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Analysis of Gramm-Bliley-Leach Act"

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REFORM OF THE FINANCIAL SERVICES INDUSTRY – ANALYSIS OF GRAMM-BLILEY-LEACH ACT

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ABSTRACT

This paper reviews the major provisions of the Gramm-Bliley-Leach Act or Financial Modernization Act which was signed into law by President Clinton in 1999. The paper explores the major issues addressed by this 380 page piece of legislation by examining the reforms of the financial service sector of the economy, the new disclosure requirements concerning financial privacy, and changes to the Community Reinvestment Act. Congress specifically resolved many conflicts between competing constituencies over the nature and form of the US financial sector, but some issues were deliberately assigned to regulatory agencies to resolve. This paper explains the new regulatory framework, the financial holding company, the functional regulatory scheme, and reviews key economic and historical developments that led to this landmark legislation.

I. INTRODUCTION

President Clinton signed the Gramm-Leach Bliley Act into law in 1999.[1] The 380 page act not only reforms the financial services industry but also tackles the issues raised by the Community Reinvestment Act and addresses the issues of financial privacy. The act will probably be remembered as the act that repealed the Glass-Speagall Act. Since the act was passed, predictions of major changes in our formal financial sector services industry did not occur, in part, it will be argued, because the industry had already maneuvered with its regulators to increase their flexibility. While some might be tempted to describe this law as the outright repeal of the Glass-Speagall Act[2], this paper reveals that the regulatory realities still produce some barriers in size and economies of scale to the outright homogenization of the financial services industry. In fact, there has been no

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[1] Gramm-Leach-Bliley Financial Modernization Act of 1999, 12 U.S.C. Section 1843 (C) (3), (k)(1) (Supp. V 1999)
[2] Kutter, Robert, "A Requiem for Glass-Steagall," Business Week, November 15, 1999, p.28.

stampede by the banking industry to take full advantage of their new license to pursue other financial services because of the significant regulatory costs associated with those industries.[3] What has changed in the financial services sector is the use of less visible 'strategic alliances' or marketing agreements subject to the privacy disclosures required by the Gramm-Leach-Bliley Act. A broad perspective of the US financial services industry suggests that while the Act is a landmark piece of legislation, it does not mark a new structure of the industry, but instead, confirms trends that had been developing through the existing regulatory process.[4] At the same time, the Act does significantly direct regulatory agencies, that were once operated somewhat independently of each other because their jurisdictions were so different, to cooperate in constructing policies where jurisdictional interests have now been blurred due to the potential of large financial institutions engaging in a myriad of financial services. This paper helps to clarify the current regulatory scheme while reviewing historical development of the US financial system.

The Act also produced significant disclosure requirements for all sorts of financial institutions concerning their use of customer information in the form of privacy notification disclosures. And the Act addressed some of the contentious issues surrounding the Community Reinvestment Act which requires that banks devote some of their financial assets within their service area to supporting minority loans.

II. THE U.S. FINANCIAL SERVICES INDUSTRY

There is quite a bit of interesting commentary over the passage of the Glass-Speagall Act which suggests that it was passed to reduce the likelihood of another collapse of the nations banking system that occurred during the 1930's. Congress wrote Glass Speagall Act to separate commercial banking from investment banking. The argument was that banks were ill equipped to handle the risks associated with the securities/underwriting industry. And vice versa. The result was that American commercial banks were restricted to lending and investment banks were restricted to underwriting. While modern scholars have challenged the notion that the depression was caused by bank's being leveraged in the stock market, valid or not, the justification for Glass Speagall is historically linked to the stock market crash of 1929 and the resulting depression.[5]

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[3] Conversation with James Bexley, Chair, Smith Hutson Chair of Banking, Sam Houston State University. Bexley acknowledges large mergers which followed the enactment of the act, but notes that these mergers were not a consequence of the act but a result of strategic decisions by banks to seek efficiencies of scale through merging rather than an expansion of existing activities. Bexley argues that most community banks have not taken advantage of the act because of the high regulatory costs if they formally affiliate with insurance and brokerage services. September 2000.

[4] Senator Phil Gramm "The New Banking Legislation: The Financial Modernization for the Twenty-First Century" SMU Law Rev. Vol 53, no 1, Winter 2000, pp. 371-5.

