Financial Services Modernization Act

Summary of Provisions of Chairmen's Mark

TITLE I - FACILITATING AFFILIATION AMONG BANKS, SECURITIES FIRMS, AND INSURANCE COMPANIES

- Repeals the restrictions on banks affiliating with securities firms contained in sections 20 and 32 of the Glass-Steagall Act.

- Creates a new "financial holding company" under section 4 of the Bank Holding Company Act. Such holding company can engage in a statutorily provided list of financial activities, including insurance and securities underwriting and merchant banking activities. The financial holding company may also engage in developing activities and activities which the Federal Reserve Board, subject to a Treasury coordinating process, determines are financial in nature or incidental to such financial activities. Complementary activities are also authorized. The nonfinancial activities of firms predominantly engaged in financial activities are grandfathered (subject to a 15% limitation) for at least 10 years, but no more than 15 years. Such financial holding companies must be well capitalized, well managed, and have at least a satisfactory CRA rating.

- Provides for state regulation of insurance, subject to certain specified state preemption standards.

- Provides that a bank holding company organized as a mutual holding company will be regulated on terms and subject to limitations, comparable to any other bank holding company.

- Liberalizes the restrictions governing nonbank banks.

- Provides for a study of the use of subordinated debt to protect financial system and deposit funds from "too big to fail" institutions and a study on the effect of financial modernization on the accessibility of small business and farm loans.

- Streamlines bank holding company supervisions by clarifying the regulatory roles of the Federal Reserve as the umbrella holding company supervisor and the state and Federal nonbank financial functional regulators.
• Provides for Federal bank regulators to prescribe prudential safeguards for bank organizations engaging in new financial activities.

• Prohibits FDIC assistance to affiliates and subsidiaries.

• Allows a national bank to engage in new financial activities, except for insurance underwriting, merchant banking and real estate development, in a financial subsidiary, so long as the aggregate assets of all financial subsidiaries do not exceed 5% of the parent bank's assets or $20 billion, whichever is less. To take advantage of the new activities through a financial subsidiary, the national bank must be well capitalized and well managed. In addition, national banks with over $1 billion in assets are required to have an issue of outstanding subordinated debt that is rated in one of the two highest rating categories by an independent rating agency.

• Ensures that appropriate anti-trust review is conducted for new financial combinations allowed under the Act.

• Provides for national treatment for foreign banks wanting to engage in the new financial activities authorized under the Act.

• Allows national banks to underwrite municipal revenue bonds

**TITLE II - FUNCTIONAL REGULATION**

• Title II amends the Federal securities laws to incorporate functional regulation of bank securities activities.

• The broad exemptions banks have from broker-dealer regulation would be replaced by more limited exemptions designed to permit banks to continue their current activities and to develop new products.

• The limited exemptions would cover transactions in connection with the following bank activities: trust, safekeeping, custodian, shareholder and employee benefit plans, sweep accounts, private placements (under certain conditions), self-directed IRAs, third party networking arrangements to offer brokerage services to bank customers, etc.

• In addition, banks would be able to continue to be active participants in the derivatives business for all credit and equity swaps (other than equity swaps to retail customers).

• It provides for a "jump ball" rulemaking and resolution process between the SEC and the Federal
Reserve regarding hybrid products that have both banking and securities elements that banks may develop in the future.

- Title II also contains important amendments to the Investment Company Act to address potential conflicts of interest in the mutual fund business and amendments to the Investment Advisers Act to require banks that advise mutual funds to register as investment advisers.

**TITLE III - INSURANCE**

Provides for the functional regulation of insurance activities.

Establishes which insurance products banks and bank subsidiaries may provide as principal.

Prohibits bank underwriting of title insurance; national bank sales of title insurance are parallel to state bank powers (with no agency restrictions on bank operating subsidiaries).

State insurance and Federal regulators may seek an expedited judicial review of disputes with equalized deference.

The Federal banking agencies are directed to establish consumer protections governing bank insurance sales.

Preempts state laws interfering with affiliations.

Provides for interagency consultation and confidential sharing of information between the Federal Reserve Board and State insurance regulators.
- Allows mutual insurance companies to redomesticate.
- Uniform multistate insurance agency licensing to be resolved by conference committee.

