UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

February 4, 1999

The Honorable Thomas J. Bliley
Chairman
Committee on Commerce
U. S. House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
U. S. House of Representatives
2322 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Bliley and Congressman Dingell:

I am writing to share the Commission's views on financial services modernization as the Congress begins to considers pending legislation.

Last year, Commission staff worked with Congress in an effort to develop legislation that would preserve principles that are fundamental to effective oversight of the securities markets. Unfortunately, the extended negotiations so eroded these basic principles that the Commission cannot support the latest version of H.R. 10, as introduced in the 106th Congress.

Rather than attempt to address all the specific provisions in this particular bill, I believe it would be more useful, at this time, to step back and outline the broader concepts we feel should be incorporated in any financial modernization bill. I have attached a brief discussion of the Commission's overall objectives for financial services reform. My staff and I are readily available to discuss these objectives further with you or your staff.

I applaud the Congress' efforts to advance financial services modernization and look forward to working with you and the Committee on this important legislation.

Sincerely,

Arthur Levitt
Chairman

Enclosure

c.c. The Honorable Michael G. Oxley
Chairman, Subcommittee on Finance and Hazardous Materials

The Honorable Edolphus Towns
Ranking Member, Subcommittee on Finance and Hazardous Materials

SEC Objectives for Financial Modernization

The SEC's mandate is to protect investors and ensure the integrity of the U.S. securities markets. In order to keep our markets the fairest, safest, most transparent and most liquid in the world, the SEC must oversee all U.S. securities activities, irrespective of location, and continue to determine how they are defined.

Focusing on market integrity and investor protection, the SEC will work with the Congress to include the following key safeguards in any financial modernization legislation:

- Maintain aggressive SEC policing and oversight of all securities activities.
  Public confidence in our securities markets hinges on their integrity. The SEC has an active enforcement program committed to fighting securities fraud. Banking regulators have a different mandate--protecting the safety and soundness of institutions and their deposits--which does not consider the interests of defrauded investors. To continue its effective policing of the markets, the SEC must be able to monitor securities activities through regular examinations and inspections, including access to books and records of all activities.

- Safeguard customers by enabling the SEC to set net capital rules for all securities businesses.
  Securities positions are generally more volatile than banking activities. The SEC's capital and segregation requirements recognize this fact and are more rigorous in addressing market risk than those imposed by bank regulators. During recent turmoil in the financial markets, SEC-regulated entities were well-collateralized and none was ever at risk of failure. We must continue to protect our markets from systemic risk by ensuring that there is enough capital backing securities transactions to protect customers.

- Protect investors by applying the SEC sales practice rules to all securities activities.
  All investors deserve the same protections when buying securities, regardless of where they choose to do so, but gaps in the current scheme leave investors at risk. For example, banks are not required to recommend only suitable investments or provide a system for arbitrating customer disputes. The high, uniform standard of the Federal securities laws should apply to all sales of securities.

- Protect mutual fund investors with uniform adviser regulations and conflict-of-interest rules.
  Mutual fund investors should always receive the protections of the federal securities laws. Accordingly, all parties that provide investment advice to mutual funds should be subject to the same oversight, including SEC inspections and examinations. In addition, any type of entity that has a relationship with a mutual fund should be subject to the SEC conflict-of-interest rules.

- Enhance global competitiveness through voluntary broker-dealer holding companies.
  U.S. broker-dealers are at a competitive disadvantage overseas because they lack the global, consolidated supervision that foreign regulators often require. To address this concern, a U.S. broker-dealer predominantly in the securities business should have the option of SEC holding company supervision. This structure would impose risk-based supervision, consistent with the firm's principal business, and would help protect market integrity by overseeing the entire corporate entity, not just an isolated domestic unit.

