tax, accounting, the very nature of the risk (i.e., is it a short-term risk or is it a long-term risk?) and so on.

Functional supervision, which is the usual description, just doesn't do it for me. I don't know what it means. In the United States, there was a view that if a bank did it, then someone should regulate it - other than a bank - or supervise it - other than a bank supervisor - or that it needed to be pushed out.

I liken this view to a situation that my predecessor, the First Vice President of the Federal Reserve Bank of New York, related to me. His wife taught a very sophisticated math course to children in elementary school. She was being evaluated. The evaluators came around and told her she had to go back to teaching the other way. She said, "Why?" They said, "Well, we can't measure you." There is still some of that going on.

There are differences between supervision and regulation. When one takes a look at the considerations involved, such as regulations/rules, on/off, the percentage of capital versus the percentage of surplus, it becomes clear that supervision is qualitative. It is judgmental and it relies on an examining force. Securities law has much more regulation to it. Banking has much

7. See Joseph B. Treaster, *Allstate Poised to Sell Insurance Over Telephone and Internet*, N.Y. Times, November 11, 1999, at C6 (mentioning that "Allstate . . . has . . . promis[ed] to pay local agents a commission of 2 percent to 3.5 percent for Internet and telephone sales of auto policies to customers in the agents' territories").

8. Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

more supervision to it. Insurance has everything to it.

If you do not know what insurance supervision and regulation are like, here's a useful analogy. Let's say there's a lawyer at Chase, and someone goes and talks to that lawyer and says, "Please draft for us a consumer loan agreement that we can use in the fifty states." The lawyer drafts the loan agreement. Someone then takes that agreement plus the interest rate and files it with fifty state bank supervisors. Each one then comes back with comments. Sooner or later, that agreement will be approved by all fifty states. That's insurance supervision and regulation, and not federal regulation or federal supervision, but state supervision.

I ask myself the question, "Why would an insurance company want to buy a commercial bank?" As I stated earlier, I don't think either of these industries are going to give returns that people are that happy with. Commercial banks bring with them commercial lending and relationships. There was an article in *The New York Times* maybe a month or two ago saying that Citigroup finally found a synergy that they could brag about⁹, apparently one so great that it was worthy of mention by *The New York Times*.

A lot of people say the synergies aren't there. John Reed¹⁰ gave a talk at Standard & Poor's Financial Services Program three weeks ago, where I believe he said that Citigroup has yet to prove that these synergies are viable, or that Citigroup will really work.¹¹ We haven't seen it. I think there is a lot more talk and fantasy on that issue than we have seen to date.

What is an insurance company? As I look at it, it consists of two different things. On the one side are these liabilities — insurance policies consisting of life, property and casualty. On the other side is a huge investment machine. That's the part people

9. See Joseph Kahn, *A New Financial Era: The Impact; Financial Services Industry Faces a New World*, N.Y. TIMES, October 23, 1999, at C1 (noting that "[Citigroup stated] that brokers working for Citigroup's Salomon Smith Barney have sold \$420 million in Citibank mortgages to their clients").

10. Former co-chairman and co-chief executive of Citigroup Inc.

11. See Dan Lonkevich, NAT'L UNDERWRITER PROP. & CASUALTY-RISK & BENEFITS MGMT., March 20, 2000, at 5 (quoting Mr. Reed, at Standard & Poor's annual conference on Banks and Insurers, as saying "[w]e're not sure [that our profitability] is sustainable I think the jury is still out [I]t's not a foregone conclusion [that the merger will work out well].").

don't see. That investment machine then gets leverage, taking us into the equivalent of private banking, hedge funds and non-leveraged hedge funds. As far as that aspect of the business goes, at AIG we do things like an India fund, or an Africa development fund, or a Greenfield fund in the United States.

In dealing with entities, as Hank Greenberg¹² has reminded me from time to time, you really have to work hard to kill an insurance company. A bank can die rather quickly if it has incompetent management, but an insurance company with incompetent management can still survive thirty years into the future. That is not great for competition because you are going to be under-priced by a competitor who is going down, and that is not a happy state of affairs.

I have just two more points I want to make. One of them is that Gramm-Leach,¹³ first, is bank-centric. It is not a financial services legislation, but is rather a bank-centric legislation. There is not much in Gramm-Leach¹⁴ about insurance, except to permit it. Also, there's not much in there about the securities aspect.

There is one issue, however, I would like to address. It's called source of strength. The bank holding company has a responsibility to be a source of strength to its subsidiary bank. By legislation, it is limited. What that means is that if the bank needs capital, there is a limited responsibility for the holding company to inject capital down to the bank.¹⁵

In this legislation,¹⁶ the Federal Reserve is the overarching supervisor — the umbrella supervisor. There was a fear that the Federal Reserve would take money out of the insurance subsidiary or the broker-dealer subsidiary and upstream it or downstream it into the bank. The legislation says, "No, Federal Reserve, you can't do that without the approval of the relevant supervisors."¹⁷

12. Maurice R. Greenberg, Chairman and Chief Executive Officer, American International Group.

13. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

14. *Id.*

15. *See id.* § 121.

16. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

17. *Id.*

This legislation is silent on the ability of the Federal Reserve to take capital out of the bank, let's say, and downstream it into the troubled insurance company, from the holding company on. Why? Because it would never occur to a bank supervisor to take a penny out.

Now, I ask myself the question, if the insurance company is in trouble and insurance has guaranteed funds. These guaranteed funds are a new concept; they are not as old as the Federal Deposit Insurance Corporation ("FDIC"). They came out of the trouble in the 1980s and early 1990s. They are unfunded (though in New York there is partial funding) insurance funds. So you can have the head of [inaudible] going to see Federal Reserve Chairman Greenspan and saying, "You have a bank that is well-capitalized. That's why there's a financial holding company. Please take capital out of the bank and upstream it or downstream it into the insurance company."

Will that happen? I look at it another way and say that there ought to be a source of strength requirement with respect to the holding company and the bank. To me, this is a moral question. If you take out dividends and you take tax benefits, you should have to give when there is a need to give. If we truly are going to see this as a financial services legislation, and not just a bank-centric legislation, there should be a source of strength requirement.

The other aspect, the final one I want to raise, is that of a federal charter.¹⁸ I think we do need a federal charter. The banking industry is going to apply a lot of pressure. If people like myself — people coming from the banking side — go to insurance and see these fifty state bank supervisors, it will be extremely difficult to get products approved and rates changed. The resulting frustration will lead one to say, "Let's deal with this another way."

I think it is going to be very, very difficult to see those products that we call personal lines, i.e., life insurance, auto

18. See generally Paul J. Polking & Scott A. Cammarn, *Overview of the Gramm-Leach-Bliley Act*, 4 N.C. BANKING INST. 1 [hereinafter Polking & Cammarn]. See also Michael P. Molloy, *Banking in the Twenty-First Century*, 25 IOWA J. CORP. L. 787, 793 (2000) (explaining that "[t]he GLB generally endorses the principle of functional regulation, positing that similar activities should be regulated by the same regulator," therefore calling for multiple regulating bodies, including both state and federal government charters).

insurance and homeowners insurance, that type of insurance, go to the federal level. Do we want a whole other federal regime dealing with consumer issues?

States' rights, which was a dirty phrase when I was growing up, is not a dirty phrase anymore. There are fifty state insurance supervisors. That is fifty states where there are jobs and where there is income. That is political power. It is not going to be easy to change that.

In our view, the first step in the way it ought to be done — and this, of course, suits us because it is the major thrust of our business — is the general insurance business. It is the nationwide business of selling to large corporations, not to individuals, and being able to do that nationwide through a federal charter. Insurance has form and rate regulations, so, as I said, the insurance form plus the rate have to be filed. There is no need for that. The European Union works without form and rate regulations. An insurance company in one country can do business across borders, either directly or through branches. No form and rate regulations are required.

As for sales practice, we don't need it. To the extent that we are dealing with sophisticated customers, they can protect themselves. We don't need sales practice in any industry, including the securities, futures, and banking industries, for there are sophisticated parties in each. The government should not step in to protect Procter & Gamble against Bankers Trust.¹⁹ Procter & Gamble is a consenting adult.

So, I think the federal charter for insurance will help move us in the direction of leveling the playing field, and I think we will have some fun over the next year working on that.

Thank you.

PROFESSOR FELSENFELD: Thank you, Ernie.

You know, one of the deceptive aspects of having Ernie Patrikis on a program is that, subject to the Boston accent, he

19. See generally Michael S. Bennett & Michael J. Marin, *The Casablanca Paradigm: Regulatory Risk in the Asian Financial Derivative Markets*, 5 STAN. J.L. BUS. & FIN. 1, 2-4 (1999) (describing the losses suffered by Procter & Gamble Co. due to an interest rate swap agreement with Bankers Trust Company, and a subsequent lawsuit against Bankers Trust Company).

speaks in a fairly normal, ordinary, non-provocative way. I just want to take a moment to indicate to you how unusually provocative he can be when he is given the opportunity.

For example, he takes the Gramm-Leach-Bliley Act,²⁰ which is an Act that the press says puts banking and insurance and securities together, and describes it to us as essentially a banking statute. I just sat here and heard that, and I'm not quite sure what to derive from that. I do, however, want to think about it and see where it gets me, Ernie.

In addition, I think he hit on the real problem of all of this – “synergy.” I hope we will be able to address it more closely as we move on through the morning. Is there a synergy among banking, insurance, and securities? Ernie says he is not sure he sees one. The law is designed to create one.

How do we move ahead? How does this shake out? We have a kind of controlled free-enterprise system in the United States, and presumably, the best way will succeed. Again, what do we do with this new opportunity? Our other speakers will have an opportunity to address that and anything else they choose to address.