**TITLE IV - UNITARY SAVINGS AND LOAN HOLDING COMPANIES**

- *De novo* unitary thrift holding company applications received by the Office of Thrift Supervision after May 4, 1999, shall not be approved.
- Transferability of existing unitary thrift holding companies will be decided by the Conference Committee through the amendment process.

**TITLE V - PRIVACY**

Incorporates the House bill's provisions on financial privacy (Title V, Subtitle A) and pretext calling (Title V, Subtitle B), with certain modifications summarized below, and eliminates, at the administration's request, the House bill's medical privacy provisions (Title III, Subtitle D).

- Addresses a potential imbalance between the treatment of large financial services conglomerates and small banks or credit unions by expanding the scope of activity that is exempted from the subtitle's opt out provision to include joint marketing arrangements between a financial institution and an entity that is not a financial institution.
- Exempts from the subtitle's "opt out" provision the disclosure of nonpublic personal information to firms that provide actuarial services.
- Clarifies that the disclosure of a financial institution's privacy policy is required to take place at the time of establishing a customer relationship with a consumer and not less than annually during the continuation of such relationship.
- Provides for a separate rather than joint rulemaking to carry out the purposes of the subtitle; the relevant agencies are directed, however, to consult and coordinate with one another for purposes of assuring to the maximum extent possible that the regulations that each prescribes are consistent and comparable with those prescribed by the other agencies.

- Extends the time period allowed for the required rulemaking from six months to a year.

- Excludes from the rulemaking and enforcement provisions of the subtitle the Farm Credit System, consistent with the preference expressed by the House Agriculture Committee.

- Adds the Federal Housing Finance Board and the Office of Federal Housing Enterprise Oversight to the list of agencies required to be consulted in the rulemaking process.

- Expands the scope of the regulators' authority to prescribe exceptions to the notice and disclosure requirements of section 502.

- Clarifies that the National Credit Union Administration's enforcement authority under this subtitle does not extend to state-chartered credit unions.

- Provides that any State insurance authority that fails to adopt regulations to carry out this subtitle shall forfeit its right to override the insurance customer protection regulations prescribed by a Federal banking agency under section 45 of the Federal Deposit Insurance Act.

- Clarifies that the remedies described in section 505 are the exclusive remedies for violations of the subtitle.

- Deletes that portion of section 506 prescribing a joint rulemaking relating to the Fair Credit Reporting Act, while leaving intact the amendment to the FCRA permitting Federal regulators to examine for compliance with FCRA in the absence of specific complaints.

- Clarifies that nothing in this title is intended to modify, limit, or supersede the operation of the Fair Credit Reporting Act.

- Extends the time period for completion of a study on financial institutions' information-sharing practices from 6 to 18 months from date of enactment.

- Modifies the definition of the term "joint agreement" to mean a "formal written contract pursuant to which two or more persons, at least one of which is a financial institution [as opposed to "two or more financial institutions"], offer, endorse, or sponsor a financial product or service."

- Modifies the definition of the term "joint agreement" to exclude the element of "profit," thereby
avoiding prejudice to credit unions, which are non-profit financial cooperatives.

- Provides for an effective date of 18 months after the date on which the rulemaking pursuant to section 504 is completed, to allow sufficient time for state legislatures to empower state insurance regulators to comply with this subtitle.

- Assigns authority for enforcing the subtitle's provisions to the Federal Trade Commission and the Federal banking agencies, the National Credit Union Administration, the Securities and Exchange Commission, according to their respective jurisdictions, and provides for enforcement of the subtitle by the States. (Prior to this modification, the FTC had sole enforcement authority.)

- Deletes a largely duplicative directive that Federal regulators prescribe such revisions to regulations and guidelines as may be necessary to ensure that financial institutions have procedures in place to prevent unauthorized disclosures of customer information. Subtitle A contains a substantially similar and more comprehensive requirement that regulators establish appropriate safeguards to, among other things, "protect against any anticipated threats or hazards to the security or integrity of [nonpublic personal] information," and "protect against unauthorized access to or unauthorized use of [nonpublic personal] information which could result in substantial harm or substantial inconvenience to any customer."

**TITLE VI - FEDERAL HOME LOAN BANK SYSTEM MODERNIZATION**

- Banks with less than $500 million in assets may use long-term advances for loans to small businesses, small farms and small agri-businesses.

