SECURITIES INDUSTRY ASSOCIATION
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December 13, 1990

Mr. Roger B. Porter
Assistant to the President
for Economic and Domestic Policy
The White House
1600 Pennsylvania Avenue, NW
Room 2/WW
Washington, DC 20500

Dear Mr. Porter:

Enclosed is a draft of the Securities Industry Association's ("SIA's") proposal for financial restructuring entitled "The Taxpayer Protection, Capital Markets Reform, and International Competitiveness Act". The proposal contains draft legislative language to implement the financial restructuring initiative that SIA announced about a year ago. I have also enclosed a short memorandum explaining the basic structure of our proposal, and a section-by-section analysis. We would like the opportunity to meet with you personally in the coming weeks to discuss this proposal and to seek your support, and we will be calling your office soon to see if this can be arranged.

In the meantime, if you have any questions, please contact either me (212/747-7012) or Marc Lackritz, Executive Vice President of SIA (202/296-9410).

Sincerely yours,

Gedale B. Horowitz
Chairman

Enclosures

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SIA'S LEGISLATIVE PLAN FOR TAXPAYER PROTECTION, CAPITAL MARKETS REFORM AND INTERNATIONAL COMPETITIVENESS

December 10, 1990

The Securities Industry Association is committed to preserving, and enhancing, the integrity and vitality of our financial markets, which are by far the world's largest, most innovative, most efficient and most competitive. At the same time, SIA recognizes that the current problems facing the commercial banking organizations, the federal deposit insurance system, as well as certain changes in the international financial environment, require reform of the way our financial services industries do business. (A "commercial banking organization," as that term in used, means a bank holding company and its federally insured commercial bank subsidiaries and its other subsidiaries.)

The objective of any restructuring must be first and foremost to safeguard American taxpayers by limiting their risk exposure while enhancing the ability of U.S. commercial banking organizations to compete internationally. At the same time, the preeminence of the U.S. capital markets must be preserved and the key to their preeminence is their open, competitive nature. For these reasons, SIA has developed a proposal for financial reform entitled "The Taxpayer Protection, Capital Markets Reform and International Competitiveness Act."

This working document, as its title implies, seeks to protect the taxpayer, keep the U.S. capital markets open, competitive and free and yet make it possible for U.S. commercial banking organizations to operate more freely domestically and internationally. The Act focuses on securities and securities-related businesses and banking as areas most urgently needing attention. If the restructuring provided for in the Act is adopted and works as intended, it will itself serve as the reform required for safeguarding the deposit insurance system.

The basic premise of the Act is that wholesale securities and securities-related activities can and should be carried on by commercial banking organizations on a free market basis without government support, and that federal deposit insurance should not stand behind, or be at risk from, such activities.

There is no reason why American taxpayers should -- and every reason why they should not -- be the ultimate insurer of losses in the securities and securities-related business of a commercial banking organization. The Act would virtually eliminate the "too big to fail" doctrine that would bail out parts of a commercial banking organization other than its federally insured banks. It would reduce the risks borne by those federally insured banks and it would recognize that all, not just big ones, but all federally insured banks (whether part of a commercial banking organization or not) are "too important to

fail." The times demand dramatic changes. SIA's plan accomplishes two seemingly contradictory objectives for commercial banking organizations:

- o Separates the wholesale securities and securities-related activities of a commercial banking organization from its federally insured banks, thus reducing risks for the federally insured banks, the Bank Insurance Fund and the American taxpayer; and

- o Provides a commercial banking organization with expansive securities powers to operate in tandem with its credit activities for international competitiveness.

Achieving both goals is made possible by the creation of a new entity: A bank holding company is authorized to establish nonfederally insured national banks known as investment banking financing companies (IBFCs), which in turn will own "securities subsidiaries" carrying on all of the wholesale securities and securities-related activities of the commercial banking organization (all underwriting, placing and trading of securities, permitted commodities and foreign exchange dealing not linked to customer trade needs, for example). The securities subsidiaries will include SEC-registered broker-dealers. The use of the separate subsidiaries facilitates functional regulation. The IBFC and its securities subsidiaries (collectively, the "IBFC securities group), will be able to operate with complete synergy.. However, the IBFC securities group can have no direct or indirect contact with or support from any affiliated federally insured bank or thrift.

[redacted] IBFCs of a bank holding company would be able to raise funds in the marketplace, accept large (over $100,000, the insured limit) uninsured deposits, make loans and fund and provide credit support to, and otherwise interact fully with, its securities subsidiaries. Securities firms will also be able to establish IBFCs to work cooperatively with their affiliates in the securities and securities-related businesses.