Our next speaker is Frank Scifo. Frank is the Senior Vice President and the Chief Compliance Officer of both the U.S. Trust Corporation and the United States Trust Company. He has a rich background in the banking industry. He joined U.S. Trust in 1992 and was its Acting General Counsel in 1998. He is Chairman of the Association of the Bar of the City of New York's committee on banking law and has served as Chairman of that committee's State Legislation Committee.

It is with great pleasure, Frank, that I welcome you here. The floor is yours.

MR. SCIFO: Thank you.

I will just start out with the usual disclaimer. My comments here today do not reflect the opinions of my employers, U.S. Trust Corporation and the Charles Schwab Corporation. Nor do they reflect those of the Association of the Bar of the City of New York.

I was sitting here and I was thinking. I originally was a lawyer

20. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

in the New York State Banking Department's legal division. Subsequent to that, I counseled Japanese banks from a private firm. Since then, I have been general counsel or senior counsel in a number of different types of institutions, from a community-sized savings bank to Citigroup, or Citibank at the time, to U.S. Trust presently. So I look at Gramm-Leach-Bliley²¹ and the things that it does more particularly from an insider's point of view. When I say "insider," I don't mean the Beltway; I mean inside the bank and looking at the dynamics that I know go on and seeing how the legislation affects banking. So essentially, my comments are probably bank-centric.

As I go along, I may not sufficiently qualify everything that I say. That is not intended to diminish in any way the complexity of the influences that need to be balanced in both putting together legislation and creating the regulations to support that legislation. The good faith of all the parties in the fray is presumed. But, nonetheless, one needs to have a point of view, especially when representing one's client.

That having been said, when I look at the Gramm-Leach-Bliley Act²² in its totality, what does it do? From the bank regulation point of view, it expedites things. Banks are allowed to get into a lot of different things on a more rapid basis. Notices can be provided after the fact, rather than having to go through an application process.²³ The range of activities is clearly broader.

There are a number of options in how to approach performing the same activity. Particularly, a subsidiary of a national bank could perform something that is very close to what a subsidiary of a financial holding company can do. There may, however, be some arbitrage differences in how the regulators go about things. The other thing that comes to mind is that there are a number of different activities which have yet to be broached that may be

21. *Id.*

22. *Id.*

23. *See id.* at § 103; *see also* Polking and Cammarn, *supra* note 18, at 7 (noting that "[u]nder the Gramm-Leach-Bliley Act, if the proposed new activity is 'financial in nature' . . . a financial holding company must simply provide 30 days' after-the-fact notice to the Federal Reserve Board of the new activities or acquisition").

plausible under the Gramm-Leach-Bliley Act²⁴ if the regulatory agencies that have the interpretative authority are so inclined. So essentially, there is the new circumstance.

What is the new challenge? I think one of the challenges is for bank management not to get confused by the broad array of choices that they have at the present time. This bill really, as Chairman Leach said earlier,²⁵ follows the evolution of the banking industry rather than prescribes how it will proceed. Therefore, in that vein, it is an evolutionary instrument rather than a revolutionary instrument. If viewed in that fashion, management can stay on focus in looking at what it does best and what it would like to do better.

When putting together products, programs and new ventures within a financial institution, timing is always important. You have a mix. The business imperative to do things quickly and profitably always runs into the regulatory construct that it must confront. So you end up now with things that are becoming somewhat more clear.

Basically, management wants to do *X*. The questions initially are: "Is it financial in nature? Is it incidental to a financial activity? Is it complementary to financial activities? What process is entailed in securing an opinion as to either of these three effects?"

At the moment, securing such an opinion is a lengthy process. The regulators have a lot of regulations and interpretations that they need to produce in a short period of time. Talking to people over the phone about this or that may not be possible. Essentially, a rapid report on the lay of the land is much more difficult these days. This is especially true when a client is looking to immediately venture into financial holding company activities on a broad basis.

I think an important concern, having worked with state bank regulators — and I think every federal bank regulator at this point in time — is clearly what is the Federal Reserve's disposition with respect to each of these subjects. Will it grow to be progressive or will it continue to be conservative in nature? Will it be too risk-

24. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

25. See James A. Leach, *Keynote Address*, 6 FORDHAM J. CORP. & FIN. L. 9 - 10 (2001).

averse and process-oriented in its approach? Will it be a restraining influence when other agencies with comparable authority look to be more progressive than the Federal Reserve would otherwise choose to be? All of these things are very confusing to the management of a financial institution, who simply want to know when they can execute something and how quickly. It makes it a little bit more difficult for bank counsel to provide expedient and accurate advice.

I think the privacy and merchant banking regulations are somewhat illuminating. A regulatory system that is more receptive to market discipline may not be here yet and we may still be looking at artificial regulatory restraints that business models show can be more successful. Those business models, however, are not well received by the bank regulators and are reshaped by regulation that may prove to be disabling, in some measure, to the affected institutions' ability to compete.

Essentially, when you look at the merchant banking provisions in the Act, there is a two-to-five-year ownership limit for a merchant banking investment.²⁶ There are limits on the ability to manage or operate the companies in which the investments are made.²⁷ Primarily, one can only do so when necessary or required to obtain a reasonable return on investment. That has generally been thought to mean that the investment has to be experiencing difficulty. Now, this is typically a bank regulatory process. When the investment is in trouble, the bank has greater powers. Before it is in trouble, however, the bank is not able to fully involve itself. I query whether that is a proper model to continue with into the future. There are also recent merchant banking regulations proposing a disconcerting haircut with respect to capital adequacy and capital maintenance.²⁸ On this level playing field, repeated

26. See Gramm-Leach-Bliley Financial Services Modernization Act § 103(a).

27. See *id.* (“A bank holding company [cannot] routinely manage or operate such company or entity[,] except as may be necessary or required to obtain a reasonable return on investment upon resale or disposition.”).

28. See Joseph J. Norton and Christopher D. Olive, *A By-Product of the Globalization Process: the Rise of Cross-Border Bank Mergers and Acquisitions – the U.S. Regulatory Framework*, 56 BUS. LAW. 591 n.148, February 2001 (“The [Federal Reserve Board] has adopted an interim rule implementing the merchant banking authority, proposed regulations to impose special capital requirements

interventions of artificial bank regulatory concepts into businesses which are not bank regulatory at the outset will result in financial institutions or financial holding companies choosing not to get into certain activities that they would otherwise pursue.

There are also certain bank regulatory concepts that end up being counterintuitive and therefore difficult for business people to understand. One instance is in the privacy proposal.²⁹ There is certain text within the proposal which leads one to believe that acquiring from the customer some readily available information, such as the kind you could get from a phonebook, renders the information non-public.³⁰ I would suggest that these types of counterintuitive rules are going to be very tough to sell to systems people and bank management, especially when they need to successfully comply with them in order to avoid liability under the Act.³¹

I think, when you view Gramm-Leach-Bliley³² in its totality, not much has changed in many ways. Management culture will be put to the test, as it has always been. Does it have traditionally well-developed business plans and visions? Does it usually plan well? Does it cover details as well as it covers big issues? Does it investigate things thoroughly?

The Act³³ makes things easier procedurally. I would submit, however, that success still depends essentially on the quality and the character of the management within the institution and their patience in making sure that things are done well rather than just quickly. One of the other things that I tended to get involved with during my banking career was dealing with a lot of regulatory employees. This can be both a blessing and, sometimes, a difficulty. As the statute now stands, a bank is going to be regulated by federal bank regulators. In addition, a bank will be subject to regulation by some state bank regulators depending

for such activities, and issued supervisory guidance for such activities.”).

29. See Gramm-Leach-Bliley Financial Services Modernization Act §§ 521-27.

30. See *id.*

31. See *id.*

32. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

33. *Id.*

upon the bank's affiliate structure. Moreover, there is the Securities and Exchange Commission ("SEC") and the Self-Regulatory Organizations. Finally, there are state administrators and state insurance departments. Each of the components of a financial holding company will come from a different discipline. Some will know how to deal with one type of regulator but not with the others.

As some of you may know, when you are dealing with an examining authority, one of the key things is being able to explain what your institution does. Your organization may do its job well, but if you cannot explain your function succinctly and correctly to a bank or another regulator the first time out, the quality of the regulatory engagement tends to degrade. There is a general perception towards bank regulators. Bank regulators tend to issue somewhat specific written authorities with relative procedural freedom. The focus is always on institutional safety and soundness, and the goal is to protect the public confidence in a particular bank and in banks in general. The regulation follows market behavior; it does not precede it. Bank regulators are comparatively slow to discipline their regulatees.

With securities regulators, the authorities tend to be more specific and less procedural freedom is involved. The focus is on consumer protection and public confidence in the markets. The overseers are comparatively quick to discipline. I was just recently at a meeting where some SEC officers were speaking, and really, the SEC is not reluctant about putting an institution out of business if SEC feels such action is warranted. Whereas, in a bank regulatory environment, that is the absolute last thing that you want to do.

There are state-by-state peculiarities regarding insurance regulators, about whom I admittedly know much less about than banking and securities regulators. The focus of insurance regulators is on the state market and it appears to involve a balancing of the ability of the insurers to exit the market or to withdraw a product, instead of the consumer fairness need and affordability issues. My understanding there, as well, is that the agencies are comparatively slow to discipline.

So what is the challenge that is faced by those trying to coordinate this multi-faceted regulatory relationship? I think there

needs to be management that is familiar with one personality and familiar enough with the others to be able to adapt and deal with them well. In-house staff are typically very candid with bank regulators. They disclose everything and they discuss it as long as the regulators desire. With securities regulators — having gone through a couple of those myself — one tends to be circumspect; giving only the information that is asked for. The goal of the engagement is not to have the examiner leave feeling prideful about your institution, but to simply stay away from the enforcement proceedings that might result.