- A new capital structure for the Federal Home Loan Banks is established. Two classes of stock are authorized, redeemable on 6-months and 5-years notice. Federal Home Loan Banks must meet a 5% leverage minimum tied to total capital and a risk-based requirement tied to permanent capital.

- Voluntary membership for Federal savings associations takes effect six months after enactment.

- The current annual $300 million funding formula for the REFCORP obligations of the Federal Home Loan Banks is changed to 20% of annual net earnings.

- Governance of the Federal Home Loan Banks is decentralized from the Federal Housing Finance Board to the individual Federal Home Loan Banks. Changes include the election of chairperson and vice chairperson of each Federal Home Loan Bank by its directors rather than the Finance Board, and a statutory limit on Federal Home Loan Bank directors' compensation.
Requires ATM operators who impose a fee for use of an ATM by a noncustomer to post a notice on the machine that a fee will be charged and on the screen that a fee will be charged and the amount of the fee. This notice must be posted before the consumer is irrevocably committed to completing the transaction. A paper notice issued from the machine may be used in lieu of a posting on the screen. No surcharge may be imposed unless the notices are made and the consumer elects to proceed with the transaction. Provision is made for those older machines that are unable to provide the notices required. Requires a notice when ATM cards are issued that surcharges may be imposed by other parties when transactions are initiated from ATMs not operated by the card issuer. Exempts ATM operators from liability if properly placed notices on the machines are subsequently removed, damaged, or altered by anyone other than the ATM operator.

- Requires disclosure of CRA agreements ("CRA Sunshine").

- Provides small and rural bank regulatory relief through CRA examinations occurring at 5-year intervals unless such banks seek to "apply for a deposit facility," which is defined to mean merger, establishing a new bank or thrift charter, establishing a new branch or relocating the home office or a branch office.

- Provides for a Federal Reserve Board study of CRA lending, focusing on default rates, delinquency rates, and the profitability of such loans. The study is due no later than March 15, 2000.

- Requires a GAO study of possible revisions to S corporation rules that may be helpful to small banks.


- Allows Federal savings associations converting to national or State bank charters to retain the term "Federal" in their names.

- Allows one or more thrifts to own a banker's bank.

- Provides for technical assistance to microenterprises (meaning businesses with fewer than 5 employees that lack access to conventional loans, equity, or other banking services). This program will be administered by the Small Business Administration.
Requires annual independent audits of the financial statements of each Federal Reserve bank and the Board of Governors of the Federal Reserve System.

Authorizes information sharing among the Federal Reserve Board and Federal or State authorities.

 Requires a GAO study analyzing the conflict of interest faced by the Board of Governors of the Federal Reserve System between its role as a primary regulator of the banking industry and its role as a vendor of services to the banking and financial services industry.

Requires the Federal banking agencies to conduct a study of banking regulations regarding the delivery of financial services, and recommendations on adapting those rules to online banking and lending activities.

Protects FDIC resources by restricting claims for the return of assets transferred from a holding company to an insolvent subsidiary bank.

Provides relief to out-of-State banks generally by allowing them to charge interest rates in certain host states that are no higher than rates in their home states.

Allows foreign banks generally to establish and operate Federal branches or agencies with the approval of the Federal Reserve Board and the appropriate banking regulator if the branch has been in operation since September 29, 1994 or the applicable period under appropriate State law.

Expresses the sense of the Congress that individuals offering financial advice and products should offer such services and products in a nondiscriminatory, nongender-specific manner.

Permits the Chairman of the Federal Reserve Board to designate a member of the Federal Reserve Board to serve on the Emergency Oil and Gas Guarantee Loan Guarantee Board and the Emergency Steel Loan Guarantee Board.

Repeals section 11(m) of the Federal Reserve Act, removing the stock collateral restriction on the amount of a loan made by a State bank member of the Federal Reserve System.

 Allows the FDIC to reverse an accounting entry designating about $1 billion of SAIF dollars to a SAIF special reserve, which would not otherwise be available to the FDIC unless the SAIF designated reserve ratio declines by about 50% and would be expected to remain at that level for more than one year.

Allow directors serving on the boards of public utility companies to also serve on the boards of banks.