[5] Jane E. Willis "Banks and Mutual Funds: A Function Approach to Reform, Clumn Bux. L. Rev. 221, 229 and A.J. Herbert III "Requiem on the Glass-Steagall Act: Tracing the Evolution and Current Status of Bank Involvement in Brokerage Activities," 63 Tul.L. Rev. 157, 158 (1988), as cited by Glass, David L. "Symposium 2000: Financial Modernization: The Effect of the Repeal of the Glass Steagall Act on Consumers and Communities, Articles Essays, and Summarized Remarks of the Panelists The Gramm-

Glass Speagall created legal barriers separating investment from commercial banking through four major policies: banks were prohibited from underwriting securities, firms engaged in underwriting were not allowed to take deposits, section 20 of the Act provided that banks may not be affiliated with any company "engaged principally" in writing securities, and Section 32 of the Act prohibited interlocking directors and management personnel between a bank and company "primarily engaged" in underwriting securities.[6]

The Bank Holding Company Act of 1956 forbids any company that owns or controls a bank to engage in any other business, except those that the Federal Reserve Board have classified as "closely related to banking."[7]

To fully appreciate the complexity of the Gramm-Leach-Bliley Act requires an understanding of the US financial services industry. While this paper cannot present a detailed examination of the structure of that industry, a quick overview may be instructive. One major contributor to the complexity of the US financial system lies in the federal nature of our system.[8] Fifty state laws regulate the insurance business. Every state has securities or blue-sky laws. The federal government and semi-independent agencies under the Securities Act of 1933 and the Securities Exchange Act of 1934 also regulate the securities business. Banks may fall under the regulatory scheme of the Federal Reserve Board, state regulators, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation depending on their charter. The reality is that there are competing regulatory agencies that have to some extent-overlapping jurisdiction over the US financial services industry. The Federal Reserve Board wanted to use its personnel to exercise jurisdiction over the financial industry supplanting to some extent the Office of the Comptroller of the Currency. The compromise was that both agencies were ordered to share staffs to develop a consistent approach to financial service regulation.

Although the large banks receive much public attention, the US financial system is not an oligopoly of large institutions. A 1997 Federal Reserve Bank report found that banks with less than $100 million in assets comprised 66% of all United States banking organizations.[9] At the same time, America faces a global environment where competing nations permit their financial institutions to offer their customers a wide variety of financial products including, traditional banking, insurance policies, mutual funds, trust management, etc. A chief promoter of the repeal of the Glass-Speagall Act (which is actually sections 16, 20, 21 and 32 of the Banking Act of 1933) was Alan Greenspan, Chairman of the Federal Reserve. In testimony before the House, Greenspan argued:

Leach-Bliley Act: Overview of the Key Provisions; Presentation Before the State of New York Banking Department, 17 N.Y. L. Sch. J. Hum Rts. 1

[6] Glass Speagall Act, 12 U.S.C.24 (1933).

[7] Bank Holding Company Act, 12 U.S.C. 1845 (c) (5)-(6) as cited in Glass, op.cit.

[8] Glass, David L. "Symposium 2000: Financial Modernization: The Effect of the Repeal of the Glass Steagall Act on Consumers and Communities, Articles Essays, and Summarized Remarks of the Panelists The Gramm-Leach-Bliley Act: Overview of the Key Provisions; Presentation Before the State of New York Banking Department, 17 N.Y. L. Sch. J. Hum Rts. 1.

[9] Independent Community Bankers Association, Community Banking in the United Staets <http:www.icba.org/cbanks.html> (accessed October 14, 1999) ftn 14 in Dixon, Robert W. "The Gram_Leach_Bliley Financial Modernization Act: Why Reform in The Financial Services Industry was Necessary and the Act's Projected Effects on Community Banking," 49 Drake L. Rev. 671 (2001).