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NASAA

MEMORANDUM

TO: HOUSE COMMERCE COMMITTEE

FROM: Thomas E. Geyer, Ohio Securities Commissioner
Chair, NASAA Financial Services Modernization Project Group
Deborah A. Fischione
NASAA Director of Policy and Office Management

DATE: April 27, 1999

RE: Comments on H.R. 10 "As Reported"

NASAA has had the privilege of testifying before the House and Senate regarding financial services modernization legislation pending in the 106th session of Congress. The issues discussed below are among the more important issues for NASAA. This list does not purport to be exhaustive and NASAA reserves the right to add to or amend this list as the legislative process continues. NASAA is basing these comments on H.R. 10 as it was reported from the House Banking and Financial Services Committee on March 23, 1999. We look forward to working with the House Commerce Committee as you begin deliberations on the bill.

1. Full Preservation of State Securities Enforcement Authority.

NASAA appreciates the preservation of State securities enforcement authority established by Section 104(d) of H.R. 10. NASAA believes such preservation is essential in order for States to provide meaningful investor protection and effectively police the securities marketplace. This express preservation is consistent with the similar preservations set out in the National Securities Markets Improvement Act of 1996 and the Securities Litigation Uniform Standards Act of 1998. However, NASAA respectfully suggests three minor changes in order to give full effect to the express preservation clearly articulated in Section 104(d).

a. Delete Section 104(b)(4)(C).

Section 104(b)(4) generally seeks to preserve certain State laws from preemption. However, because of the use of a double negative, Section 104(b)(4)(C) appears to have the actual effect of preempting State securities enforcement. Such preemption seems inconsistent with the careful and express preservation of State securities enforcement authority contained in Section 104(d). NASAA believes that the most efficient solution to this oversight is to simply strike Section 104(b)(4)(C).

b. Add Preservation Language to Section 307.

Section 307 generally preempts State law that would "prevent or significantly interfere with the ability of any insurer, or any affiliate of an insurer . . . to become a financial holding company or to acquire control of an insured depository institution." NASAA's concern is with the affiliates of insurers. Such affiliates could be broker-dealers or investment advisers under the jurisdiction of the State securities authorities, and the broad preemption of Section 307 could conflict with the State securities enforcement preservation language carefully and expressly preserved by Section 104(d). To remedy this confusion, NASAA suggests that preservation language identical to that appearing in Section 104(d) be added to Section 307. This new language could appear as follows:

> (4) subsections (1), (2) and (3) shall not be construed as affecting the jurisdiction of the securities commission (or any agency or office performing like functions) of any State, under the laws of such State, to investigate and bring enforcement actions, consistent with section 19(c) of the Securities Act of 1933, with respect to fraud or deceit or unlawful conduct by any person, in connection with securities or securities transactions.

c. Change "and" to "or" in Section 104(b)(4)(D)(iii).

As previously mentioned, Section 104(b)(4) generally seeks to preserve certain State laws from preemption. Section 104(b)(4)(D) in effect provides that a State law will not be preempted if it satisfies all parts of a four-part test. Part three of the test (Section 104(b)(4)(D)(iii)) provides that a State law will not be preempted if it "does not effectively prevent a depository institution, wholesale financial institution, or subsidiary or affiliate thereof from engaging in activities authorized or permitted by this Act or any other provision of federal law." This provision is inconsistent with the express preservation of State securities law set out in section 104(d) because State securities enforcement action may properly and intentionally have the effect of preventing such activities. Consequently, NASAA believes it is inappropriate and inconsistent with Section 104(d) to provide that such an effect is fatal to State law. To remedy this, NASAA suggests that the "and" at the end of Section 104(b)(4)(D)(iii) be changed to "or." This would have the effect of changing the four-part preemption test into a preemption test with four alternative standards. In other words, a State law would avoid preemption if it met any one of the four standards set out in Section 104(b)(4)(D), rather meeting all four parts as is currently the case. NASAA believes that such an alternative standard is consistent with, and gives full effect to, the preservation of State securities enforcement authority set out in Section 104(d).