This feature of the Act achieves three important objectives:

(i) It addresses the stated desire of U.S. commercial banking organizations to compete in worldwide markets with full interplay between their securities and credit activities; and,

(ii) It eliminates the possibility that federally-supported commercial banking organizations will competitively distort the U.S. capital markets through unfair competitive advantage.

(iii) It ensures that no entrepreneurial risk undertaken by a commercial banking organization in the non-retail securities and securities-related businesses will fall upon any of its federally insured bank or thrift subsidiaries.

Securities firms would be able to own federally insured retail banks to serve the families and households of America. Federally insured banks within a commercial banking organization could establish SEC-registered broker dealers to carry on retail securities brokerage activities on an agency basis.

With securities firms' ownership of federally insured retail banks, new management and new capital would be brought into the banking industry. These new retail banks would also contribute premiums to the Bank Insurance Fund. Consumers of banking services would benefit from new capital in retail banking.

Regulation of the various entities would be undertaken on a functional basis, with the SEC having jurisdiction over the securities activities of commercial banking organization just as if these activities were not being carried on by securities firms affiliated with banks. The appropriate banking regulator, the Comptroller or the FDIC (if state-chartered), would control the activities of the federally insured bank subsidiary of the registered broker-dealer of a securities firm. The Comptroller of the Currency would be the regulator for the IBFC of a bank holding company and the IBFC of a securities firm.

The Act establishes a private system to supplement, and perhaps replace, the Federal Reserve System's large dollar payments system. In addition to banks, SEC-registered broker-dealers would have direct access to such a system. Until such a system is established, SEC-registered broker-dealers (pre-qualified by the SEC), whether within a bank holding company or owned by a securities firm, would have direct access to the large dollar payments system.

The goal of this provision is also to shift risks of the large dollar payments system away from the federal government to the private sector. It is also hoped that the increased number of participants and market rate pricing would enable the system to develop a quality but cost-effective system to cope efficiently with the ever-growing volume of transactions in a global market. In the meantime, the addition of pre-qualified broker-dealers to the present large dollar payments system would increase the efficiency with which it operates.

In times of generalized liquidity crisis, pre-qualified, SEC-registered broker-dealers would have emergency access on a fully collateralized and non-discount basis to the Federal Reserve. This emergency borrowing back-up from the Federal Reserve Board would be activated only subsequent to a declaration by the SEC that a generalized liquidity crisis exists. (An example would be what occurred on October 19 and 20, 1987). Such borrowing possibility is provided for as a cautionary, antidiscrimination measure. Securities firms should not be at the mercy of fully competitive commercial banking organizations in the event of such a liquidity crisis. The very existence of the arrangement hopefully will suffice to eliminate the possibility of such behavior occurring and the need to utilize the arrangement.

SIA's legislative proposal, responding to the concerns raised by the savings and loan disaster and the current, well-publicized problems in the commercial banking industry, is specifically designed to reduce the risk to the federal deposit insurance system and the American taxpayer; to improve retail banking services available to families and households; to provide new management and capital for federally insured retail banking services; to add premium flow to the federal deposit insurance system; to allow greater participation of commercial banking organizations in the wholesale securities markets; to permit nonfederally insured deposit taking, lending and wholesale securities activities to be conducted on an integrated basis; to preserve the integrity of our capital markets through avoidance of competitive distortions based on government subsidization of certain participants; and to increase investor protection through appropriate regulation and supervision.

The reorganization within a bank holding company family provided for in the Act responds to the crisis building within the commercial banking industry. A commercial banking organization acquires enormous flexibility in bringing together credit, securities and securities-related activities while, at the same time, the risks to the Bank Insurance Fund and the taxpayer are reduced, not increased. The IBFC securities group will follow normal accounting principles, so as activities and assets are transferred to the IBFC and its subsidiaries a picture more reflective of market realities is created, to the benefit of all concerned.

Since a securities firm can also form an IBFC, but will have no access to the Fed to support its securities and securities-related activities and will have no backing from the Bank Insurance Fund for such activities, it will lead the way to a much more privatized commercial banking system than the U.S. has had in decades. When the crisis surrounding the Bank Insurance Fund and commercial banking organizations and their federally insured banks has subsided, assuming the reorganization proposed by the Act takes place, the need for the Bank Holding Company Act and the Fed's regulatory role may disappear.

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