Financial Services Management

Bank/BHC Activity Prohibitions

Cite
S. 1282
21st Century Glass Steagall Act of 2013

Recommended Distribution
Corporate Planning, Legal, Government Relations

Website
http://www.gpo.gov/fdsys/pkg/BILLS-113s1282is/pdf/BILLS-113s1282is.pdf

Overview

A small but influential group of bipartisan senators has introduced legislation to reinstitute barriers between banking and non-traditional activities, effectively seeking to repeal the financial holding company (FHC) structure authorized in the 1999 Gramm-Leach-Bliley Act.[1] The bill in fact would go considerably further, also reaching beyond the Volcker Amendment to Dodd-Frank[2] to bar even those proprietary-trading and hedge-fund/private-equity activities and to overturn years of decisions by the OCC allowing national banks to engage in non-traditional activities now deemed within the "business of banking." The bill would also go further than the Lincoln Amendment to Dodd-Frank[3] by flatly barring most swaps and related activities in insured depositories, regardless of whether or not these are needed for hedging purposes (with hedging apparently possible in the newly-restricted activities also proscribed for bank holding companies). By virtue of its broad definition of "banking," the bill would also eliminate an array of longstanding unitary thrift holding companies and non-bank banks by redefining "deposit" to extend activity restrictions to parent companies and affiliates of most insured depositories.

---

1 See *Financial Services Regulation & Legislation*, November 29, 1999.

2 See Client Reports in the PROPTRADE series.

3 See DERIVATIVES20, *Financial Services* Management, April 27, 2010.

Impact

The measure seeks to focus banks on "socially-valuable core banking activities," continuing a trend in which advocates seek to have large banks focus only on activities they believe promote the public good, a difficult term objectively to define and thus on which to base statutory direction. This bill does, though, try its hand at defining "core" banking activities, at least for national banks and federal savings associations. Despite the bill's findings and purposes (which express strong opposition to non-traditional activities), state member and non-member banks could apparently engage in broader activities as provided by state law, creating some incentive for national-bank charter conversions where activities are wholesale in nature and the bank thus is less concerned with avoiding state consumer-finance and interest-rate restrictions.

As noted, this bill takes a very broad view of impermissible activities, thus overturning decades of banking-agency opinions and statutory change. With regard to securities activities, the bill not only bars underwriting (as was clearly banned in Glass-Steagall), but also reaches to proprietary trading left untouched by the Volcker Amendment (e.g., market-making). The bill would also bar bank activity in or affiliation with any firm engaged in offering mutual-fund and/or investment-advisory services, thus outlawing activities of particular importance to the largest banks with significant wholesale banking activities and capital-markets operations. The broad nature of the measure would reach through the range of bank affiliations, meaning that it would also apparently overturn decades of law and rule allowing U.S. banking organizations to engage overseas in activities otherwise barred within the United States. Any foreign banking organization (FBO) with a U.S. insured depository would come under all of these prohibitions, effectively forcing an FBO engaged abroad in banned activities to divest its U.S. bank.

The redefined "business of banking" for national banks would strike down decades of OCC rulings authorizing banks to engage in insurance, broker-dealer, real-estate development, commodity-trading and other activities. Indeed, because the bill's definition of permissible "core" banking is so narrowly drawn (largely harkening back to the rules applicable before 1935), many activities routinely conducted in national banks not generally considered non-traditional – e.g., mortgage servicing, advising customers on financial transactions other than loans, debt collection – might also be barred.

Because the bill reaches to parent companies (BHCs, FHCs, unitary thrifts and other parents), the measure would – as it clearly desires – sharply divide banking not just from commerce, but also from any array of newly-barred financial services. Because the bill does not repeal the "Hotel California" provisions of Dodd-Frank,[4] companies like Goldman Sachs and Morgan Stanley that became BHCs during the crisis could apparently not now divest their insured depositories and evade the activity restrictions, essentially

[4] See SYSTEMIC29, *Financial Services Management*, July 13, 2010.

forcing them to convert to traditional BHCs even though few of their existing activities now fall within the tightly-proscribed restrictions for BHCs and FHCs.