2. Full Regulatory Deference and Functional Regulation.

NASAA also appreciates the regulatory deference contained in Section 111, which would amend Section 5(c) of the Bank Holding Company Act of 1956 to require banking regulators to defer to the Securities and Exchange Commission, State insurance authorities and State securities authorities under certain circumstances. To accomplish full functional regulation, NASAA suggests one minor change to proposed Section 5(c)(5) of the Bank Holding Company Act, which deals with the functional regulation of securities and insurance activities. Specifically, NASAA recommends that Section 5(c)(5)(B) be amended to apply to brokers, dealers and investment advisers required to be registered with State authorities, in addition to applying to brokers, dealers and investment advisers actually registered under State laws. New Section 5(c)(5)(B) could read as follows:

> (B) the relevant State securities authorities with regard to all interpretations of, and the enforcement of, applicable State securities laws (and rules, regulations, orders and other directives issued thereunder) relating to the activities, conduct, and operations of brokers, dealers and investment advisers registered or required to be registered under applicable State securities laws (or rules, regulations and other directives issued thereunder).

Many State securities enforcement actions are directed against persons who are unregistered. This proposed amendment would include such actions within the scope of required deference. This amendment would also make Section 5(c)(5)(B) more consistent with the express preservation of State securities enforcement authority set out in Section 104(d) of H.R. 10.

3. Full Functional Regulation of Securities Subsidiaries.

NASAA appreciates that H.R. 10 moves towards functional regulation of securities activities. However, NASAA believes that Section 124 of H.R. 10 contains a minor oversight, the correction of which will result in true functional regulation in this section. NASAA respectfully suggests a minor amendment to Section 124 of H.R. 10. Section 124 would add to the Federal Deposit Insurance Act new Section 46 regarding the functional regulation of securities and insurance subsidiaries of insured depository institutions. Currently, proposed new Section 46(a) provides in pertinent part that a broker or dealer that is a subsidiary of an insured depository institution shall be subject to regulation under the Securities Exchange Act of 1934. In order to accomplish full functional regulation, NASAA recommends that a reference to State securities law be added to this provision. A revised Section 46(a) could read as follows:

> (a) Broker or Dealer Subsidiary.
>
> A broker or dealer that is a subsidiary to an insured depository institution shall be subject to regulation under the Securities Exchange Act of 1934 <u>and State securities laws</u> in the same manner and to the same extent as a broker or dealer that --

This amendment accomplishes full functional regulation and also serves to establish a level-playing field by ensuring that subsidiary and non-subsidiary broker-dealers are subject to the same set of complementary State and federal securities laws.

In addition, in order to provide for complete functional regulation of securities subsidiaries, NASAA suggests that a provision regarding investment adviser subsidiaries be added. Such a provision could be added as new section 46(b) and read as follows:

> (b) Investment Adviser Subsidiary.
>
> An investment adviser that is a subsidiary of an insured depository institution shall be subject to regulation of the Investment Advisers Act of 1940 and State securities laws in the same manner and to the same extent as an investment adviser that –
>
> (1) is controlled by the same bank holding company as controls the insured depository institution; and
>
> (2) is not an insured depository institution or a subsidiary of an insured depository institution.

It is important to note that the failure to add this suggested provision regarding investment advisers would result in significant ambiguity as to the appreciable regulation of investment adviser subsidiaries. If this suggested provision is added, current subsection "(b)", regarding insurance subsidiaries, should be redenomiated as subsection "(c)". And current subsection "(c)", definitions should be changed as follows:

(e) (d) Definitions.

For purposes of this section:

(1) the terms "broker" and "dealer" have the same meanings as in section 3 of the Securities Exchange Act of 1934; and

(2) with respect to the term "investment adviser"

(A) such term shall have the same meaning as in section 202(a)(11) of the Investment Advisers Act of 1940 if the investment adviser subsidiary is registered with the Securities and Exchange Commission under section 203 of the Investment Advisers Act of 1940; or

(B) such term shall have the same meaning as defined in the State law of the State in which the investment adviser has its principal place of business if the investment adviser subsidiary is ineligible to register with the Securities and Exchange Commission under section 203 of the Investment Advisers Act of 1940 and is instead registered with appropriate state authorities.