> Technologically driven proliferation of new financial products that enable risk unbundling have been increasingly combining the characteristics of banking, insurance, and securities products into single financial instruments. These changes, which are occurring all over the world, have also dramatically altered the way financial services providers operate and the way they deliver their products. In the United States, our financial institutions have been required to take elaborate steps to develop and deliver new financial products and services in a manner that is consistent with our outdated laws. The costs of these efforts are becoming increasingly burdensome and serve no useful public purpose. Unless soon repealed, the archaic statutory barriers to efficiency could undermine the global dominance of American finance, as well as the continued competitiveness of our financial institutions and their ability to innovate and to provide the best and broadest possible services to U.S. consumers.[10]

Not all proponents of the act believe that the banking industry required a bail out through expansion of services. Some argue that banking as seen from its role in providing depository services and loans is fundamentally different from the business of investment banking or underwriting and that they are not perfect substitutes for one another.[11]

III. THREE MAJOR ISSUES

The Gramm-Leach-Bliley Act really deals with three issues: (1) the activities and regulatory scheme which in effect codified certain trends already apparent in the financial services industry, (2) the issue of privacy and disclosure of how financial institutions would handle customer or client information, and (3) revisions to the Community Reinvestment Act to provide some regulatory relief for smaller institutions. It is more efficient to deal with each topic separately although in the legislative process, it is clear that compromises among competing interests, constituencies and bureaucracies were obtained by combining all three areas into one legislative effort.

In terms of bank activities, what the Act does is maintain the current complexity of the existing regulatory scheme while literally ordering federal agencies to coordinate their regulatory overview to avoid duplication and contradicting regulations as noted above. The obvious advantage to this approach was to leave intact existing regulatory

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[10] Statement of Alan Greenspan, Chairman of the Federal Reserve Board of Governors, The Financial Services Modernization Act of 1999: Hearings on H.R. 10 Before the Comm. On Banking and Financial Servs. of the U.S. House of Representatives, 106th Congr. 254 (1999) ftn 63 in Dixon, Robert W. "The Gram_Leach_Bliley Financial Modernization Act: Why Reform in The Financial Services Industry was Necessary and the Act's Projected Effects on Community Banking," 49 Drake L. Rev. 671 (2001).

[11] Macy, Jonathan R. "The Business of Banking: Before and After Gramm-Leach-Bliley" 25 Iowa J.Corp.L. 691, 693.

agencies and their staffs. First let's review how the Act changed the regulatory scheme or rather as some would argue codified changes that were made by agencies who liberally interpreted the Bank Holding Act. The Act permits most companies that own a bank to elect to become FHC or financial holding companies and to engage in any activity that the Fed determines is financial in nature. These activities include:

- "Lending, exchanging, transferring, investing for others, or safeguarding money or securities;
- Underwriting, dealing and making markets in securities;
- Insuring, guaranteeing, or indemnifying against harm, loss, illness, disability or death as principal or broker;
- Issuing or selling annuities;
- Providing financial or investment advisory services to individuals, businesses, and mutual funds; issuing or selling interests in pools of assets that a bank could own;
- Owning through a securities affiliate shares or assets acquired as part of underwriting or merchant banking activities;
- Owning through an insurance company shares or assets acquired as an investment in the ordinary course of business;
- Engaging in any activity permitted to a bank holding company on November 11, 1999; and
- Engaging in the united states in any activity permitted to a U.S. bank holding company outside the U.S."[12]

To qualify as a financial holding company, a company that owns a bank must be 'well managed' and 'well capitalized.' A company cannot become an FHC unless each of its FDIC insured depository subsidiaries meets the well managed definition of having a rating of 1 or 2 for its overall composite CAMELS rating, the Management component of its CAMELS rating, and be in compliance with the Community Reinvestment Act.[13] To be in compliance with the "well capitalized" standard involves: having a Tier 1 risk-based capital ratio of at least 6%, a total risk-based ratio of at least 10%, a leverage ratio of at least 5% and not have any regulatory actions pending.[14] So, what the Act really does is require the formation of a financial holding company which then may engage in a variety of financial services activities. A bank holding company that has U.S. Commercial banks can be certified as a FHC if all the banks meet the criteria described above. A securities firm or insurance company that acquires one or more banks must apply to be a bank holding company along with filing for certification as a FHC.[15]

The reason why some commentators have observed that the Act really did not reform the financial services industry but rather codified actions that had already been taken by regulatory authorities. Their argument is that the Glass Speagall Act that concerns sections 16, 20, 21, and 32 of the Banking Act of 1933 had substantially been altered through regulatory interpretations. Recall, "Section 16 limits a bank to purchasing and

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[12] PriceWaterhouseCoopers "An Executive's Guide to U.S. Financial Modernization" Regulatory Advisory Services, Washington D.C. 2001, p. 3