What's Next

S. 1282 was introduced on July 11 by Sens. Warren (D-MA), McCain (R-AZ), Cantwell (D-WA) and King (I-ME). No legislative action is likely in either the House or Senate on this bill nor on any of the other similar measures introduced to date. However, the measure responds to growing debate about the role of banks in the financial market. At least eighteen states have introduced resolutions or taken similar action to call upon Congress to revive the Glass-Steagall Act. This is unlikely to spur Congress to act, but debate around the country has put growing pressure on the bank regulators to take a more conservative approach to non-traditional activities. Reflecting recent Senate hearings, the FRB has signaled a review of BHC physical-trading activities,[5] and the OCC is now also reviewing its approach to new products.

However, the banking agencies generally oppose the activity restrictions included in this measure. The bill takes a very different approach to bank reform than another Congressional initiative, which seeks to curtail only the largest banks by imposing stiff new capital charges on them and tightening inter-affiliate transaction restrictions.[6] Some regulators support aspects of this alternative reform approach, although its prospects for near-term passage are also slim.

Analysis

The bill includes an anti-evasion provision governing all of the prohibitions discussed below. To bolster this, the bill also requires BHC "executives" (the bill does not say who or how many) to attest under penalty of perjury to their company's and its affiliates' compliance. The agencies would also be required regularly to report to Congress on how they are enforcing all the new restrictions.

A. Affiliation and Activities

1. Prohibitions

Any insured depository institution (IDI) could not be or become an affiliate of an:

[5] See Client Reports in the COMTRADE series.

[6] See TBTF8, *Financial Services Management*, May 2, 2013.

- insurance company; as now defined for bank holding companies
- securities entity, which as noted would be broadly defined to bar underwriting, market-making, and broker-dealer activities. Further, also barred are futures commission merchant, investment-company, investment-advisory, hedge-fund, and private-equity services (except where advice or similar services are provided in a trust or similar capacity to customers); and
- "swaps" entity, with this term broadly defined to cover an array of SEC- and CFTC-registered entities.

Further, the IDI could not be in common ownership or control with the above entities or engage in any activity qualifying as one of these entities.

2. Transition

All barred affiliations and relations are to be terminated within five years of enactment by IDIs and FHCs. However, regulators could order termination of these activities or relationships before the five-year deadline following an opportunity for a hearing. Such early terminations are to address matters such as concentration, "unfair competition" and other matters. The deadline could also be extended under defined circumstances. Interestingly, any IDI receiving such an extension would need to notify its shareholders and the general public to this effect.

B. Boards

Officers, directors, employees or partners of the three non-bank entities cited above also could not serve as IDI directors, employees, officers, or institution-affiliated parties of any IDI absent a rule from the applicable federal banking agency that a limited number of exceptions would not unduly influence the IDI's investment policies or its advice to customers. Individuals serving in positions that violate these prohibitions would need to end their affiliations as soon as practicable, but no later than sixty days after enactment.

C. Business of Banking

As noted, the bill would also redefine IDI-permissible activities to overturn many prior decisions by the OCC authorizing non-traditional activities in national banks. "Core" banking to which national banks would be limited is defined to include:

- receiving deposits;
- extending credit;
- discounting and negotiating promissory notes, bills of exchange, similar evidences of debt;

- extending loans on personal security;
- participating in the payment system;
- buying, selling and exchanging gold and bullion; and
- investing in eligible securities for the bank's own account.

Going forward, these permissible investments and the definition of trading for the bank's account for national banks would be governed by joint rules from the OCC, FRB and FDIC. Except for obligations acquired before 1935, banks could hold no more than ten percent of capital in any single issuer.

The bill would also bar national banks from investing in structured products.

D. Federal Savings Associations

Their activities would have conformed to those authorized for national banks.

E. Bank Holding Companies

The activities defined for BHCs as "closely related to banking" are revised to conform to the activity restrictions noted above. In addition, management consultant and prime brokerage would be barred. As in the IDI prohibition above, swaps would be barred, but the BHC provisions would, as noted, expressly permit hedging (as long as it is perfectly matched) and covers limited risks defined in the bill).

F. Financial Holding Companies

FHCs would generally need to be dissolved if they involve any impermissible activity or affiliation.

Federal Financial Analytics, Inc.
1121 Fourteenth Street, N.W., Washington, D.C. 20005
Phone: (202) 589-0880 Fax: (202) 589-0423
E-mail: info@fedfin.com Web Site: www.fedfin.com