The bifurcated definition of "investment adviser" is necessary because of the bifurcation in oversight resulting from the National Securities Markets Improvement Act of 1996.

4. Notice of Preemption of Certain State Provisions.

Because NASAA's members are devoted to consumer protection, NASAA recognizes the importance of the consumer protection provisions contained in Section 176 of H.R. 10, which would add to the Federal Deposit Insurance Act a new Section 47 dealing with customer service and education issues. In light of the States' commitment to consumer protection and experience in administering securities laws, NASAA respectfully requests that State securities administrators be added to the consultation provisions in proposed new Section 47(a)(3).

In addition, NASAA is concerned that States will have neither notice of, nor an opportunity to be heard on, the preemption of State law by the joint regulations prescribed by the federal financial institutions regulators. Specifically, proposed new Section 47(f)(2)(B) of the Federal Deposit Insurance Act provides that such joint regulations will preempt State law if the federal financial institutions regulators determine jointly that the "protection afforded by such provisions for consumers is greater than the protection provided by a comparable provision" of State. While NASAA wholeheartedly agrees that the strongest consumer protection standard should govern, it offends notions of due process and fundamental fairness that federal authorities could preempt State law without public notice and an opportunity to be heard.

Consequently, NASAA would respectfully request that publication in the Federal Register and a public comment period be required. This could be accomplished by adding the following to the end of proposed new Section 47(f)(2)(B):

> Provided, however, that such joint determination shall not be effective unless such joint determination is made after notice of such joint determination is published in the Federal Register and subject to public comment for a period of not less than sixty days.

5. The Definition of "Broker."

NASAA agrees completely with eliminating the blanket exemption for banks in the definition of "broker" under the Securities Exchange Act of 1934. However, NASAA remains concerned that the approach taken by Section 201 of H.R. 10 creates a series of exceptions that swallow the general rule. NASAA's specific concerns are as follows:

a. Third-Party Brokerage Arrangements.

NASAA fully supports this exception, but respectfully suggests that it can be improved by being moved in line with the existing standards in this area. In particular, in February 1998, the National Association of Securities Dealers ("NASD") "bank broker-dealer rule," Rule 2350, took effect. In October 1998, the NASAA membership approved Model Rules for Sales of Securities at Financial Institutions, which track NASD Rule 2350. Both NASD Rule 2350 and the NASAA Model Rules address the issues relevant to third-party brokerage arrangements, namely; setting and physical separation, brokerage agreements and program management, customer disclosure and acknowledgment, communication with the public, and notice of termination. NASD Rule 2350 resulted after nearly three years of input from the banking and securities industries on how to properly regulate third party brokerage activities. Because NASD Rule 2350 represents a well-developed and well-reasoned approach, NASAA respectfully suggests that the third-party brokerage arrangement exception as proposed in new Section 3(a)(4)(B)(i) of the Securities and Exchange Act of 1934 be amended to include either a cross reference to NASD Rule 2350 or a list of the exact provisions contained in NASD Rule 2350.

b. Trust Activities.

NASAA does not object to codifying that banks engaged in traditional trust activities are excepted from the definition of "broker." However, NASAA is concerned that proposed Section 3(a)(4)(B)(ii), as drafted, permits banks to engage in activities exceeding those of traditional trust activities, without providing investors the protections of the federal and State provisions governing the conduct of investment advisers. The effect of the proposed exception for certain "trust" activities, including the extension of the exception to an "other department that is regularly examined by bank examiners," coupled with the solicitation activities permitted under this exception, is to permit banks to solicit publicly advisory business from deposit-holders and non-deposit-holders, devoid of the substantive federal and State regulation under the securities laws. NASAA respectfully suggests that the proposed limitless solicitation of advisory business be narrowed.