[13] Ibid. p. 7

[14] Ibid. p. 7

[15] Federal Reserve Bank of San Francisco Newsletter, March 31, 2000 as accessed at <http://www.frbs.org/econrsch/wklyltr/2000/el2000-10 html>

selling securities only at the request of a customer and not for the bank's own account. Section 21 of the Act prohibits enterprises "engaged in the business of underwriting, selling, or distributing securities' from receiving deposits from customers. Section 32 requires that no officer, director or employee of a bank serve simultaneously in the same capacity for a firm primarily engaged in the issue or underwriting of securities. Section 20 was designed to prevent banks from circumventing these restrictions by creating subsidiaries or affiliates by prohibiting banks from affiliating with any organized engaged principally in the issue, flotation, underwriting, public sale or distribution" of securities.[16] However, prior to the repeal of the Glass-Steagall act, the Federal Reserve's interpretation of Section 20 permitted several large securities and banking combinations. These included Banker's Trust buying Alex Brown & Company, Canadian Imperial's acquisition of Oppenheimer and Company, and J/P. Morgans' acquisition of a substantial stake in American Century.[17]

Knowing that Congress would be slow to repeal the Glass Speagall Act, the Federal Reserve and other agencies took steps to broaden their interpretation of the act to stimulate bank mergers and reorganization of the financial services industry. For example, in 1987, the Federal Reserve interpreted section 20 to permit a bank holding company to operate a subsidiary engaged in the securities business. By the time the Act was passed, there were 51 banking organizations operating securities subsidiaries including Solomon Smith Barney, Montgomery Securities, and Robertson Stephens. However, an attempt by the Comptroller of the Currency to authorize First National City Bank of New York to establish and operate a mutual fund was overturned by the U.S. Supreme Court under a lawsuit filed by the National Association of Securities Dealers.[18] During the 1990's, the Fed allowed more types of securities to be underwritten and approved additional activities to be included in the revenue base for computing the permissible amount of "ineligible underwriting. In 1997, the Fed raised from 10 to 25 percent the maximum amount of revenue a bank affiliate could derive from ineligible underwriting without being deemed to violate the "engaged principally test.[19]

Another route to financial integration that was taken prior to the enactment of the Gramm-Leach-Bliley Act is described as follows: "Financial integration also has come from the other direction – securities firms and insurance companies have found side routes, mainly by linking up with certain types of depository institutions whose activities are restricted in some ways. One such type of depository is the so-called nonbank bank. This includes industrial loan banks, several of which operate in Utah; for example, American Express owns an industrial loan bank with about $12 billion in assets. Another option has been credit card banks, such as the one owned by Household Finance in Nevada. Finally, the law allowed securities firms, insurance companies, and even non-

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[16] Nance, Mark E. and Singhof, Bernd "Banking's Influence Over Non-Bank Companies After Glass Steagall: A German Universal Comparison, 14 Emory Int'l L. Rev. 1305, Fall 2000, p. 1308.
[17] Kini, Satish M. "Gramm-Leach-Bliley's Bumpy Start Doesn't Justify Thinking It a Failure" *American Banker*, Vol. 166, Issue 81, April 27, 2001, p. 13.
[18] Case *is Inv. Co. Inst. v. Camp*, 401 U.S. 617 (1971) as cited in Dixon, Robert "The Gramm-Leach-Bliley Financial Modernization Act: Why Reform in the Financial Services Industry was Necessary and the Act's Projected Effects on Community Banking" 49 Drake L. Rev. 671, ftn 57&58.
[19] Ftn 52 See Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities, 61 Fed.Reg. 68,750 (Dec.30, 1996) in Glass, David L. Op.Cit.

financial firms to link up with depositories through the acquisition of a single thrift, knows as a 'unitary thrift.'"[20]