With the insurance regulators, as Mr. Patrikis was saying before,³⁴ there seems to be a constant conversation taking place, concerning both products and examinations. In my view, this general dialogue seems to be less troublesome than bank employees dealing with securities regulators.

The emerging question really is how financial holding companies and bank holding companies deal with and manage these relationships all at the same time. Clearly, each of these agencies is going to want information in formats and in particular aspects to their liking. The systems will have to generate reports that are similar in nature, but different because each of the regulators will have their own peculiarities. There will be an initial level of frustration when each of these regulators comes into a shop and the information is not ready.

So, it seems to me that, as a financial institution moves from one business to the other, there will be a significant amount of work necessary to make sure that the institution is ready to manage that relationship well. There are some resources that need to be committed that otherwise wouldn't have been budgeted for.

The next thing I would like to talk about is the risk of being a financial holding company. The downside of the statute and the certification as a financial holding company is that once the institution is certified, it had better stay that way. It needs to be well capitalized and well managed.³⁵ The institution's CRA³⁶

34. See *supra* pp. 24-31.

35. See Gramm-Leach-Bliley Financial Services Modernization Act § 103(a) (stating that to engage in certain activities a bank holding company's depository institution subsidiaries must be well capitalized and well managed).

ratings need to be satisfactory in each of the insured depository institutions that are part of the affiliate family.³⁷

This is the first time that there is actual statutory and enforcement reliance on CRA ratings and bank management ratings within the regulatory scheme designed for commercial banks.³⁸ What happens if an institution falls out of the profile of a financial holding company? It gets frozen in place with respect to activities.

That is probably a move backwards. There are no new powers. Again, if it is standing still, it is suffering financially because its capital is already invested in doing that which it is now limited in doing. If things get bad enough, the institution may face a divestiture of the insured depository institutions. Separate from that, it has the potential for having to make public disclosures in its securities filings, with respect to degradation in any of the suffering areas. That, in and of itself, can have capital adequacy repercussions and other degrading results.

So what challenge is presented here? The task, and a difficult one at that, is for a financial institution or a company to be honest in appraising itself. I think it needs to look at lines of business, the

36. Community Reinvestment Act, 12 U.S.C. §§ 2901-2907 (2000). See generally Miho Kubota, Note, *Encouraging Community Development in Cyberspace: Applying The Community Reinvestment Act to Internet Banks*, 5 B.U. J. SCI. & TECH. L. 8, 8 (1999) (stating that "Congress enacted the Community Reinvestment Act . . . to encourage banks to serve the credit needs of their entire communities, including low- and moderate-income individuals and areas").

37. See Gramm-Leach-Bliley Financial Services Modernization Act § 103(a) (stating that a financial holding company may not engage in certain activities: if any insured depository institution subsidiary of such financial holding company, or the insured depository institution or any of its insured depository institution affiliates, has received in its most recent examination under the Community Reinvestment Act of 1977, a rating of less than "satisfactory record of meeting community credit needs").

38. See Adam Nguyen and Matt Watkins, *RECENT LEGISLATION: Financial Services Reform*, 37 HARV. J. ON LEGIS. 579, 583 (2000) (noting that "the bank holding company must pass minimum Community Reinvestment Act ("CRA") requirements, although the Act does not grant the Fed any remedial powers, such as requiring dissolution of a holding company because of a poor CRA rating").

resources that are dedicated to the various activities in which it is engaged, and whether, in fact, it is knowledgeable about its customers. This opinion is not based on a Bank Secrecy Act³⁹ point of view, but on the product delivery/product acceptability standpoint.

Also, what is its perception of the markets? Is the perception accurate? For instance, is there a high degree of success with product delivery methods via the Internet to high-net-worth customers that are used to meeting with an account representative? Or is that something that is more of a pilot project? If so, should resources commensurate with that level of engagement be committed?

Are the incremental benefits of being a financial holding company worth the inherent risks? There are many things that an institution will be able to do as a bank holding company. There are, I think, 150-some-odd financial holding companies that have been approved or certified at this point in time⁴⁰. Clearly, when we look at the list of the first 117 that came out day one, it ran all over the lot. Some institutions were simply certifying so that they could get rid of the office and the "Community of 5,000,"⁴¹ to be able to sell insurance agency services in small regional banks or community banks. Others, of course, include Citigroup, Chase and the like, and have robust business plans and multi-faceted areas of business.

I think there is clearly room for being a successful financial

39. Bank Secrecy Act, Pub. L. 91-508, 84 Stat. 114 (1970) (codified as amended at 12 U.S.C. § 1829b, 12 U.S.C. §§ 1951-1959, and 31 U.S.C. §§ 5311-5330). See generally Sandra L. Gramman et al., *Financial Institutions Fraud*, 37 AM. CRIM. L. REV. 551, 576 (2000) (showing that "Congress enacted . . . the Bank Secrecy Act . . . out of concern that financial institutions increasingly were being used to launder unreported income and obtain funds illegally").

40. See Rob Garver, *Fed Rebuts Foreign Banks' Claim on New Rules' Bias*, AM. BANKER, Apr. 19, 2000 at 2 (noting that through April, 2000 "155 financial holding companies [had] been formed").

41. "For many years, the Office of the Comptroller of the Currency (OCC) has interpreted [12 U.S.C. §92] [as] permitting any bank office located in a place not exceeding 5,000 persons to act as a general insurance agent, even though the bank's principal office is located in a community exceeding 5,000." See Barry A. Abbott, et. al, *Survey: Banks and Insurance: An Update*, 43 BUS. LAW 1005, 1015-16 (1988).

institution, either from a bank holding company model or a financial holding company model. If one, however, goes the financial holding company route, because of the draconian results from not complying with the affiliate depository institutions, is clear that it is absolutely necessary to reduce the number of insured depository institutions that are in an affiliate group. This will enhance the simplicity with which the compliance and control risks can be managed. If management degrades it, this will bring down the management's rating. A downgraded management rating could well be a very difficult thing to reclaim in a very quick way. The other thing that counterbalances this reduction of number of affiliates within a group is the need to maintain some ability to sustain regulatory arbitrage. This is so that options remain open to the institution that should be prudently maintained.

When I look at the spread of bank-type regulation to other industries through the Gramm-Leach-Bliley Act,⁴² I become concerned about the potential for the spread of increased regulatory burdens, rather than a level playing field where people do businesses in non-banking areas or industries as they always have been done. There are more regulators and more diverse requirements. Each regulator, as I said before, will want information in the way and mode it is used to receiving it.

There is a desire, from the regulators' point of view, to simplify things by having "one-size" policies fit all affiliates. Yet we are talking about distinct and very different businesses. I am not quite sure how well this policy works, but it is clearly one of the demands that is being made on financial holding companies at this point. In addition, there is a push-out of broker-dealer and fund advisor activities mandated by the statute.⁴³ That will, in and of itself, create some inherent operational and compliance issues that were not there before.

42. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

43. See generally Polking & Cammarn, *supra* note 18, at 16 (stating that because under Gramm-Leach-Bliley's functional regulation provisions "it is impracticable in many cases for a bank itself to register as a broker-dealer, many of the securities activities traditionally conducted by banks . . . must be 'pushed out' into an affiliated securities firm that is otherwise registered as a broker-dealer").

There is also a heavy reliance on risk-managed-based review of the activities of a financial holding company. In this instance, one of the issues is who is basing the risk. The management, in its experience of how its companies operate, may have one view of what the inherent-in-any-particular-activity level of risk is, while the regulators may have a different view. But there is a heavy reliance on risk management; to me that is just the gloss on it. The real nuts and bolts about how much risk is allocated to a particular activity is where the real digging goes on.

The other thing about this “one size fits all” issue is that, with a financial holding company that is complex and involved in diverse activities and industries, there ends up being a request to upstream these types of controls from the insured depository institutions and the securities firms up to the holding company. That begs for symmetry and simplicity, but I am not quite sure that these are attainable. It may well be the case that an institution simply has to, at the holding company level, have a greater faith in the ability of the functional regulator to come to proper judgments on how the different affiliates are performing.

I also worry about the creep of what I call government instrumentality-type regulations, from financial institutions (the financial institutions have been laboring under certain of these requirements for years) to other types of affiliates. However, the affiliates’ competitors that are not part of a financial holding company are not similarly burdened. Examples of this are the “know your customer” requirements that are now being impressed by examination only,⁴⁴ but were part of a proposed regulation⁴⁵ that was soundly handed back to the government with a “no, thank you”. Suspicious activity reporting, which in itself is a dilemma causing people to make law enforcement judgments basically in a commercial environment, is very difficult and very risky for a private enterprise.

44. See Currency & Foreign Transactions Report Act 31 U.S.C. §§ 5311-5329 (2000). See generally Brian W. Smith & Ramsey J. Wilson, *The Electronic Future of Cash: How Best to Guide the Evolution of Electronic Currency Law*, 46 AM. U. L. REV. 1105, 1123 (1997).

45. Currency & Foreign Transactions Report Act 31 U.S.C. §§ 5311-5329 (2000).

The privacy requirements, which are in Title 5 of the legislation, are only applied to new financial companies.⁴⁵ The definition, as Chairman Leach said before,⁴⁷ of what a financial activity is may grow over time. I would imagine, however, that as that growth occurs there will be increasing resistance, by the businesses that are being drawn into the privacy compliance arena, to limit the growth of things that are financial in nature by definition. This is simply so they will not have to deal with these types of requirements.

The other thing with respect to regulation itself, at least from my point of view, is that there is an increasing incidence of regulation by guidance by bank regulators. Rather than looking to a regulation for guidance, an institution gets a statement or a notice which, in lieu of regulations, acts as guidance. The examiners incorporate it into their manual, and it is as if there was discourse between the industry and regulators and this is the result. But, in fact, that disclosure has been bypassed.