The language regarding solicitation activities now limits the activities to those banks that do not "publicly" solicit brokerage business. NASAA would note that this language, while appearing to limit a bank's solicitation activities, now would permit banks' brokerage businesses to actively solicit deposit holders (in a non-public fashion).

NASAA respectfully recommends that the proposed new Section 3(a)(4)(B)(ii)(II) be revised as follows.

> (II) does not ~~publicly~~ solicit brokerage business, other than by advertising that it effects transactions in securities in conjunction with advertising its other trust activities.

c. Private Securities Offerings.

NASAA respectfully believes that the exception set out in proposed Section 3(a)(4)(B)(vii) falls short of establishing true functional regulation for private securities offerings. Documented sales practice abuses have occurred in private placement transactions, and investors need the assurance that the intermediary who is selling the security is trained and subject to the obligations applicable to other broker-dealers. To afford true functional regulation in this area, the securities should either be required to be sold through a registered broker-dealer, or in the alternative, to at least require bank employees to take and pass the examination contemplated in Section 203 of H.R. 10, which would add Section 15A(j) to the Securities Exchange Act of 1934.

NASAA is pleased with Section 3(a)(4)(B)(vii)(II), since NASAA believes that, to the extent a bank maintains an affiliation with a broker-dealer firm, all private placements be effected through that broker-dealer rather than through the bank itself. However, NASAA would respectfully suggest that the existing language creates little incentive for a bank to establish an affiliation with a broker-dealer firm through whom to channel these securities transactions.

NASAA believes that the registration and regulatory provisions provided under the Securities Exchange Act of 1934, State provisions, and self-regulatory organization rules are critical components of the investor protection equation. Regulators use these provisions to monitor the activities of broker-dealers and to screen out those entities and individuals that should not be permitted to engage in the offer and sale of securities in our markets. NASAA is also concerned that, by excusing banks from compliance with virtually all of the Securities Exchange Act of 1934 registered broker-dealers will suffer a significant competitive disadvantage when seeking to distribute securities in a nonpublic offering.

d. De Minimis Exception.

NASAA continues to oppose the de minimis exception in proposed Section 3(a)(4)(B)(x). By allowing securities transactions to occur outside the established complementary State/federal securities oversight framework, the exception is inconsistent with true functional regulation and creates an unlevel playing field.

Nonetheless, if the de minimis exception is to be included in H.R. 10, NASAA respectfully suggests that the de minimis be in terms of customers, rather than transactions.

Underlying the de minimis exception seems to be the belief that banks should be allowed to carry out a certain few securities transactions as an accommodation for certain bank customers. Accordingly, a de minimis exception based on the number of customers seems more logical. Further, "customers" are more easily counted. "Transactions" is an amorphous concept not generally defined in the securities laws. Confusion would certainly arise as to what activity constituted a "transaction."

In contrast, it is clear who constitutes a customer. Support for this approach can be gleaned from the National Securities Markets Improvement Act of 1996, where Congress defined certain investment adviser de minimis standards in terms of people, not transactions.

Specifically, NASAA suggests that the de minimis be set at one hundred customers. In suggesting this number, NASAA started with the fact that the de minimis exception is designed to allow smaller, typically rural banks to undertake securities transactions as an accommodation and convenience for certain customers. From that starting point, it is reasonable to assume that small banks have about 2,000 customers. Using the general banking industry guidelines that

20% of an institution's depositors account for 80% of an institution's deposits, there would be 400 customers who would be larger depositors of a 2,000 depositor institution. It is safe to assume that these 400 larger depositors would be more likely to engage in securities transactions. And since the exemption is designed to be "de minimis" in nature, it would be reasonable to permit transactions for up to 100 or 25% of those customers.