If reform requires the restructuring of the regulatory structures of an industry, then the Act does fall short of a 'reform'. However, the Act did create a 'functional regulatory scheme' that gave neither the U.S. Treasury (which its politically appointed office holders) nor the Federal Reserve Board (which have longer and staggered terms of office that do not coincide with Presidential elections) complete power over the U.S. financial services industry. The regulation of bank holding companies was essentially given to the Federal Reserve but state banks continue to fall under Office of the Comptroller of the Currency.[21] Function regulation essentially reflected Congress's desire to avoid disturbing competition among regulatory agencies and instead chose to permit existing organizations to regulate particular parts of a financial holding company according to their functions. By requiring each activity to be housed in a subsidiary, functional regulation was a politically pragmatic decision. While the Federal Reserve was ordered to undertake certain studies and make specific recommendations on a number of regulatory issues to Congress, insurance companies will continue to be regulated by states,[22] securities firms by the SEC and state boards, etc. One example of a study ordered by Congress requires the Board of Governors of the Federal Reserve System and the Secretary of the Treasury to conduct a study of "the feasibility and appropriateness of establishing a requirement that, with respect to large insured depository institutions and depository institution holding companies the failure of which could have serious adverse effects on the economic conditions or financial stability, such institutions and holding companies maintain some portion of their capital in the form of subordinated debt in order to bring market forces and market discipline to bear on the operation of, and assessment of the viability of, such institutions and companies…"[23]

One of the interesting features of the Act is the "jump ball" provision dealing with rulemaking and resolution process between the Securities and Exchange Commission and the Federal Reserve. The Act reflects some degree of financial sophistication in that it anticipates the development of new financial "products." Rather than having those new financial products serve as means to circumvent regulation and monitoring, the Act provides that the SEC will use formal rule making process before regulating bank sales of any new financial products. Formal rule making requires publication and notice. Should the Federal Reserve disagree with the proposed regulation the Federal Appeals court will act as final arbiter.[24]

Another important feature of the Act is the 'push out' provisions.[25] Because Glass-Speagall took banks out of the securities business, federal securities laws exempted banks from registration as broker-dealers given their limited role in the securities

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[20] Furlong, Fred "The Gramm-Leach-Bliley Act and Financial Integration" FRBSF Economic Letter, March 31, 2000. Vol. 2000, Issue 10, p 1-5.

[21] Dixon, Robert Op. Cit. p. 680.

[22] The McCarran-Ferguson Act grants states the right to tax and regulate the insurance industry. McCarran-Ferguson Act, 59 Stat.33, codified at 15 U.S.C. 1011-15 (1994).

[23] The Financial Services Modernization Act, or Gramm-Bliley-Leach Act, Section 108 Use of Subordinated Debt to Protect Financial System and Deposit Funds from "too Big to Fail" Institutions.

[24] Hamilton, James "Gramm-Leach-Bliley Act Creates financial Dynamic for the Next Century" CCH Federal Securities Law Reporter, as accessed at <http://www.bankinfo.com/compliance/reform.html>

[25] Gramm-Leach-Bliley Act Section 201, 202.

industry. Gramm-Leach-Bliley repealed the broad exemption for banks from the definitions of "broker" and "dealer" in the securities laws and provides narrower exemptions for traditional bank securities activities. The loss of the blanket broker-dealer exemption means that many securities activities that were previously allowed in banks must be pushed out into subsidiaries that are properly registered with the SEC.[26] Under the Act, a bank is not a 'dealer' if its transactions involve the purchase and sale of securities for its own account that are limited to exempted securities (such as government bonds, commercial paper, etc), investment trusts, or fiduciary transactions, or secularization (certain asset-backed transactions with qualified investors.[27] So long as banks trade securities in their role as fiduciaries of trusts, those activities need not be "pushed out." However, if the bank is merely acting as custodian of a trust account in which the trustees are ordering trades, those trades must be "pushed out." Management must be sure that an employee who executes a securities transaction is an employee of the broker-dealer affiliate or a dual employee who works on a fee or referral basis. While part of the justification for reform was to provide customers with seamless financial services 'supermarkets', the reality is that functional regulation means that each activity (insurance, securities, etc) must be sold by an appropriately licensed and regulated entity. Hence, so-called universal banking is not a feature of the Gramm-Leach-Bliley Act. The reality is that those activities that must be pushed out to a registered broker dealer will now be subject to the more rigorous capital requirements imposed by the SEC and to more vigorous record keeping and oversight provided by the SEC. The Act gave bank holding companies 18 months to review their securities activities, categorize them and realign personnel as necessary.

Ever since the passage of the Investment Advisers Act of 1940 banks have been excluded from registration and licensing requirements of the act. The Gramm-Leach-Bliley Act eliminates the bank exclusion from the definition of investment adviser. This change means that banks must either have affiliates that are licensed and under the regulatory oversight of the SEC to act as investment advisers or they may set up their investment advisory services as a separate department. In either case, the activity must comply with the SEC's rules and regulations for investment advisers.