The subjects that are being addressed now are fiduciary activities; this is a very difficult topic to not have a lot of discussion on. Clearly, fiduciary activities are risky. They have, however, been going on and have been successfully managed, both from a regulatory point of view and a business point of view, for a very long time. These kinds of guidance without regulatee input, to me, are somewhat unfortunate, and hopefully we will get back to the promulgated regulation mode more frequently.

There is a potential for regulatory relief in all of this, notwithstanding what I have just said. You now have three industries — only one of which is used to dealing with the financial institution regulators — and they tend to be a conservative lot. My thought is that, as they get a better flavor of the type of regulation that they have acquired by becoming part of a financial holding company, there may be a better balance in the discourse and a better balance in the result with respect to the regulatory burdens that are put upon financial holding company affiliates in the near

46. See Gramm-Leach-Bliley Financial Services Modernization Act §§ 501-527.

47. See James A. Leach, *Keynote Address*, 6 FORDHAM J. CORP. & FIN. L. 9, 14-15 (2001).

future.

I think that, at the end of the day, there are two things that have to be done. First, there must be an enlightened management approach to all of these issues - one that is not afraid of complexity, one that is not afraid of discussion that goes on for more than five minutes on any subject. There must also be an agile computer system to support a bank because it is very difficult to anticipate how that system will need to perform in the future.

The privacy regulations of the legislation are a case in point.⁴⁸ There is the federal level, where affiliate exchanges are acceptable, but an institution needs to be able to implement opt-out with respect to third-party sharings.⁴⁹ There is also the Fair Credit Reporting Act,⁵⁰ which makes necessary the ability to implement an opt-out between affiliates.⁵¹

Then, there is the state “wild card,” if you will, where the Act⁵² invites states to become even more restrictive on the ability to exchange information.⁵³ What does that do? It means there is a need for systems where multiple switches can be turned on and off. If a compliant state, whatever state it may be, is an opt-in state, an institution needs to be able to run an opt-in in that state while it is running opt-outs everywhere else.

That gets down to a very fine stroke in a control environment and in the data processing and how many switches are available to control the aggregate product of that system. It means that there is a need to put regulatory thought into systems enterprises very early on, probably at an unprecedented level.

With that, I will close.

PROFESSOR FELSENFELD: Thank you, Frank. You gave

48. See Gramm-Leach-Bliley Financial Services Modernization Act §§ 501-527.

49. See Gramm-Leach-Bliley Financial Services Modernization Act § 502(b).

50. 15 U.S.C. § 1681-1681(u) (2000).

51. Gramm-Leach-Bliley Financial Services Modernization Act § 508(a).

52. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

53. See *id.* § 507(a) (stating that “a State statute, regulation, order, or interpretation is not inconsistent with the provision of this subtitle if the protection such statute, regulation, order, or interpretation affords any person is greater than the protection provided under [federal law]”).

us a lot to think about.

I will just mention the issue of synergy that I talked about before,⁵⁴ which Ernie raised.⁵⁵ You will note it was a dominant ingredient of Frank's talk, but he approached it from a different point of view; that is, the synergy in the regulatory process. Is it appropriate to have securities regulation and banking regulation and insurance regulation come from essentially the same point, or do they have different points of view that require different regulatory attitudes? It is a very interesting question that those in the trenches will have to consider and pursue, in the time we spend under Gramm-Leach-Bliley.⁵⁶

Our next speaker is William J. Sweet, Jr. Bill is a partner in the Washington D.C. office of Skadden, Arps, Slate, Meagher, & Flom. Before he joined Skadden Arps, Bill was an attorney with the Federal Reserve System, so he learned his banking from the ground up and now applies it. He does a great deal of international banking. He also works on mergers and acquisitions, including the recent Citigroup merger.⁵⁷ He has a strong background in representing foreign banks. This leads me to bring a new ingredient into this discussion, which is the effect of Gramm-Leach-Bliley⁵⁸ upon the foreign banking community. Today, some mere three weeks after the effective date of Gramm-Leach-Bliley,⁵⁹ we see what may be a severe dislocation in the relation of American banks and foreign banks. As you may know, to take advantage of the statute, in general, you have to be a financial holding company;⁶⁰ this requires an application to the Federal

54. See *supra* p. 34.

55. See *supra* pp. 25, 28.

56. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

57. See Timothy L. O'Brien & Joseph B. Treaster, *Shaping a Colossus: The Overview; In Largest Deal Ever, Citicorp Plans Merger with Travelers Group*, N.Y. Times, Apr. 7, 1998, at A1 (reporting on the merger between Citicorp and Travelers Group Inc.).

58. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

59. See *id.* § 161 (setting forth that all provisions of the Gramm-Leach-Bliley Act, except section 104, will become effective 120 days after enactment).

60. See Gramm-Leach-Bliley Financial Services Modernization Act § 103(a).

Reserve. Of the 160-something . . .

MR. SWEET: I think there are about 150 now.⁶¹

PROFESSOR FELSENFELD: Of the 160 financial holding companies, I think only seven are foreign and the rest are American.⁶² Most of the foreign applications have been rejected, largely for reasons of capital, I am told.⁶³

Does this mean we are leaving foreign banks behind? Are we creating a kind of domestic favoritism in the banking system? It is, of course, much too soon to know. I think, however, it is something that we should take note of and evaluate.

I am pleased to see we have in our audience this morning Larry Uhlick, the Executive Director and General Counsel of the Institute of International Bankers for the Federal Reserve Bank of Chicago. This is the organization that represents foreign banks in the United States. Maybe, Larry, you can give us your thoughts before the morning wears out on whether we are prejudicing foreign banks under Gramm-Leach-Bliley.⁶⁴ It is an issue I never thought about until I started to see these figures.

I haven't forgotten you, Bill. You are our next speaker and I look forward to hearing from you. Thank you.

MR. SWEET: Thank you very much.

The foreign banking subject is an important one. Over the last two decades, the federal government has basically decreased

61. See Garver, *supra* note 40.

62. See *id.* (stating that of the financial holding companies that had been formed through April, 2000, 13 were formed by foreign banks).

63. See, e.g., *EU Urges Equal Treatment Under New US Banking Laws*, PR NEWSWIRE, Mar. 6, 2000 [hereinafter PR NEWSWIRE] (quoting John B. Richardson, Deputy Chief of Mission at the European Commission's Washington delegation as saying:

[an area] of concern [with Gramm-Leach-Bliley] regards the well-capitalized standards for foreign banks. US bank holding companies qualify if their US bank subsidiaries meet the well-capitalized numerical criteria on a risk and leverage basis. In the case of foreign banks, the test is more complicated. It is somewhat troubling that the US authorities require foreign banks on a global basis to satisfy risk-based capital requirements that exceed the internationally agreed upon risk-based standards in the Basle Accord.

64. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

foreign banks access to the U.S. financial system⁶⁵ - to the long-term detriment of the system, in my opinion. That is, however, a subject for another day.

Gramm-Leach-Bliley⁶⁶ is something I approach with a great deal of humility and nostalgia. I approach it with humility because, as Chairman Leach mentioned before,⁶⁷ the Act itself is several hundred pages long. If you look at Tab B in the "telephone book" that you received, most of that book represents regulations that have come out to date. Much more, by far, of the regulations are still ahead of us. Also, I have to confess, as an active practitioner advising firms in all industries, I have yet to read all of this. What we got so far is, nevertheless, remarkable.

Also, I have to speak to the nostalgia. When Congress dealt with this subject the last time, in 1933,⁶⁸ they managed to tear asunder the banking and securities industries with about two pages of text. It was far simpler to understand that than what we have got to deal with today. Nonetheless, it is remarkable legislation.⁶⁹ It would have been more remarkable had it been enacted ten years ago. It has been under consideration over the last two decades.⁷⁰

In the interim, banks, securities firms, and insurance

65. See generally H. Rodgin Cohen, *Landmark Legislation Passes; Examining Impact on Financial Services Global Consolidation*, N.Y. L.J., Nov. 15, 1999, at S3, (stating that the "[Gramm-Leach-Bliley Act] . . . removes restrictions now imposed on banks under the Glass-Steagall Act of 1933 and the Bank Holding Company Act of 1956 (BHCA) . . . The BHCA restrictions generally apply to foreign banks that conduct U.S. operations through a branch or agency.").

66. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

67. See James A. Leach, *Keynote Address*, 6 FORDHAM J. CORP. FIN. & L. 9 (2001).

68. See Glass-Steagall Act, Pub. L. No. 73-66, 48 Stat. 162 (1933) (codified in scattered sections of 12 U.S.C.) (also known as the Banking Act of 1933).

69. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

70. See Nguyen and Watkins, *supra* note 38, at 579 (noting that "after twenty years of effort by industry lobbyists and lawmakers, the Gramm-Leach-Bliley Financial Modernization Act was signed into law"); Polking & Cammarn, *supra* note 18, at 1 (noting that the passage of the Gramm-Leach-Bliley Act "represents the culmination of Congressional financial reform efforts spanning more than 30 years").

companies have really learned how to offer a full package of financial services — be they retail or commercial — to their customers without being affiliated, by and large, with their sister organizations. Therefore, while this legislation⁷¹ takes some important steps in structural reform, such as allowing banks and insurance firms to affiliate,⁷² these changes are going to be regarded as more of a marginal improvement by an industry. Moreover, that industry is already competing with products and services from all of their affiliated and non-affiliated organizations.