Thus, NASAA would propose that the de minimis exemption read as follows:

> (x) De minimis Exception.
>
> The bank effects transactions in securities on behalf of not more than 100 customers in any calendar year; provided that such transactions are not effected by an employee of the bank who is also an employee of a broker or dealer; and provided further that prior to executing the first securities transaction in any calendar year on behalf of a customer under this de minimis exception, the bank obtains from the customer a written acknowledgement indicating the customer understands that the bank executing securities transactions on behalf of the customer within the de minimis exception to the federal definition of "broker", and the consequences thereof.

The written acknowledgment is designed to assist the bank in accounting for the number of transactions within the de minimis.

6. The Importance of Registration for Sales of Private Securities Offerings.

NASAA fully supports Section 203 of H.R. 10, which would add to the Securities Exchange Act of 1934 Section 15A(j) requiring the NASD to create a limited qualification category for an associated person of an NASD member firm effecting nonpublic securities transactions. While this provision creates a limited registration category for associated persons of member firms, it would presume such qualification if the same individual happened to be distributing the same securities not for a broker-dealer but for a bank.

It would appear that this provision is added to permit associated persons of NASD member firms to engage solely in the distribution of securities through a nonpublic offering without having to undertake full registration as a registered representative. It is NASAA's observation that very few registered representatives engage solely in the distribution of private placements. Additionally, it would appear that bank employees would be "grandfathered" from any examination requirement. However, Section 203 does not appear to require the "non-grandfathered" bank employees to satisfy any qualification requirements to distribute these securities.

This provision would appear to place NASD member firms at a competitive disadvantage with banks in the private placement market. It is assumed that, like other limited examinations, the examination is a "subset" of the Series 7 examination. Broker-dealer representatives would be permitted to take this limited examination. However, bank personnel effecting the same transactions would not be required to take this examination, even though the conduct in which they would be engaged could be identical to that of the broker-dealer representative. There exists no other provision of the federal securities laws or of H.R. 10 that would place any requirements or registration upon these bank personnel. To provide some minimal protections for the depositor/investor, NASAA believes it imperative for bank personnel to at least be required to take this limited qualifying examination.

The mechanism that would provide for true functional regulation would be to require the NASD to create this limited qualification examination, but require associated persons of member firms and bank personnel to take and pass this qualification examination (or be qualified under a more comprehensive examination, such as the Series 7) prior to effecting transactions in securities not involving a public offering. NASAA believes that the following language would address this issue:

> (j) Registration for Sales of Private Securities Offerings. A registered securities association shall create a limited qualification category for any associated person of a member who effects sales as part of a primary offering of securities not involving a public offering, pursuant to section 3(b), 4(2), or 4(6) of the Securities Act of 1933 and the rules and regulations promulgated thereunder, <u>shall permit any bank employee to take the qualification examination required for this limited registration category for purposes of section 3(a)(4)(B)(viii)(II) of this title</u>, and shall deem qualified in such limited qualification category, without testing, any bank employee who, in the six month period preceding the date of enactment of this Act, engaged in effecting such sales.

As a practical matter, the NASD currently administers qualifying examinations for individuals not associated with a member firm, and thus would appear capable of administering this new examination for members and non-members alike. For example, NASAA would note that individuals not affiliated with a member firm could, in certain circumstances, sit for the Series 7 examination, which is owned jointly by the NASD and New York Stock Exchange. NASAA would note that little reason exists to excuse bank personnel from sitting for a qualification examination as a prerequisite of effecting private securities transactions. It would appear that the exception in proposed Section 3(a)(4)(B)(vii) of the Securities Exchange Act of 1934 could be conditioned upon the transaction being effected either through a registered broker-dealer or through a bank employee that has passed a qualifying examination:

> (II) at any time after one year after the date of enactment of the Financial Services Act of 1998, is not affiliated with a broker or dealer that has been registered for more than one year; and
>
> <u>(III) is effected solely by bank employees that have attained a passing score on the qualification examination created pursuant to section 15A(j) of this title or through a broker or dealer; and</u>
>
> ~~(III)~~<u>(VI)</u> effects transactions exclusively with qualified investors.