IV. THE PRIVACY PROVISIONS

Most visible to the American public were the regulations concerning privacy notification. In order to secure votes for the passage of the Act, the sponsors were forced to address the touchy issues of financial privacy. The Act required all financial institutions regardless of whether they are formally a financial holding company or not to disclose to their customers their policies and practices for protecting the privacy of non-public personal information. Note that these provisions on privacy are not limited to banks but to any entity which conducts business that is 'financial in nature.'[28] While the

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[26] Dickey-Kemp, Lisa "Impact of the Push-Out Provisions of the Gramm-Leach-Bliley Act" Bank Accounting and Finance, Spring 2001, pp. 35-38.
[27] Ibid. p. 37.
[28] Tatelbaum, Charles "Gramm-Leach-Bliley Act Impacts Business Credit" *Business Credit*, June 2001, p. 6.

bill sounds innocuous enough, the American Bar Association wrote a letter to the head of the Federal Trade Commission seeking a specific exemption for the practice of law from the statute's implementing regulations! So evidently there was concern among attorneys that their profession may be viewed as 'financial in nature' and therefore require attorneys to make detailed information/privacy policies known to their clients both at the time they are first engaged and annually thereafter.[29]

These disclosures must be made at the time the relationship first begins and annually thereafter. The Act does permit financial institutions to share personal customer information with affiliates within the holding company.[30]

The privacy rules only apply to non-public personal information that is provided by a customer to a financial institution or that results from any transaction with the customer or any service performed for the customer, or is otherwise obtained by the institution.[31] Disclosures of corporate privacy policies must be made at the time the relationship is first entered into and annually after that. These disclosures must include: the institution's policies for maintaining private information and sharing such information with both affiliated and non-affiliated third parties, the categories of information that the institution will collect, the categories of persons to whom the information may be disclosed, and the institution's policies regarding former customer's information.[32] Customers are provided the opportunity to opt out although the Act places no restrictions on a financial institution's ability to share private information with affiliates. And a financial institution does not have to worry about customers opting out of when they disclose private information to non-affiliated third parties that perform services or function on behalf of the institution. Provided that the activity is disclosed to the customer and the third party is required by contract to maintain the confidentiality of information it receives from the institution.[33]

The Act does not preempt any stricter state regulations on consumer privacy and notification thanks to an amendment by Senator Sarbanes. However, there is a likelihood of litigation over that amendment.[34]

The Act also restricts the reuse of information acquired with permission of customers by third parties. A non-affiliated third party that receives private information from a financial institution cannot disclose such information to any other non-affiliated person unless that disclosure would be lawful if made directly to that other person by the institution.[35]

Pretext calling which involves deception for the purpose of obtaining private customer information becomes a federal crime punishable by up to five years in prison.[36]

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[29] ABA Network "Legislative and Governmental Advocacy – What is New In Washington" Accessed on 10/1/01 at <wysiwyg://1//http://www.abanet.org/poladv/new.html>

[30] Security Industry Association. Background on Gramm-Leach-Bliley Act. Accessed at <http://www.sia.com/gramm_leach_bliley>

[31] Gramm-Leach-Bliley Act Section 509 (4)(A), 113 Stat. At 1444.

[32] Gramm-Leach-Bliley Act Section 503 (4)(A), 113 Stat. At 1439

[33] Gramm-Leach-Bliley Act Section 502 (b)(2), 113 Stat. At 1437

[34] Glass, David L. Op.Cit. p. 12.

[35] Ibid.

[36] Hamilton, James Op.Cit.

V. COMMUNITY REINVESTMENT ACT – RELIEF FOR SMALLER FINANCIAL INSTITUTIONS

One of Senator Phil Gramm's key provisions in the Act was to secure relief for smaller institutions from the claws of the Community Reinvestment Act. In Gramm's own words: "…what has happened over the years is that since you have to get CRA approval in order to merge or close a branch or open a branch … the CRA today allocates more capital than Ford, General Motors, and Chrysler combined. CRA is now bigger than the discretionary budget of the federal government…. bigger than the Canadian economy… one of the largest capital allocation programs in the world."[37] According to Gramm, banks were forced to pay out some $9.5 billion in cash payments to people "who are totally unaccountable to the public for the uses to which those funds are put. "Now this is a very big issue with me. I see this as, in many cases, little more than extortion."[38] To address this concern, the Act provides that if financial institutions make lending agreements with community groups, in connection with merger applications or even if a non-merging institution wants to farm out some of its CRA activities, they must disclose those agreements. Only loans of less than $50,000 a year and payments of less than $10,000 are exempt from disclosure.

