TESTIMONY OF
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SECURITIES INDUSTRY ASSOCIATION

BEFORE
THE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE
UNITED STATES SENATE

"EXAMINATION OF THE GRAMM-LEACH-BLILEY ACT FIVE YEARS AFTER ITS PASSAGE"

Chairman Shelby, Senator Sarbanes, and members of the Committee:

I am Steve Judge, Senior Vice President of Government Affairs, Securities Industry Association (SIA).[1] I appreciate the opportunity to present our views on the Gramm-Leach-Bliley Act (GLBA) as we approach the five-year anniversary of the enactment of that landmark legislation.

SIA commends this Committee for its efforts in enacting the GLBA, and for holding these hearings to examine the effects of the Act. SIA believes that these hearings will initiate an important dialogue in the financial services industry and with policymakers about identifying and eliminating unnecessary regulatory restrictions that impede the ability of our financial services firms to: develop and offer consumers a full range of financial services and products; structure themselves optimally; mitigate risk for themselves and for the broader financial markets, and;

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[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

maintain global competitiveness and preeminence. SIA looks forward to participating in that dialogue.

In considering the effects of the GLBA, it is useful to recall how constrained the financial services industry would have been without enactment of GLBA. The ability of financial services firms to affiliate was primarily governed by the Glass-Steagall Act, a Depression-era law that ceased to reflect the realities of the modern financial services industry. That law's prohibition on affiliations between banks and securities firms, for example, had long since lost any rationale it might once have had. In the 66 years since enactment of the Glass-Steagall Act, banks and securities firms had begun to offer an array of competing products and services to their retail and institutional clients, and many banks and securities firms determined that they could best serve their customers by offering "one-stop financial shopping."

The banking regulators, in particular, had adopted a variety of regulations that permitted banks to acquire certain securities firms, although securities firms were prohibited from affiliating with banks. The result was a "mish-mash" of confusing rules and regulations, which were never able to provide the full range of relief the industry sought and consumers needed, and which tilted the playing field in favor of the banks. For example, national banks could own subsidiaries that engaged in securities brokerage activities as long as the subsidiary did not engage in dealer or underwriting activities. Securities firms owned by bank holding companies could engage in a limited amount of dealer and underwriting activities, but those activities could not account for more than 20 percent (and eventually 25 percent) of that firm's revenues. Securities firms were prohibited from owning banks, although they were able to affiliate with thrifts and certain other types of financial institutions. State laws further complicated the regulatory picture, and banking and securities regulators occasionally wrestled in court over various jurisdictional issues.

The resulting legislative restrictions and regulatory uncertainties artificially restricted affiliations among financial services firms. Such restrictions undermined their competitive position, their ability to develop and offer new services and products, and consumers' access to a full range of financial products and services from a single financial institution.

SIA and various members of the financial services community had been working with Congress for decades to pass legislation to permit affiliations between and among securities firms, banks and insurance companies. We sought legislation that would create a "two-way street" by allowing banks, securities firms, or insurance companies to affiliate on an equal footing. Essential to that goal was the assurance that competition, not regulatory fiat, would dictate when and how financial services firms could affiliate. We sought legislation that protected consumers by ensuring that each affiliated financial services entity would be functionally regulated – that is, regulated by the regulator with the regulatory expertise and statutory mandate to regulate the activities in which that entity engaged.

The enactment of GLBA has in many respects rationalized and modernized the untenable and antiquated financial institution regulatory environment that existed prior to its passage. Under the GLBA:

- Banks, securities firms and insurance companies can now affiliate under a financial services holding company (FSHC) structure. The FSHC is regulated by the Federal Reserve Board (FRB), and each of the subsidiary financial services firms are regulated by their respective functional regulators. A securities firm in a FSHC structure is not limited to an artificial cap on the amount of revenue it can derive from underwriting and principal transactions (such as the 20 percent, and then 25 percent, caps imposed under the Bank Holding Company Act). The ability of financial services firms to more easily affiliate under a FSHC structure should permit larger firms to become more diversified, which should in turn result in greater product and services offerings, increased domestic and international competitiveness, and greater financial stability.

- Financial services firms also have a number of other structural options available to them, further increasing their flexibility and competitiveness. For example, bank holding companies can elect to remain under the same structure as they did prior to the enactment of the GLBA. Holding companies that own securities firms, but that do not have substantial commercial banking activities, can elect to be regulated as investment bank holding companies, which are subject to the jurisdiction of the Securities and Exchange Commission (SEC). Well-capitalized and well-managed banks can own securities firms. And securities firms and certain other companies that owned thrifts and other non-bank banks prior to the enactment of the GLBA may continue to own those entities.

