Citigroup to Congress: Never Mind!
(Some reflections on the Gramm-Leach-Bliley Act prompted by Citigroup's exit from insurance underwriting)

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There is an obvious irony in Citigroup's decision, announced in February, to sell most of its life insurance business, thus largely completing an exit from the insurance underwriting business that began with the spin-off to shareholders of its property and casualty operations in 2002. Citigroup, as a financial conglomerate combining banking, securities and insurance in a single holding company, had been both the midwife and the most obvious beneficiary of the Gramm-Leach-Bliley Act ("GLBA"), whose enactment in 1999 (as opposed to, say, 2019) was undoubtedly hastened by The Travelers Group's bold acquisition of Citicorp the year before. Pared down essentially to banking, securities and insurance agency activities, Citigroup could have operated under the pre-GLBA bank regulatory structure, albeit with some inconvenience.

So now that Citigroup may not really need GLBA anymore, it seems appropriate to consider what the law actually accomplished that is of lasting importance. This article is a highly selective assessment of only a few aspects of the statute, using as a framework three of the claims made for it by one of its architects, Representative Jim Leach. In his remarks at the bill signing ceremony on November 12, 1999, Congressman Leach asserted, among other things, that GLBA:

- "advances competition at home and . . . increases our ability to compete abroad;"
- "plugs the loophole that allows some mixing of commerce and banking in this country;" and
- contains "the strongest privacy provisions ever enacted into statute."

Let's consider each of these claims in turn.

Competition. The assertion that GLBA increased competition at home and abroad is in some ways the most sweeping and it can be understood to refer to many aspects of the statute. GLBA was supposed to remove artificial barriers to competition among different sectors of the financial services industry, creating a "two way street" that would allow banking organizations to engage in the securities and insurance business, while investment firms and insurance companies would be able to own banks. The banking, insurance and securities businesses were each to be functionally regulated by the appropriate federal or state regulator, under the umbrella supervision of the Federal Reserve. GLBA was also intended to provide a framework for the authorization of additional financial activities for financial holding companies, so that the law could keep pace with, rather than impede, market developments.

Measured against these lofty goals, GLBA falls short on some counts. To be sure, GLBA has been widely embraced by banking organizations. As of July 8, 2005 (the date of the most recent list on the Fed's Web site, as of this writing) well over 600 bank holding companies in the United States (including Puerto Rico) had elected financial holding company status, the prerequisite to exercising the full range of financial powers available under GLBA. All of the 15 largest domestic banking organizations, and a substantial majority of the top 25, are financial holding companies. (Significant exceptions include credit card powerhouse MBNA Corporation – whose acquisition by Bank of America Corporation, which *is* an FHC, is pending -- and such significant regional bank holding companies as M&T Bank Corp. and North Fork Bancorp).

Thirty-seven foreign financial institutions have also elected FHC status, including, unsurprisingly, all the big Canadian banks and many, if not most, of the other non-U.S. banking organizations with a substantial U.S. presence, including Deutsche Bank, ABN AMRO, Société Générale, BNP Paribas, UBS, Crédit Suisse, HSBC Holdings and the Royal Bank of Scotland Group. No doubt the tally would be higher but for the fact that no Japanese bank holding company is an FHC, probably because the election is not yet an option for most of them, given the still-murky condition of the Japanese banking sector.

For larger banking organizations, FHC status offers significant competitive benefits:

- the ability to engage in a full range of securities powers, including running a mutual fund family, without the inconvenience of complying with the "Section 20" regime developed by the Fed while the affiliation restrictions of the Glass-Steagall Act survived;

- broader equity investment opportunities through "merchant banking" authority;

- the freedom to sell insurance without resorting to loopholes such as the "place of 5000" available to national banks, however indulgently interpreted by the forward-looking OCC;

- the flexibility to make nonbank acquisitions without Fed approval (albeit, in some cases, with a new requirement of making costly Hart-Scott-Rodino premerger filings); and

- the possibility of exercising new financial powers (should any ever be authorized).