7. Definition and Treatment of Banking Products.

NASAA fully concurs with the removal of the concept of "derivatives" from the definition of "traditional banking product" set out in Section 205 of H.R. 10. This section now appropriately lists items in which banks have historically dealt. NASAA has one aditional investor protection concern with Section 205, and that is that Section 205(a)(5)(B) would permit loan participations to be sold to non-qualified investors. The sale of loan participations presents the opportunity to shift the risk of bank loans, defaulting mortgages or insolvent borrowers onto investors. Consequently, only those investors meeting the financial standards of being a "qualified investor" should be permitted to purchase these products.

As a result, NASAA respectfully suggests that Section 205(a)(5)(B) be deleted.

8. Governmental Entities as Qualified Investors.

In general, NASAA believes that the definition of "qualified investor," set out in Section 206 of H.R. 10, sets out an appropriate standard for persons and entities who can "fend for themselves" when making investment decisions. However, NASAA remains concerned with the relatively low threshold of $50,000,000 in investments for governmental entities.

NASAA is concerned that many county and local governments will meet this threshold yet not possess the sophistication or knowledge to be appropriately deemed "qualified investors." This relatively low standard and the absence of any required professional management make this part of the definition, NASAA believes, inadequate. Many state, county and local government pensions are advised by volunteers, or elected or appointed officials who are not principally engaged in the business of investment management. Requiring that professionals manage the investments, or that the investments be of a size where the fund will be professionally managed as a matter of course, would greatly decrease the likelihood that entities that sell to qualified investors will later become defendants in securities suits alleging unsuitable recommendations or other violations of the securities laws.

To remedy this problem, NASAA would respectfully suggest that governmental entities be treated as "qualified investors" only if a registered broker-dealer, investment adviser, insurance company, or insured depository institution professionally manages the investments. In the alternative, NASAA would respectfully suggest that this classification of qualified investor be required to own and invest a greater quantity of investments, such as $250 million. This higher threshold would greatly increase the likelihood that professional advisers manage the portfolio, due to its size. Language addressing this issue could appear as follows:

> (xiii) any governmental or political subdivision, agency or instrumentality of a government who owns and invests on a discretionary basis not less (I) than $250,000,000 ~~$50,000,000~~ in investments, or (II) than $50,000,000, provided that investments are managed by (AA) a bank (as defined in paragraph (6) of this subsection); (BB) a savings and loan association (as defined in section 3(b) of the Federal Deposit Insurance Act), (CC) a broker, dealer, or insurance company (as defined in section 2(a)(13) of the Securities Act of 1933), (DD) an investment adviser registered under the Investment Advisers Act of 1940 or with any state, or (EE) a foreign bank (as defined in section 1(b)(7) of the International Banking Act of 1978).

9. True Functional Regulation of Banks who act as Investment Advisers.

To provide for true functional regulation over persons providing investment advice to others for compensation, NASAA would respectfully suggest an amendment to the definition of "investment adviser" found at Section 202(a)(11) of the Investment Advisers Act of 1940, in addition to Section 217 of H.R. 10. Just as advisers to investment companies should be subject to the substantive regulatory provisions of the Investment Advisers Act of 1940, NASAA believes it imperative that advisers to retail clients be subject to appropriate federal and State provisions, regardless of whether the investment advice is offered by a bank or nonbank adviser.

Consistent with the exceptions for "qualified investors," it would appear consistent to permit banks to provide advice to "qualified investors" other than investment companies and still maintain the exception from the definition of "investment adviser" This exception would also be consistent with the private securities offering exception in proposed Section 3(a)(4)(B)(vii) discussed previously. NASAA's concern is that those advisers providing advice to retail clients be subject to even-handed and fair regulation at the local level.