- Subsidiaries of FSHCs can engage in a wide variety of financial activities beyond banking, securities and insurance activities, including merchant-banking activities. Notably, the intent of the GLBA was to permit securities firms in a FSHC structure to engage in merchant-banking activities to the same extent as securities firms that are unaffiliated with a bank. Securities firms that are subsidiaries of FSHCs also are permitted to continue to engage in certain pre-existing commercial lines of business until 2009.

- Banks are permitted to engage in a variety of specified securities activities without being required to register as broker-dealers. The SEC has recently re-proposed regulations (proposed regulation B) that would implement these provisions.

- Financial services firms (regardless of whether they are affiliated with FSHCs) are subject to comprehensive privacy requirements, which among other things require disclosure of the firm's privacy policies, and impose substantive limitations on the circumstances in which a financial services firm can share confidential financial

> information about a customer or consumer. Financial services firms are required to implement policies and procedures to safeguard confidential customer information. To SIA's knowledge, no other industry in the United States is subject to the comprehensive federal privacy requirements that now apply to financial services firms.

Since the enactment of the GLBA, there have been a number of significant combinations of financial services firms. Some firms have chosen to combine with commercial banks. Other firms have chosen to remain independent. That is how it should be. One of the overarching goals of the GLBA was to allow financial services firms to choose the optimal structure to best serve their customers' needs. Among SIA's membership, bank or financial-holding company-ownership has increased from 13.4 percent in 1999 to 21 percent today. Moreover, banks have significantly increased their presence in capital markets activities. For example, banks now lead-manage 58.2 percent of equity underwriting deals versus only 36.8 percent in 1999.

As a further example of the effectiveness of the GLBA, these combinations generally have not resulted in the newly affiliated firms having to shed significant lines of business or having to artificially limit their revenues from securities underwriting and certain other activities, as was often the case prior to the GLBA. These combinations also generally have not required federal regulators to provide the type of significant regulatory relief that was often necessary pre-GLBA.

When examining the overall effectiveness of the GLBA, it is important to note that various economic factors and significant changes in the capital markets over the last five years have made it tenuous, at best, to determine cause-and-effect relationships post-GLBA. We need more time and experience to get the full picture of the GLBA's effects. What we do know is that the GLBA is a comprehensive statute regulating a diverse, dynamic, and constantly evolving financial services industry. As a result, there have been, and likely will continue to be, issues concerning the implementation of the legislation. SIA and other industry participants have questioned how, for example, the FRB proposed to implement the merchant-banking provisions of the GLBA, and how the Federal Trade Commission and other regulatory agencies proposed to implement the Act's privacy provisions. Currently, the SEC has re-proposed rules governing the scope of bank-securities activities; the re-proposed rules are intended to respond to the significant criticism of the rules as they were initially proposed.

Neither these nor similar implementation issues, however, necessarily suggest structural problems with the GLBA. Rather, they may well be normal transition issues that are almost inevitable when first permitting combinations of companies that had largely been prohibited, or significantly restricted, from combining for over 60 years. In this regard, GLBA is notable for the fact that, despite its complexity and scope, it was so carefully drafted that not a single technical or similar amendment has been enacted to correct any of its provisions.

Moreover, there are some weaknesses that have always existed with GLBA that this Committee could address. Among the most significant of those are:

- Securities firms in a FSHC should be able to engage in a full range of commercial activities to the same extent as securities firms that are unaffiliated with a bank. Currently, the GLBA only permits securities firms in a FSHC structure to continue engaging in pre-existing commercial activities until 2009.

- There should be solely national standards governing customer privacy requirements, especially given the national scope of many financial institutions, and the fact that even many smaller financial institutions now have customers from a number of states. Requiring financial institutions to comply with federal requirements and then the additional requirements potentially imposed by each state in which that firm operates is burdensome, cumbersome, and contrary to an overarching goal of the GLBA of increasing efficiency in the regulation of financial services companies.

- There should be uniform national standards for securities. The National Conference of Commissioners on Uniform State Laws (NCCUSL) has adopted a Model Uniform Securities Act that brings uniformity to the registration process, facilitates electronic signatures, filing and records, and adopts additional investor protections. SIA is actively working with state securities commissioners for adoption of the *Uniform Securities Act* by their state legislatures.

The U.S. capital markets and financial services industry are stronger, healthier, and more dynamic since Congress enacted the GLBA in 1999. In spite of the tremendous challenges and changes of the last several years, consumers and financial services firms alike are better off as a result of the increased opportunities and choices that the GLBA made possible. SIA commends this Committee for holding these hearings, and looks forward to working with you, the regulators, and other industry participants to maintain our nation's preeminent capital markets.

Thank you.