Against this marginal advantage, organizations are going to have to think about the costs associated with the ownership of a bank. Those costs, I think, are significant and real. I am going to review them as one of the three topics I will talk about. As a result of those costs, securities and insurance firms, and even those banking firms that are already bank holding companies, have to give very serious thought to whether they want to become a financial holding company. The foreign banking organizations, by and large, will be not be able to become financial holding companies because of capital rules that are unique to the United States.⁷³

Those organizations that are not currently financial holding companies are going to give serious consideration to alternatives that continue to exist in the current scheme. If they become financial holding companies, they are going to do so only if they have a strategic objective for which there is no other alternative besides becoming a financial holding company. Such an example is the Charles Schwab/U.S. Trust transaction⁷⁴ — the acquisition of an investment management firm by a securities firm. It just so happened that the investment management firm was, in fact, chartered as a bank.

The three things I would like to talk about are the costs of becoming a financial holding company, the alternatives, and then,

71. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

72. *Id.* §§ 101-103.

73. See Garver, *supra* note 62 and PR NEWSWIRE, *supra* note 63.

74. See Schwab Wins Approval to Buy U.S. Trust, N.Y. TIMES, May 2, 2000, at C14 (reporting on the Federal Reserve's approval of Charles Schwab Corporation's acquisition of U.S. Trust Corporation).

briefly, the Internet. I know we have limited time, so feel free to let me know if I am running too long.

PROFESSOR FELSENFELD: We have a lot of time.

MR. SWEET: All right.

The financial holding company costs are four-fold. The first is the complexity of the regulations and the statute itself. Second, beyond complexity, there is increased regulatory leverage over private companies, which has been introduced by the legislation. Third, there is decreased flexibility with respect to non-banking activities, especially for those firms that are not currently in the banking industry. Fourth, there are capital costs that we have yet to fully see.

Regarding the complexity of the statute and its regulations, I know other reasonably sophisticated practitioners who get Gramm-Leach-Bliley⁷⁵ questions wrong all the time. It is going to take a long time before we really understand what all of this means, and actually can give meaning to the interaction of these statutes and regulations. It will be much more complex for management, which has to actually plan ahead two or three or five years for the organization, to understand the ramifications of this statute and to deal with them effectively.

The second cost, increased leverage by regulators over banking affiliates, results from many factors. In order to be a financial holding company, you have to have banks that are well capitalized, rated by examiners as well managed.⁷⁶ In addition, you must also be rated, for Community Reinvestment Act (CRA)⁷⁷ purposes, as satisfactory or better.⁷⁸

The downside to being a financial holding company is, as Frank Scifo pointed out,⁷⁹ the fact that an institution can be decertified as a financial holding company. If that happens, it can no longer conduct its activities and must divest to its affiliates. It means big trouble, particularly with respect to the managerial

75. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

76. *See id.* at § 103(a).

77. 12 U.S.C. §§ 2901-2907 (2000).

78. *See* Gramm-Leach-Bliley Financial Services Modernization Act § 103(a).

79. *See supra* pp. 38-39.

rating and the CRA rating. Those ratings are provided through exams that are not subject to what I would call objective criteria, but rather subjective judgments as to the conduct of management and their ability to satisfy the community's needs. There will be a huge increase in the leverage of an examiner who walks in and says, "I don't think you've been doing that CRA activity quite right" or "I don't think your risk management system is quite up to par." Previously, those debates went on all the time. A banking organization was able to sit down and discuss it with the regulators, disagree and take the issue to a higher authority. If the disagreement persisted, then the bank would continue its life without coming to an agreement. In the future, that will not be the case. Banking organizations will be far more constrained by the views of their examiners than they ever were in the past.

Third, there is also the issue of decreased flexibility in the conduct of non-banking businesses. This will be less an issue for current banking organizations that have found their activities, and the affiliates they can own, to be broadened. It is more of an issue for securities and insurance firms, investment managers and other entrepreneurs, which might want to affiliate with a bank and are currently accustomed to no limits on their businesses, or at least on those businesses outside of their regulated affiliates. An insurance company conducting its swaps activities is not regulated, and there is no limit on what swaps can be executed. If you are doing merchant banking outside of your securities affiliate, no one is telling you how long you can hold the investment or what you can do.

The merchant banking authority, in particular, is an example of a situation where the costs, I think, have been significantly increased over those contemplated in the statute.⁸⁰ Basically, the statute provided that an entity could conduct investment merchant banking in a manner that was designed to ensure that it did not engage in commerce.⁸¹ Essentially, it required that you would eventually divest the company. You could not control that company on a day-to-day basis, even though you could own all of

80. See Gramm-Leach-Bliley Financial Services Modernization Act §§ 103(a), 122.

81. See *id.* § 103(a).

its stock and control its board.⁸²

The Federal Reserve has chosen to promulgate a very detailed set of regulations, that thoroughly regulate this business and impose capital requirements. The Fed acted so for reasons peculiar to its culture - out of fear about what may happen if the economy falls off the cliff and every bank makes a merchant banking investment. They have claimed, in good faith in my opinion, to impose regulations on the basis of a model that they have researched with the industry.

I think that what the Federal Reserve misses is that the financial services industry is a lot larger than New York. It's very diverse. The sorts of merchant banking investments that will be made by this diversity of organizations would be far too heterogeneous to define.

Secondly, even if an industry exists within the New York capital markets business, it is one thing to operate under this model; it is another thing to operate within the particular limits of a rule. It is much more difficult to raise capital when you have to tell investors "I have to be out of this investment in ten years. Even if it is not doing well or it is on the upswing, I absolutely have to be out of it." One is also at least uncertain that you would be able to hold onto the investment, because regulators have the discretion, basically, to tell you to unload it at that point.

The capital costs exist at several levels. There is going to be a decreased flexibility with respect to allocation of capital at the bank level. Previously, banks were heavily regulated from a capital standpoint. If they had more capital, they could do more things; if they had less capital, they could do fewer things. It was, however, still their choice. Essentially, banks could operate at a less-than-well-capitalized level and do quite well — allocate capital to other affiliates and return capital to shareholders. Under the financial holding company system, if any of an entity's banks drops below "well-capitalized," the entity would lose all of its authority as a financial holding company⁸³ — again with disastrous consequences.

There have been capital requirements imposed for merchant banking. This is something that the private sector does with its

82. *See id.*

83. *See* Gramm-Leach-Bliley Financial Services Modernization Act § 103(a).

own judgment, over a range of capital levels. There is now, however, an established government-mandated capital level that will reduce the management of capital within holding companies.

Finally — and we have yet to see this — the statute gives the Federal Reserve very specific authority to regulate capital at the parent level.⁸⁴ This is something it does for bank holding companies today, but not for a securities firm or an insurance firm at the parent level. The only entities that are regulated from a capital standpoint in non-bank holding companies are the regulated entities, the insurance companies and the securities firms.

We do not quite know what those future regulations are going to say. The rule makers could not mess around with the capital requirements of subsidiaries; they could simply establish consolidated rules. Through the magic of accounting, however, all capital at subsidiaries tends to roll up to the parent. So how all of this will be resolved remains to be seen. I think there is a real question as to whether the regulators have acted inconsistently with the (merchant banking) capital requirements directive. If merchant banking is concerned in an affiliate that is regulated, for example, by the SEC, then the Federal Reserve has, essentially, independently imposed new capital requirements. It will be sure to say that the activity is at the parent level.

There are alternatives to the financial holding company. People will give these alternatives very serious consideration. Certainly, prior to this legislation⁸⁵ many insurance firms (including the AIG) and securities firms established thrifts, which required no regulation at the federal level. Regulation was entirely at the bank level — at the thrift level. That continues to be an option.

As Chairman Leach indicated,⁸⁶ this is no longer an option for commercial firms. They cannot acquire thrifts because the businesses of a parent must be limited to financial services

84. *See id.*

85. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

86. *See* James A. Leach, *Keynote Address*, 6 FORDHAM J. CORP. & FIN. L. 9, 15 (2001).

businesses.⁸⁷ But for a Charles Schwab or an AIG, the businesses they conduct, by and large, are consistent with those allowed for financial holding companies. They are the model for these thrift holding companies,⁸³ with the understanding that these companies don't become financial holding companies. They are subject neither to Federal Reserve nor capital regulation. They are not subject to the oversight of anyone; they must merely limit their activities. So that is a real alternative and it will continue to be an alternative. People will look to credit card banks, non-bank trust companies, and other alternatives to provide financial services.

PROFESSOR FELSENFELD: I really had trouble getting up because I found myself thinking so hard about what you were saying. I would have preferred to sit and muse over it a little longer, but we must move ahead.

Our next speaker is William Lifland.⁸⁹ I think I have known him about as long as I have known Ernie Patrikis, which is to say forever. I can't remember when it started. Bill is a partner at Cahill Gordon & Reindel, and is one of the leaders in the United States in the field of antitrust law. Incidentally, we are very proud to have him as an adjunct professor here at Fordham. Bill graduated from Yale College and then went to the Harvard Law School, where he was President of the Law Review. He has been on top of the legal world ever since. We are very happy to have you here, Bill.

MR. LIFLAND: Thank you very much, Professor Felsenfeld, for that very nice introduction. Thank you also for inviting me to this program. I have learned a lot from the other panelists this

87. See Gramm-Leach-Bliley Financial Services Modernization Act § 401(a); see also Polking & Cammarn, *supra* note 18, at 27 (arguing that Gramm-Leach-Bliley "significantly diminishes the value of the thrift charter to commercial firms that had previously considered chartering or acquiring a thrift to obtain certain powers conferred on financial institutions . . . without becoming subject to bank or thrift holding company acting restrictions").

88. See generally Susan Sirota Gaetano, Note, *An Overview of Financial Services Reform 1988*, 5 CONN. INS. L. J. 793, 811 (1999) (noting that "a unitary thrift is a company that controls a single savings association and [prior to Gramm-Leach-Bliley] allow[ed] unitary thrift holding company parents to engage freely in business activities, including commerce and finance").

89. Mr. Lifland is a Partner at Cahill Gordon & Reindel.

morning. I would like to talk very briefly on just two subjects. One is antitrust and the other is strategic planning.