Community banks with assets of $250 million or less will now be subjected to CRA exams every four or five years depending on their level of past compliance instead of annually or biannually.[39]

The Act also orders the Federal Reserve and the Treasury to conduct new studies of CRA. The Fed is responsible for a comprehensive survey of financial institution lending terms, default rates and profitability rates of CRA loans. The Treasury is charged with the studying the effect of CRA on financial services in low and moderate-income communities and to persons of modest financial needs.[40]

VI. CONCLUDING OBSERVATIONS

There are numerous studies to be conducted by various federal agencies ordered by the Act. And there are many other changes to existing laws that this paper does not cover. However, from this overview of the three main features of the act, one can draw some conclusions. First, the Act is not a radical change from the intent of the Glass-Speagall Act. The overall intent was to quarantine certain financial activities from one another in order to avoid another financial 'train wreck.' While scholars debate the actual cause and effect of the depression, there is no question that the intellectual capital needed to assess risk in insurance, making loans, or investing is quite different depending

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[37] Gramm, Phil "The New Banking Legislation: The Financial Modernization for the Twenty –First Century, *SMU L. Rev.*, Vol 53, No 1, Winter 2000, pp. 371-5.

[38] Ibid.

[39] Am.Bankers Assn, "Financial Modernization: The Gramm-Leach-Bliley Act" Summary 9 (1999).

[40] Remarks by Governor Edward M. Gramlich before America's Community Bankers, Government Affairs Conference, Washington D.C. March 7, 2000 Accessed at <http://federalreserve.gov/boarddocs/speeches/2000/200000307.htm>

on the activity. Risk assessment and capital allocation is the essence of a financial system. What the Gramm-Leach-Bliley Act does is maintaining the function regulation for each activity and provides for certain capital requirements, record-keeping requirement, and licensing requirements in order to maintain a financial integrity for each activity. In this manner, it does preserve some of the concern that organizations that mix or attempt to do all may subject society to serious financial repercussions if undue risk is undertaken or if there are too many 'interlocking' activities. One only has to look at the recent Enron bankruptcy for an example of overly complex and relatively undisclosed complex financial activities that resulted in disaster for Enron shareholders. So while it may be fashionable to criticize skepticism over large institution's ability to provide comprehensive financial services under one roof, having functionally oriented regulators who understand their particular activities may not be such an antiquated strategy.

The vary nature and structure of the formal financial services industry in the United States and the role that industry plays in capital aggregation is beyond the scope of most commentary on the import of the Gramm-Leach-Bliley Act. In yet, those who yearn for 'universal' banking where equity and lending decisions might be made by one entity does not necessarily lead to a vibrant economy. The German model that is often held as an ideal may offer some stability and utility of size, but capital aggregation for new enterprises through secondary capital markets is almost non-existent in Germany. The banks own businesses either directly in equity or through loan-equity packages. Would they then dare to underwrite potential competitors? The reality is that the Germans do not have the vibrant NASDAQ market that the US does. So, to transplant a universal banking model onto the US would produce distortions in our system of capital aggregation.

In making marginal reforms that acknowledge some advantages in marketing by permitting a sharing of information among affiliates of financial holding companies, the Act recognizes that there are potential gains to customers of financial services. And, the Act demands better functional alignment and reduction of duplication of regulations among the major players: Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, State insurance regulatory agencies, Office of Thrift, etc. The Act clearly anticipates the development of 'hybrid' or new financial products and creates a system for the Fed and the OCC to arbitrate their proposed regulations.

Further review of the studies that the agencies were to undertake and an examination of the new regulations and timetables should be undertaken. The area of financial services regulation requires more attention to the issues of costs of regulation versus benefits even in the face of the Enron saga. The high costs of regulation create their own set of economic barriers to entry. However, some of the benefits obtained by mergers may be better assessed through strategic marketing agreements. Again, regulatory changes promulgated since the passage of the Act should be reviewed in the context of soundness, safety and efficiency of our financial marketplace.