Reportedly, the vast majority of the hundreds of smaller bank holding companies that elected to become FHCs were primarily motivated by the freedom to sell insurance that GLBA provides. It is noteworthy that the Fed's current regulatory reform agenda includes permitting insurance agency for bank holding companies that are not financial holding companies, and would also restore the Fed's authority – frozen by GLBA -- to authorize new "closely related to banking" activities for non-FHC bank holding companies. If enacted, these two modest measures might prompt a number of smaller FHCs to relinquish that status.

But if GLBA swept away or lowered the barriers that had prevented or impeded affiliations among banks, securities firms and insurers, it does not seem to have induced many securities firms or insurance companies to acquire commercial banks, nor have many large banking organizations begun underwriting insurance.

It continues to be striking that few nonbank financial firms followed The Travelers' lead in becoming bank holding companies. To date, there have been only a handful, including: The Charles Schwab Corporation (by acquiring U.S. Trust Corporation); MetLife, Inc. (by acquiring Grand Bank, N.A.); Friedman, Billings, Ramsay Group, Inc. (by acquiring FBR National Bank); Franklin Resources, Inc. (by acquiring Fiduciary Trust Company International); Countrywide Credit Industries, Inc. (by acquiring Treasury Bank, Ltd.); and Canada's Manulife Financial Corporation (by acquiring John Hancock, whose "nonbank bank" subsidiary, First Signature Bank and Trust Company, lost its exemption from the Bank Holding Company Act). None of the transactions compares in scope with Travelers/Citicorp, and several might have been possible with only modest tweaking under the pre-GLBA Bank Holding Company Act. Friedman Billings got out of the retail banking business and is no longer a bank holding company.

One can speculate as to the reasons why there has been relatively little traffic on the two-way street that GLBA was supposed to create. As recently reported in The Wall Street Journal, no doubt many bank holding companies have, like Citigroup, reached the conclusion that insurance underwriting is simply not as profitable as other banking and securities businesses.[1]

As to securities and insurance companies, some would probably cite the Fed's reputation as a strict regulator as a significant disincentive for financial firms that are not already bank holding companies to subject themselves to the Fed's oversight, particularly when it is still possible to own a depository institution without becoming a bank holding company. While GLBA did away with the unitary thrift option (a subject that is discussed further below), it did nothing to prevent securities or insurance concerns from acquiring savings institutions. (Of the five insurance companies with banking operations named in the Wall Street Journal article referred to above, four are using thrift institutions as their banking vehicle.) The Office of Thrift Supervision, in contrast to the Federal Reserve, has been perceived as a more flexible supervisor of depository institution holding companies, and the thrift charter has many attractive features. It is well known, for example, that federally chartered thrift institutions benefit from federal preemption of burdensome state laws to at least as great an extent as national banks and also enjoy a more liberal interstate branching regime. And, in April 2001, the OTS's Chief Counsel opined that multiple savings and loan holding companies are authorized, under the Home Owners' Loan Act, to engage in the full range of financial activities permissible for financial holding companies under GLBA, apparently without having to meet the strict

[1] See Shefali Anand, *Supermarket Savvy: Insurers See Success in Banking Sector,* Wall Street Journal, July 18, 2005, at C1.

financial and managerial criteria that apply to a bank holding company seeking financial holding company status.

The OTS has even been recognized as a consolidated supervisor by the European Union, enabling U.S. financial conglomerates that it regulates to meet the requirements of the EU's Financial Conglomerates Directive. (It remains to be seen whether this new role will affect the OTS's relatively non-intrusive approach to holding company regulation). In sum, for financial companies willing to cope with the relatively minor and quite manageable special requirements and restrictions of the thrift charter, using a thrift subsidiary to offer insured deposit products and other banking services is eminently feasible. As discussed further regarding banking and commerce, establishing an industrial loan company is also an option for both financial *and* commercial or industrial companies.

The lower-than-expected traffic on the two way street may also be due to the fact that, for some players in the financial services business, sectors that had been off-limits seemed appealing for precisely that reason. Perhaps it was necessary to remove the artificial barriers for participants in the industry to take a clear-eyed look at the opportunities on the other side of the barriers, and decide that they simply were not that attractive. It is also plausible that, for some financial industry participants, the calls for a two-way street represented a tactic to forestall reform, rather than a genuine goal.