First, on the issue of antitrust, the head of the Antitrust Division of the Department of Justice⁹⁰ and the Chairman of the Federal Trade Commission⁹¹ appeared a couple of weeks ago before the Senate Antitrust Subcommittee. In response to questions, the Justice Department official was reported as stating:⁹²

The U.S. economy is in the midst of dramatic changes that warrant close antitrust scrutiny. Increased globalization, rapid technological innovation and deregulation are creating an environment in which many firms are choosing to merge or undertake other types of strategic business alliances. While most of these arrangements foster efficiency, to the benefit of consumers and businesses alike, some can result in market power that decreases competition.⁹³

Now, he could have been talking about the financial services industry, couldn't he? From what we have heard from Chairman Leach and the other panelists, we certainly have a situation where there has been increased globalization that continues to this day. In this morning's news, there was an account of a British bank taking over a French bank, or trying to.⁹⁴ We have seen many foreign firms enter the United States, and of course, the reverse is true as well.

Technological innovation is highly apparent. One is inclined to agree with the Counsel to the Office of the Comptroller of the Currency. He recently stated that it is "rather ironic" that after so

90. Joel I. Klein. *See generally* David Segal, *Joel Klein, Hanging Tough; Why Justice's Antitrust Chief Is Taking Firms to Court*, WASH. POST, March 24, 1998, at C1. [hereinafter Segal] (describing Klein's background).

91. Robert Pitofsky. *See generally* Sharon Walsh, *Going to Bat for the Trustbusters; FTC Chairman Pitofsky Wears a Moderate Mantle, but Is Ready to Take on Agency Critics*, WASH. POST, April 13, 1995, at D12 (describing Pitofsky's background).

92. *See* Statement of Joel I. Klein, Assistant Attorney General, Antitrust Division, U.S. Department of Justice before the Antitrust, Business Rights and Competition Subcommittee Committee on the Judiciary United States Senate, Mar. 22, 2000.

93. *See id.*

94. Andrew Garfield, *HSBC Leads the Way into Euro Zone with 6.6BN Pounds French Bank Takeover*, THE INDEPENDENT (London), Apr. 3, 2000.

much time spent by the banking industry trying to get out from under Glass-Steagall, the forces that seem to be determining which financial services will be offered by banks and how they will be packaged, seem to be driven by technological issues rather than by regulatory ones. Furthermore, the regulatory situation is not what could properly be described as deregulation, although it has some elements of deregulation. It seems to be, from what we have heard from the other panelists, that it is more accurate to call it re-regulation - re-regulation that will take a number of years for its exact content to settle down.

Now, what happens in the meantime? The head of the Antitrust Division⁹⁵ suggests that there may be substantial mergers.⁹⁶ Well, if that happens, people in the financial services industries are generally well equipped to handle it. The process for clearing mergers is pretty well known.⁹⁷ Should there be problems with a particular transaction, the government agencies, at least in the relatively recent past, have found ways to be accommodating by insisting upon certain divestitures that, if made, will enable them to approve the transaction.⁹⁸

But I think we should focus a little bit on the possibility that there may be other types of strategic business alliances undertaken.

95. Joel I. Klein, Head of the Antitrust Division of the U.S. Department of Justice; *see also* Segal, *supra* note 90.

96. *See supra* p. 54.

97. *See* 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41,561 (1992). *See generally* Nguyen & Watkins, *supra* note 38, at 583-584 (describing the government's "step-by-step process by which they determine whether any particular combination of firms will have anticompetitive consequences").

98. For example, the Department of Justice required Zions Bancorporation and First Security Corporation to divest 68 bank branches in Utah and Idaho in order to permit a merger between the two banks. *See BankWest Will Acquire 68 Utah, Idaho Branches Divested in Zions-First Security Merger*, PR NEWSWIRE, Jan. 18, 2000. The Department of Justice also approved a divestiture plan for the sale of 285 bank branches, to allow for the merger of Fleet Financial Group and BankBoston Corporation. *See Fleet Successfully Completes the First of Three Planned Divestitures to Sovereign Bank of New England*, BUS. WIRE, Mar. 27, 2000. The mergers between Bell Atlantic and Vodafone AirTouch and Aerial Communications and VoiceStream Wireless also required divestitures of overlapping cellular properties. *See FCC Approves Bell Atlantic-Vodafone Airtouch*, WASH. TELECOMNEWSWIRE, Mar. 30, 2000.

Such alliances need not necessarily be governed by the same antitrust regime as mergers. In fact, the government published for comment last October a set of proposed guidelines on collaboration among competitors falling short of mergers.⁹⁹ These collaborations, which may include arrangements, are referred to as “strategic business alliances,” and can be governed by an entirely different regime. This regime, which in antitrust jargon is called the “rule of reason,”¹⁰⁰ provides either for clearance at one extreme, or criminal prosecution at the other extreme, and quite a lot in between. Therefore, if you are considering an arrangement that is more in the nature of a strategic business alliance, it is a very good idea to test it against the proposed guidelines. In some situations it may be best to actually bring it to the attention of the agencies.

Putting antitrust aside, I would like to turn very briefly to the subject of strategic planning. I have had the good fortune to be exposed to a fair number of strategic plans, largely because it is usually the first thing a government antitrust investigator will ask for - i.e., “Show me the strategic plan; then I can figure out what is really going on in this industry and I will get it in the words of the people who really know.” The strategic plans I have seen adopt, usually, a five-year time frame and are revised periodically during the course of the plan. They include numbers - that is, predictions of what the firm’s revenues are going to be, what the firm’s costs will be, and, of course, what the likely profits will be.

Anyone who has met with strategic planners or has done strategic planning, has probably had to deal with the frustrations of personnel who say, “It is very difficult to know what my costs are going to be over the next five years. It is just about impossible to know what the revenues are going to be because that depends on

99. The Federal Trade Commission consulted with the Department of Justice in drafting the “Antitrust Guidelines for Collaborations Among Competitors.” See Diane Brady, *When is Cozy too Cozy*, BUS. WK., Oct. 25, 1999. The final form of these guidelines was released April 7, 2000. See *Comm Daily Notebook*, COMM. DAILY, Apr. 10, 2000.

100. The “rule of reason” essentially requires courts to conduct the antitrust analysis. See Harry S. Davis and Todd S. Fishman, *The Proposed Antitrust Guidelines For Competitor Collaborations*, N.Y. L.J., Nov. 9, 1999 (Outside Counsel) at 1.

events beyond our control.” Nonetheless, top management insists on these plans. Why does management do it? Because their responsibility is to allocate the resources of the firm in a way that makes for the greatest profit. In order to do that they have to be able to compare one planner’s output with another planner’s output and reach a conclusion as to what is in the best long-term interest of the company.

Now, top management may view these plans in the same way that an orchestra conductor views opera stars. That is, very difficult to live with but impossible to live without. But, at the same time, there is absolutely no question that a good strategic plan is essential to a firm’s profitable operation in ordinary times. Now, as we have just discussed,¹⁰¹ these are far from ordinary times, for technology is reshaping the product offerings and globalization is expanding competitive markets. It is quite difficult, in fact, to know who one’s competitors are.

Now, what does this imply for a plan? First, it implies that the plans have to be more expansive than they have been up until now. Even with a company that might say, “our revenues today are 80 percent derived from businesses that we were not in five years ago” there has to be some element of planning to bring that about. That has to have been part of the scenario that was evaluated and changed as the business developed.

But now it is, to say the least, more complicated. The planning document has to allow for many more contingencies than before. In addition, it must be recognized that the degree of uncertainty introduces either an additional or greater element of risk in the operation of the firm.

Well, what does one do in that kind of a situation? I would suggest that one of the things that we see happening is that there are more checkpoints as to whether the plan’s assumptions and conditions are still being satisfied. A second, and very important, concept is the spreading of risk through diversification. One form of such diversification is to engage in joint venture activity, such as we discussed a moment ago.¹⁰² In order to let that joint venture

101. See *supra* p. 54-55.

102. See sources cited *supra* note 99 and accompanying text (discussing collaboration by competitors and potential guidelines to regulate such

activity produce true diversification, it is very important to include in the joint venture document a provision for dissolving it.

When I was a younger lawyer, an old fellow told me the most important provision in a joint venture document is the provision for dissolving it. The clients will never like you when you insist on putting it in because they will say that you are being negative rather than constructive. But, time and again, it turns out that those provisions are very, very important.

Finally, if you are prepared for the negative things that may result from lack of adequate planning, it may be useful to go the additional step and patent successful methods and models. Many general lawyers are unaware of the fact that the patent laws now permit the patenting of business methods in a number of circumstances.¹⁰³ I have seen a number of cases in which people have gone on to derive substantial income from those business method patents.

Thank you. I hope that allows us some time for discussion, Carl, before we have our lunch.

PROFESSOR FELSENFELD: I think we have a few minutes before we go into lunch, so let me throw it out to you folks. Does anyone have any questions?

QUESTIONS & ANSWERS

MR. SWEET: I will ask a question of Ernie Patrikis. Ernie was talking about the future of insurance regulation.¹⁰⁴ I just note that, I think in the 1970s, securities price regulation essentially was thrown out the door, and then in the 1980s there was deregulation of pricing in the banking industry.¹⁰⁵ I think the insurance industry is the last financial services firm with a form of pricing regulation, which strikes me as being a bit of a handicap. Where do you foresee that going?

MR. PATRIKIS: It is beginning to go. Some of the states have begun deregulation on the general insurance side, but not on

collaboration).

103. For a discussion on the expansion of patent law to include business methods, see generally, Charles R. McManis, Symposium, *Re-Engineering Patent Law: The Challenge of New Technologies*, 2 WASH. U. J.L. & POL'Y 1 (2000).

