DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.
March 15, 1998

SECRETARY OF THE TREASURY

MEMORANDUM FOR PRESIDENT CLINTON

FROM: Robert E. Rubin

SUBJECT: Financial Modernization Legislation

Background. Last year we sent to Congress draft legislation proposing sweeping changes in the laws governing the financial services industry. Our bill would both broaden the range of financial activities permissible for banking organizations and allow insurance and securities firms to own banks. The House Banking Committee and the House Commerce Committee, each of which has jurisdiction, reported out significantly different versions of the bill last year. The Republican Leadership in the House -- with no involvement of Democrats -- has recently forged a compromise version, which it is proposing to move to the Floor quickly, perhaps in the next few weeks.

We propose to send the Leadership a letter stating that we will oppose the bill and recommend against its enactment unless our concerns are resolved. We believe it will be difficult for the Leadership to pass this bill over our objection -- although they are likely to make a strong effort to do so.

While the compromise would achieve some of our basic objectives, it includes a number of provisions that we find highly objectionable. In particular, it would significantly weaken the national bank charter in several important respects:

- First, it would bar national banks (but not state banks) from conducting new financial activities through their own "operating subsidiaries" and would force all such activities to be conducted through holding company affiliates, under the sole jurisdiction of the Federal Reserve. In this respect the proposal is intended to shut down the Comptroller of the Currency's "Part 5" initiative, under which Comptroller Ludwig has moved to give national banks more flexibility in conducting new financial activities through subsidiaries.

  This would significantly limit the role of the Executive Branch in the development of banking policy and would put the national bank charter at a competitive disadvantage compared to the state charter. We think it would also have the effect of weakening the Community Reinvestment Act, by reducing the volume of bank resources that could be taken into account by the Comptroller in assessing a bank's CRA performance.

- Second, it would make national banks more vulnerable to state laws that discriminate against banks (such as those limiting the ability of banks to sell insurance) by eliminating the tradition deference the Federal courts have given to the Comptroller's decisions on preemption of such state laws. It would also discriminate against national banks in a number of other respects, for example by imposing restrictions that do not apply to state banks and by failing to eliminate outdated restrictions in Federal law that apply only to national banks.

- There is no safety and soundness or competitiveness basis for these restrictions.

The bill would also significantly limit the utility and flexibility of the Federal thrift charter.

We repeatedly informed the two Committees and the Leadership of our objections to these provisions, but they pointedly ignored out position, largely out of a fear of offending the Federal Reserve. We are informed that they fully expect opposition from us. (We and the Federal Reserve have compartmentalized this disagreement from the rest of our working relationship.)

Where the Parties Stand. The major insurance and securities groups appear to be supportive of the compromise proposal, largely because it allows their members to acquire banks. We believe the Independent Insurance Agents are likely to be supportive because of the restrictions the bill would put on new bank insurance activities. Several major banks, such as NationsBank and BancOne, support the proposal. The American Bankers Association has not yet taken an official position, although it is known to be unhappy about a number of the bill's provisions. We have heard reports that the House Leadership has been lobbying heavily to get bankers on board.

The Independent Bankers Association of America, which represents smaller community banks, and the major trade association representing thrift institutions are strongly opposed to the bill. Consumer groups are also opposed, principally because they believe the bill does not have sufficient protections for consumers and because it does not extend CRA to insurance and securities companies. (We were urged to include such an extension of CRA in our bill, but elected not to do so because we thought it could not pass and would create strong opposition to the basic structural reforms we were proposing.)

House Banking Committee Democrats are disaffected because they were not given a role in forging the compromise. However, John Dingell, Ranking Member of the Commerce Committee, has supported some of the provisions that we oppose, and he could support the Leadership compromise. Gene Ludwig and Ellen Seidman, who is Director of the Office of Thrift Supervision, both have strong objections to the bill.

Our Recommended Position. The bill has gone further than any prior financial modernization proposal, and it has much in it that we support. However, we are strongly opposed to the provisions weakening national banks and the authority of the Comptroller's Office. If the bill could be altered to satisfy our concerns we could be supportive. While the Leadership has urged that we try to get our concerns addressed in the Senate or in Conference, and that we not try to prevent passage in the House, we are reluctant to allow a bill to pass the House in this form -- in part because the Senate may well not act on the proposal this year and a House-passed bill might then become the baseline for the next Congress.