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REPEAL OF THE 1934 GLASS-STEAGALL ACT WILL STRENGTHEN THE COMPETITIVENESS, INTEGRITY, & SOUNDNESS OF BANKS AND OTHER U.S. FINANCIAL INSTITUTIONS

Events have rendered obsolete the 1934 Glass-Steagall Act, which attempts to segregate commercial from investment banking. New legal instruments now skirt its outdated regulatory prohibitions. New computer and communications technologies have globalized financial markets, subjecting U.S. financial firms to tough new competitive pressures. Consumers of financial services -- individuals, governments, and businesses --demand the convenience and flexibility of one-stop financial shopping. Glass-Steagall weakens U.S. firms, by undermining their ability to accomodate these irreversible trends.

The need for comprehensive reform is clear. As stated by Senate Banking Committee Chairman William Proxmire:

> "[A]ction on fundamental financial services reform is long overdue. The statutory and regulatory framework is no longer adequate to cope with the changes that have taken place in the marketplace."

The 1987 Competitive Equality Banking Act recognized the need for prompt reform:

> "It is the intent of the Congress . . . to conduct a comprehensive review of the banking and financial laws and to make decisions on the need for financial restructuring legislation."

Similarly, Federal Reserve Chairman Alan Greenspan has observed:

> "[W]e now have an historic opportunity to put the financial system on a sounder footing -- perhaps a unique opportunity to make it more responsive to consumer needs, more efficient, more competitive in the world economy, and equally important, more stable."

This paper, prepared at the request of the Association of Bank Holding Companies,[1/] briefly reviews the benefits that have led experts such as Chairmen Proxmire and Greenspan to champion

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1/ The Association of Bank Holding Companies represents over 120 enterprises organized under the Bank Holding Company Act of 1956, as amended, comprising over 75% of the nation's commercial banking assets.

financial regulatory reform. The paper then addresses criticisms made by opponents of reform, in particular, by the Securities Industry Association (SIA).

The paper concludes:

- o Repeal of Glass-Steagall will open to effective competition economic sectors in which a few giant securities firms currently control market shares as high as 90%, and, as the General Accounting Office (GAO) concluded in a February 10 1988 report,"both households and businesses are likely to benefit from lower prices and enhanced services," including reduced financing costs, broader and more flexible options to choose from, greater availability of capital, and the convenience of one-stop financial shopping.

- o By permitting banks to recapture traditional markets and to diversify into stable and profitable markets, Glass-Steagall repeal will enhance both their safety and soundness and competitiveness. For example, arbitrary exclusion of banks from issuing commercial paper has cut their share of the low-risk market for short-term financing of major U.S. corporations from 49% in 1975 to 26% in 1986. Similarly, underwriting securities, from which banks are generally barred, requires the financial intermediary to hold a risk for only minutes or perhaps days, while issuing commercial loans, a traditional bank function, may involve holding risks for decades.

- o Glass-Steagall repeal is needed to strengthen U.S. financial firms in global markets: In 1970, seven of the ten largest banks in the world were U.S. banks. Today, the U.S. has only two banks in the top ten, measured by assets, while Japan has five.

- o Diversified financial firms are now and will continue to be stringently regulated by banking, securities, and other legal safeguards that did not exist when Glass-Steagall was originally passed. In part because these laws are so effective, the Federal Reserve Board observed in 1987 that there is "no evidence that banks' loan participation activities have produced serious conflicts of interest."

- o New and even more stringent legal safeguards, contained in proposed legislation such as S. 1886, sponsored by Senators Proxmire and Garn, minimize legitimate "safety and soundness" and "conflict of interest" concerns without depriving financial services customers of the benefits of greater competition and integrated product offerings. Safeguards similar to those contained in S. 1886 were approved February 8, 1988 by the U.S. Court of Appeals for the Second Circuit for applications to the Federal Reserve to permit bank affiliates to underwrite limited amounts of certain broad classes of previously "bank-ineligible" securities.

o Claims that Glass-Steagall repeal would enable banks to compete "unfairly" with securities firms because banks benefit from a federal "safety net" are without merit -- first, because under all the pending reform bills, banks could only affiliate with securities firms in a bank holding company and could not cross-subsidize these affiliates, and, second, because the asserted "unfair" bank advantages are illusory:

-- Alleged "privileged" access to the Fed's "discount window" is in fact available (both directly and indirectly) to all financial institutions, and is useable only in extreme emergencies as a "lender of last resort" -- not as a routine liquidity-raising tool. All borrowings from the discount window must be 100% collateralized, and the Fed has stated that "there is no evidence that [bank holding company] underwriting subsidiaries would, by reason of their affiliation with federally insured banks, enjoy access to lower cost funds than their competitors."

-- Similarly, access to the payments system is not a unique bank privilege. All depository institutions (including non-bank banks owned by securities firms) have access to it at the same price, and banks pay for their access by holding non-interest-bearing reserves on deposits, at a cost to the banking industry of well over $2.5 billion annually.

-- FDIC insurance does not provide banks with unique "subsidized" access to depositors' funds. Banks paid the FDIC over $1.6 billion in premiums to ensure deposits up to $100,000 in 1986, compared to the less than $24 million paid by securities firms to the Securities Investors Protection Corporation, which insures investor accounts up to $500,000.