104. See *supra* p. 28.

105. See Donald I. Baker, *Searching for an Antitrust Beacon in the Bank Merger Fog*, ANTITRUST BULL., Sept. 22, 1992.

the life insurance side. The issue in those cases is how far down will the premium go. It is very interesting. One of the opposing forces is the agents' cadre. With form and rate, they know the form. With deregulation, the forms could be different because they will be created for smaller customers. The agents don't want to learn that the form says, "You know our life is wonderful today." They have been one force.

Another issue is, at a time when premiums are already at levels that I would say are too low, that deregulation of rates is going to cause more competition, which will accelerate what I believe will be the number of failures. That's not to say we should stop it, but I think that is another reason why we are seeing perhaps a ceiling on how far deregulation goes. On the life insurance side, from a consumer interest perspective, I think it is going to be some time before we really see deregulation.

PROFESSOR FELSENFELD: Clyde Mitchell, who is also an Adjunct Professor of banking law here at Fordham, did you have a question?

MR. MITCHELL: I don't mean to be picking on Ernie Patrikis, but this is also for Ernie. In banking we have the dual banking system, state and federal.¹⁰⁶ It has been around for a long time. In ten years what do you think the insurance regulatory system will look like? Is there a chance that we would have every insurance company with federal regulators setting out how regulations get established, or will we have mixed state and federal level regulations?

MR. PATRIKIS: I, at first, have wondered why there hasn't been more of a shift, in banking, to the national bank charter for those organizations that are branching across state lines. Why subject yourself to two supervisors? What benefit is there to be subject to a state banking department plus the Federal Reserve or the FDIC? Consider the cost of all that regulation.

In insurance, I am hopeful that we will see a federal charter. I

106. The dual banking system allows banks to be chartered and regulated by either the federal or state governments. See ABAIA's Proposal for Optional Federal Chartering of Insurance, available at http://www.aba.com/ABAIA/abaia_opdualcharter1.htm, (last visited Sept. 21, 2000).

hope it does not come about because of a downturn in the industry. In the past, the general insurance business went through bad times. The last time the issue of a federal charter came up, it was because of a necessity to restructure the industry.¹⁰⁷ I believe it is better for the industry to work it out for itself.

What I see as the difficult issue is what will be the nature of the federal charter. In banking there is one charter. A bank can either be wholesale, retail or everything, as per its own choice. In insurance, there are separate charters for life, property, casualty, surety, etc.¹⁰⁸ Will we have a single entity wherein the organizers will have a choice of what businesses they want to conduct? Will the charter be capable of allowing all types, or will it be narrower? Which one will it be?

The National Association of Insurance Commissioners ("NAIC")¹⁰⁹ is now fearful of the federal charter movement.¹¹⁰ This has prompted them, under Commissioner Nichols,¹¹¹ to support dual regulation.¹¹² This is positive, for there is nothing like

107. The Dingell bill (H.R. 4900) was introduced by Rep. John Dingell, D-Mich., then chairman of the House Energy and Commerce Committee, to address insurance insolvencies by creating a dual federal and state regulatory system. See Paul Dykezicz, *Solvency is State Issue, Industry Groups Say*, J. COM., Apr. 23, 1992.

108. See e.g., *Financial Services Modernization Act: Hearing before the House Comm. on Banking and Financial Services*, 106th Cong. 2 (1999) (statement of John B. McCoy, President and Chief Executive Officer of Banc One Corp.) (stating that "[Banc One officials] are confident that the proposals that Congress has considered to mix banking and commerce could be safely and soundly executed by this Nation's financial services and companies and commercial firms").

109. See generally <http://www.naic.org>, (last visited Apr. 1, 2001).

110. See State Implementation of the NARAB Subtitle in the Gramm-Leach-Bliley Act: Hearing Before the Securities Subcommittee, Committee on Banking, Housing, and Urban Affairs (Apr. 12, 2000) (statement of Terri Vaughan, Chair, NAIC Financial Services Modernization Working Group on NARAB), available at <http://www.naic.org/1news/testimonies/pdfs/4-12-00testimony.pdf> (last visited Sept. 21, 2001).

111. George Nichols III, Commissioner of Insurers of Kentucky, member of the 2001 NAIC Executive Committee, and former President of the NAIC. See http://www.naic.org/1misc/about/naic_officers.htm, (last visited Apr. 1, 2001).

112. But see Gene Linn, *NAIC Wrestles with Regulations*, J. COM., Mar. 1, 2001, at 8.

competition in regulation. It doesn't necessarily mean disregarding safety and soundness, but prompting them. Will we see states now pulling away from form and rate regulations?

New York State is a tough state. The New York State Insurance Superintendent¹¹³ believes itself to be - and it may well be - the best insurance department in the country. They are not going to readily accept what another insurance department does.

You can't buy a bank so simply. One can't buy a bank with an alias, as one can with an insurance company, and we have had some scandals.¹¹⁴ The quality of state regulation in insurance varies tremendously. Banking supervision in some states may be better than in others. Those are all issues to grapple with.

New York State is never going to accept something like a European Community view,¹¹⁵ where you allow an entity to come in across borders. In the European Union there are no form and rate regulations, but the host country, the country in which one is doing business, is allowed to regulate for the common good. This means consumer regulation.

Then, of course, there is the problem of cheating. The French would say that any insurance contract that is not in French obviously needs to be in French, in order to protect consumers. I would like to do one more for the French. We saw a British bank that wanted to acquire a French bank, but a French firm won. This happens all the time in France. There is a major question of whether there is de jure and de facto nationalist treatment. One never knows when a French government official will call up a French firm and say, "We must not allow X from Y country to acquire this organization. You must acquire it for the good of France." That is a wicked issue.

In Germany we are also beginning to see that the German firms have huge unrealized profits on securities that they have held

113. Neil D. Levin. See <http://www.ins.state.ny.us/hp97nl.htm>, (last visited Apr. 1, 2000).

114. See e.g., Dennis Kelly, *Caught Off Guard*, BEST'S REV. Oct. 1, 2000, at 143; *Pressure Builds For Federal Charters For Insurance*, FED. & ST. INS. WK., Sep. 25, 2000; *New Book Examines Fugitive Financier Frankel*, BEST'S INS. NEWS, Apr. 3, 2001.

115. See Lisa S. Howard, *Cross-Border Rules for EU Brokers Eyed*, NAT'L UNDERWRITER - PROP. & CASUALTY, Oct. 2, 2000.

since the Depression in 1929. They are going to be allowed to divest those securities tax-free. There is going to be a huge amount of funds rolling into the German banking and insurance systems. Where are they going to want to make acquisitions? Right here in the United States.

So the level playing field internationally is something to watch out for. Regarding those firms that buy here, I have asked the supervisors in the New York Insurance Department, "Did you ever read the footnotes on a financial statement of a European insurance company when you do a review of its acquisition?" The answer was, "No." Well, no one does. Analysts do not read the footnotes either. The true profitability and capital adequacy of those foreign firms does not approach that of ours. This is going to be a very interesting future, I think, in this area.

PROFESSOR FELSENFELD: Larry Uhlick, may I follow through on what I suggested earlier? Would you accept a question as to whether in the first weeks of Gramm-Leach-Bliley¹¹⁶ the foreign banks have fallen behind the domestic banks, and whether there is resentment in your foreign bank membership as to their status in the United States?

MR. UHLICK: At this stage, there is great concern that the statutory pattern and its implementation may not work out as well as people had anticipated months ago. Up to this point, it seemed like a reasonable principle that the foreign banking organizations, in order to become financial holding companies, need comparable capital and management standards. But, there have been big problems in terms of the Federal Reserve getting itself comfortable, and letting through what people think are a reasonable number of good institutions that should be approved.

Let me be more specific on that issue. The European Community has made various diplomatic protests that the system is lopsided and it is almost, in a way, as though the institutions elsewhere in the world have been domesticated by the United States.¹¹⁷ Obviously, these institutions are not going to be

116. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

117. See, e.g., PR NEWSWIRE, *EU Envoy Urges Equal Treatment under New US Banking Laws*, March 6, 2000 (detailing the demands and concerns of

comfortable with the United States as a host company regulator, purporting to domesticate or micro-regulate the institution from elsewhere in the world, when that institution is supposed to be regulated globally by the home country regulator. So there is quite a tiff going on amongst the regulators.

There will be ramifications for American financial institutions if this doesn't get worked out. There has been a bananas' war¹¹⁸ and one would hate to see a banking war. It is in the cards, however, because there is a huge imbalance between the way other countries, as host regulators, are regulating U.S. institutions doing business abroad, and the way the U.S. as a host regulator is seeking to regulate non-American institutions from elsewhere in the world.

Personally, I think a little bit of fine judgment, as is always the case, can work this thing out. The Federal Reserve is going to have to treat these institutions with sensible judgment. It's almost like the second child theory: with the first child, the bottle drops and you get hysterical; with the second child, you pick the bottle up, put it in the baby's mouth and everything is fine. The Federal Reserve is going to have to deal with these institutions on a sensible judgmental basis - letting in the good ones, and objecting when they have a fundamental problem. Until that is done, the jury is out. Until that is achieved, I really do think there will be very serious diplomatic protests and very serious practical ramifications for American-based financial institutions.

PROFESSOR FELSENFELD: Thank you, Larry.

A question up here?

QUESTION: You have all been speaking about how the legislation has followed the innovation in the industry, rather than led it in terms of direction for change. I'm wondering if you think there will be even more innovation developed outside of the financial holding company charter, before the industry segments learn how to use that new charter to develop whatever it needs to

European bankers and regulators); see also Rob Garver, *Fed Rebuts Foreign Banks' Claim of New Rules' Bias*, AM. BANKER, April 19, 2000, at 2.