Before turning to the banking/commerce question, two additional areas where GLBA has not completely fulfilled its promise are worth a brief mention. First, functional regulation of the securities activities of banks has not been properly implemented. Although it is scarcely believable almost seven years after GLBA was signed into law, there is still no sensible rule permitting banks to conduct certain traditional brokerage-related activities without being regulated as brokers under the Securities Act of 1934. For this, many in the banking industry would blame the SEC, which they view as seeking to achieve through regulation what it failed to gain under the carefully negotiated statutory provisions of GLBA.

A second disappointment concerns new financial powers: no significant new ones have been authorized. The Fed, in consultation with the Treasury, determined in 2000 that acting as a "finder" is an activity incidental to a financial activity, and therefore permissible for financial holding companies. The "finder" activity has long been permitted for national banks under rulings of the Comptroller of the Currency. To date, acting as a finder is the only new activity approved by the Fed under GLBA. (The Fed has also permitted all bank holding companies -- not just financial holding companies -- to conduct a broader range of nonfinancial data processing in connection with processing financial data.) Sadly (at least from the banks' perspective), a rule to permit financial holding companies to engage in real estate brokerage has been hung up by the massive opposition of real estate agents, in an effective display of the same kind of legislative lobbying that kept banks out of the insurance business for so many years. It was probably naive to hope that GLBA would put an end to such battles.

Separation of Banking and Commerce. Whether banking and commerce should continue to be separated, and if so, to what degree, was an important part of the debate regarding financial modernization that preceded the enactment of GLBA. The advocates of continued separation achieved victories in doing away with the so-called unitary thrift loophole, which had permitted industrial and commercial companies to own a single thrift institution, and in limiting the nonfinancial activities of financial holding companies through activities such as merchant banking. Nevertheless, the claim that GLBA plugged a loophole in the separation of banking and commerce overlooks the industrial loan company option. Under a limited exemption from the Bank Holding Company Act, any kind of company can operate an ILC, a depository institution that has virtually all the powers of a commercial bank, with the exception of providing checking accounts (if the ILC has more than $100 million in assets). A number of states, including, notably, Utah, offer an ILC charter, and many industrial and commercial concerns have Utah ILC subsidiaries. In fact, Volvo, which acquired Mack Truck in 2001, owns a Utah ILC, which may be indicative of the size of this banking/commerce loophole. Whether ILCs should be permitted to offer checking accounts (or their equivalent) and enjoy expanded interstate branching options may be the next front in the banking/commerce battle.

Privacy. GLBA unquestionably broadened the reach of federal privacy protection to a much broader swath of companies. At the same time, it seems to have left unresolved more issues than it settled. These include:

- the degree to which federal privacy requirements should preempt state laws;
- whether opting in or out is the correct approach to information sharing with affiliates and third parties;
- the adequacy of data protection; and
- resolving the competing claims of law enforcement and personal privacy.

But it is probably unfair to fault GLBA for leaving open so many privacy-related questions. Other issues addressed by GLBA – such as the permissibility of affiliations among banks, securities firms and insurance companies, and how financial conglomerates should be regulated – had been debated for years if not decades before the law was enacted. Whatever one may think of GLBA's resolution of these issues, the advantages and disadvantages of different approaches had been extensively considered. Privacy questions, in contrast, had not been at the center of bank regulatory reform discussions. It seems likely that GLBA's privacy provisions will be revisited in years to come.

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Measured against some of the expectations that GLBA evoked, especially concerning the promotion of widespread financial services firm competition under a unified regulatory structure, the achievements of the law might seem disappointing. On the other hand, considering how creaky the U.S. bank regulatory structure had become with respect to affiliations among different types of financial services companies and in other respects, GLBA – or at least significant parts of it – were both necessary and overdue. Can anyone seriously argue that the financial services industry is not better off under GLBA than it would be without the law? The fact that the financial services debate has moved on to other issues is a measure of how much GLBA accomplished.

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