118. See generally Steve Pearlstein, *U.S., EU Hold Off on Imposing Trade Sanctions*, WASH. POST, November 18, 2000, at E1 (discussing the dispute between the United States and the European Union over the European Union's ban on the importation of bananas from United States-based producers into Europe).

survive and prosper in the new economy?

PROFESSOR FELSENFELD: Would somebody other than Ernie Patrikis care to pick that one up? Bill Sweet?

MR. SWEET: Looking at the flow of human capital, Heidi Miller, the CFO of Citigroup, left to go to Priceline.¹¹⁹ An executive, I learned today, from Sumitomo has gone over to Sony to help them with their Internet bank. If one examines the flow of human capital, I think it suggests that yes, in fact, innovation will occur, at a minimum, at a much more rapid pace outside of the financial holding companies than within them. The question then is whether the financial holding companies can retain any of that capital. One of the ways you do that is by making investments in these companies and offering your employees an interest. Secondly, you look at whether they will be able to make the investments to participate indirectly.

PROFESSOR FELSENFELD: I would like to ask Bill Lifland a question about antitrust enforcement. My question is, Bill, really, where is antitrust enforcement? We have seen some mind-boggling bank mergers over the last ten years in the United States. I can't help but develop a substantial sense that the authorities, whether they are the traditional antitrust authorities, i.e., the FTC, the Attorney General's office, or the banking regulators, seem to be almost primed in advance to let bank mergers go through without obstacles, except perhaps here and there, you know, "dispose of a half-a-dozen branches in Cincinnati and you will be okay." Do we really have vigorous bank antitrust enforcement in the United States and will we have it under Gramm-Leach-Bliley?¹²⁰

MR. LIFLAND: I think, Carl, that the answer to your question would clearly be a "yes" if you left the word "bank" out. We do have vigorous antitrust enforcement. The government enforcers are fond of pointing out that in the past year they have collected Sherman Act¹²¹ fines that are many times more than what

119. See Patrick McGeehan, *Web Concern Hires Officer of Citigroup*, N.Y. TIMES, February 24, 2000, at C1.

120. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

121. 15 U.S.C. §§ 1-7 (2000).

they had collected in the past.¹²² There was one \$500 million fine¹²³ - I didn't say \$500, but \$500 million - and there was at least one other \$100 million fine.¹²⁴ So the general tendency has been to increase the level of enforcement and to maintain it at a high level.

Now, when you add the word "bank" back into the question, then I think two points are raised. First, as Ernie Patrikis said earlier, there are still an awful lot of banks in the country, and some of the things that banks do can be done by other financial service institutions. In general, then, one would not expect to find the same level of antitrust activity in that area, were it not for the fact that banking has traditionally been viewed as a local or regional activity, rather than a national activity.

Second, given the techniques that the government applies in analyzing mergers, and also that it is sometimes possible for these institutions to make divestitures which eliminate the likelihood that prices for bank services will increase as a result of the transaction, you often tend to find that the agencies do not proceed.

Frank Scifo, do you have a different view on that?

MR. SCIFO: No, I think that is quite right. I am sitting here thinking about whether there will be any difference with respect to the Act¹²⁵ and the shift in jurisdiction. But basically, when you look at the industry, I think it's so fragmented that any procedural difference between bank regulators and antitrust regulators outside of banks is yet to be seen.

MR. PATRIKIS: I see two separate issues. One is that there is

122. For a discussion on the increase in such fines, see the U.S. Department of Justice Antitrust Division Annual Report FY 1999, Part II: The Criminal Enforcement Program, available at <http://www.usdoj.gov/atr/public/4523e.htm> (last visited Sept. 15, 2000).

123. See generally David Barboza, *Six Big Vitamin Makers Are Said to Agree to Pay \$1.1 Billion to Settle Pricing Lawsuit*, N.Y. TIMES, Sept. 8, 1999, at C2 (describing a settlement agreement by "six of the world's largest vitamin makers" to settle a class-action lawsuit concerning a conspiracy to fix vitamins).

124. See generally Kurt Eichenwald, *Archer Daniels Agrees to Big Fine for Price Fixing*, N.Y. TIMES, Oct. 15, 1996, at A1 (writing about Archer Daniel Midland's \$100 million fine for conspiring to fix the prices of two agricultural products).

125. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

a 10 percent cap under the legislation that allowed interstate banking.¹²⁶ No bank can make an acquisition if it has over 10 percent¹²⁷ of the deposits in the United States. I think Bank of America is already at that point. No acquisition can be done in a state, and this is federal law, if you are acquiring more than 10 percent of deposits held in the United States.¹²⁸

Now, a second issue is how do we measure this limitation. It is pretty simplistic if we use deposits. So if a Chase and a Chemical merge and they use deposits as an indicia of competition, where are those deposits from? If I look at the deposits booked at Chase in New York City, they can be from all over the world. These are not necessarily consumer deposits. Where are the loans? What are the sources of the loans?

What is not done in antitrust analysis in banking, because it because combing through all the data and product lines, while saying "Ah, yes", would be too expensive and difficult for the Justice Department to do. The only area where this really comes out in is within medium and small business loans, where the Justice Department has carved out an exception, saying that loans to medium and small sized businesses is a concern.¹²⁹ It is in these cases that we have the divestitures.

That doesn't consider a bank like Wells Fargo, which is located in California and that does mailings. Wells Fargo mails throughout the United States and Canada, for loans to medium and small sized businesses, which drives the Canadian banks crazy because Wells Fargo doesn't have a branch in Canada. That is not considered in an antitrust analysis. If we are to do a merger analysis, a community in upstate New York that has small

126. See 12 U.S.C. 1831(u) (passed as part of the Riegle-Neal Interstate Banking and Branching Efficiency Act (IBBEA), Sept. 29, 1994).

127. According to Charles A. Gabriel, Jr., an analyst with Prudential Securities in 1998, Bank of America had over 8% of the national deposit share as of June 1998. See James P. Lucier, *The Big Banks Get Together*, INSIGHT ON THE NEWS, Jun. 1, 1998.

128. See 12 U.S.C. 1831(u) (2000).

129. See Constance K. Robinson, Director of Operations, Antitrust Division, Bank Mergers and Antitrust, Address Before the Association of the Bar in the City of New York (Sept. 30, 1996), available at <http://www.usdoj.gov/atr/public/speeches/robins2.htm>.

businesses that Wells Fargo is making loans to, using credit scoring (not even knowing who the owner of the company is), is disregarded for regulation purposes.

So it is a difficult issue. Where does one get the data for doing a real fine analysis?

PROFESSOR FELSENFELD: Maybe we need another *Philadelphia National Bank*¹²⁹ decision, as well as a return to “Go” and a fresh start.

Last question, Larry Uhlick.

MR. UHLICK: I agree with Ernie’s analysis that this is not really a statute regulating financial holding companies. It is a statute holding banks up to a broader authority and imposing umbrella supervision on them.

But what would he give us instead? We are always looking forward, not only analyzing this statute,¹³¹ but always looking at where things are going. Would he be happy with a system where any owner of a financial holding company would be subject to umbrella supervision; or as they are in Europe? If an entity is involved with securities and insurance, but not with banking, would it be subject to some umbrella supervision? Right now it is all on the banks. My question is, what is the new system?

MR. PATRIKIS: Oversight. Is there really a need to have capital adequacy at the holding company level? I don’t understand it. Each of the firms is adequately supervised and regulated. We have said as a matter of public policy that banks, broker-dealers, investment managers and insurance companies will all be supervised and regulated. An oversight policy would say, “Well, I want to know relations with affiliates.” There are laws in all of these areas that govern transactions with affiliates, and in banking, that means ten percent relationships, not twenty-five percent.

So I don’t see the need for this “almost regulation” if the Federal Reserve is not an oversight supervisor. If it really were oversight - that is, understanding the entity, knowing the inter-

130. *United States v. Philadelphia Nat. Bank*, 374 U.S. 321 (1963) (enjoining a proposed bank merger as a violation of Section Seven of the Clayton Act, due to the merger’s deleterious effect on competition).

131. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 and 15 U.S.C.).

relationships between the firms, having the ability to get information at any time - that, to me, is a very doable, safe and sound alternative. But putting in capital adequacy, or, in other words, saying that this is just a big bank while all the corporate separation is irrelevant and all the unsupervised and unregulated activities are very relevant, is not the solution in my opinion.

Let's say a swap activity occurs with an unsupervised, unregulated swap subsidiary with a triple-A rating. That triple-A rating is the best regulator, not a process of sending in some supervisor or regulator to possibly find something. I don't see that.

We do our foreign exchange trading in a foreign exchange subsidiary that is unsupervised and unregulated. It's the eleventh or twelfth largest foreign exchange trading subsidiary in the world. It's triple-A rated. That's the regulator. It's the concern about the marketplace and that rating that should govern.

The Fed should understand the relationships. But to set capital adequacy standards on it - must everything be regulated? You see, I start with the premise that everything need not be regulated. If something takes place in the wholesale market, or concerns wholesale counter-parties, then there is no need for regulation.

I don't like the system that we have in place today where the SEC goes after Bankers Trust for what it did with Procter & Gamble. There's no need for it because you can't deal with an agency. There is no de facto due process. If the SEC or the Federal Reserve comes after you, the issue is, "How much do I pay to get out of this picture?" It is not, "Did I do something wrong?" Any firm with integrity will not challenge the Fed or the SEC. You cannot do it.

So I say the only way to deal with this topic is to deregulate entirely. This legislation does not deregulate, nor does it re-regulate; it is a new layer of regulation. Does that make the world a safer place? I'm skeptical.

PROFESSOR FELSENFELD: Please join with me in thanking our panelists for being here and giving us their thoughts.

MR. OLIVERIUS: I also want to thank Professor Felsenfeld for doing an excellent job moderating this panel.