NASAA would respectfully suggest that the proposed definition of "investment adviser" be amended slightly as follows (this language assumes the amendment proposed at Section 217 of H.R. 10):

> (11) "Investment adviser" means any person who, for compensation . . . but does not include (A) a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956 which is not an investment company, except that the term 'investment adviser' includes any bank or bank holding company to the extent that such bank or bank holding company acts as an investment adviser to a registered investment company <u>or to any person other than a 'qualified investor,' as that term is defined in section 3(a)(55) of the Securities Exchange Act of 1934</u>, but if, in the case of a bank, such services are performed through a separately identifiable department of division, the department or division, and not the bank itself shall be deemed to be the investment adviser . . .

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April 22, 1999

State Insurance Regulators Oppose HR 10 as Passed by the House Banking Committee Because the Bill Is Hostile to Consumers and the States

Gentlemen:

HR 10, as passed by the House Committee on Banking and Financial Services, is very harmful to insurance consumers and the States. Consequently, we believe it is absolutely essential that the Committee on Commerce exercise its jurisdiction over insurance matters to fix HR 10, and protect the American public from the dangers of unregulated insurance products in the marketplace.

In its current form, HR 10 needlessly sweeps away State authority used to regulate the solvency and market conduct of insurance activities conducted by banks and traditional insurers that affiliate with them. If the Federal government prevents the States from supervising those insurance activities, they will not be regulated at all. There is no Federal guarantee program for insurance losses, so the costs of such regulatory failures will fall directly upon policyholders, claimants, State guarantee funds, and State taxpayers.

The NAIC requests that the Committee on Commerce correct the insurance regulatory problems in HR 10. To help accomplish that goal, State regulators are undertaking two important initiatives – (1) NAIC is providing the Commerce Committee with a package of amendments to HR 10 that, if adopted, will adequately protect insurance consumers and the States without impairing the goals of the bill's sponsors; and (2) NAIC and State regulators are commencing an intensive, public campaign to inform consumers, State officials, and Members of Congress regarding the harm that passage of HR 10 will cause.

As an organization of State officials responsible for protecting the public, the National Association of Insurance Commissioners (NAIC) pointed out the following serious flaws in HR 10 during our testimony before the House Banking and Financial Services Committee on February 11, 1999.

- HR 10 flatly prohibits States from regulating the insurance activities of banks, except for certain sales practices. There is no justification for giving banks an exemption from proper regulations that apply to other insurance providers.

- HR 10 prohibits States from doing anything that might "prevent or restrict" banks from affiliating with traditional insurers or engaging in insurance activities other than sales. This exceedingly broad standard undercuts ALL State supervisory authority because every regulation restricts business activity to some degree. HR 10's total preemption of State consumer protection powers goes far beyond current law, and casts a dangerous cloud over the legitimacy of State authority in countless situations having nothing to do with easing financial integration for commercial interests. It could also throw into question the regulatory cooperation between State insurance regulators and Federal banking agencies being achieved under current law.

- HR 10 uses an "adverse impact" test to determine if State laws or regulations are preempted because they discriminate against banks. This unrealistic standard fails to recognize that banks are government-insured institutions which are fundamentally different from other insurance providers. Sound laws and regulations that are neutral on their face and neutral in their intent would still be subject to preemption under such a standard.

- HR 10 does not guarantee that State regulators will always have equal standing in Federal court for disputes which may arise with Federal regulators.

Frankly, we are quite disappointed and concerned that the House Banking and Financial Services Committee chose not to fix these and other problems pointed out by NAIC. We were told that all parties affected by HR 10 will suffer a certain amount of pain, but nobody has informed insurance consumers that they are among the groups who will suffer when State laws and regulations are preempted.

The NAIC and State insurance regulators strongly oppose HR 10 as passed by the Banking and Financial Services Committee. Nor do we believe the public will be complacent about the negative impact that HR 10 will have upon the safety and soundness of financial products involving insurance, a unique product which is purchased to protect people during the times in their lives when they are most vulnerable.

The NAIC looks forward to working positively and cooperatively with the Commerce Committee and its Members as you perform your responsibilities on HR 10. We cannot – and will not – stand by silently if the push for HR 10 becomes a means for effectively deregulating the insurance activities of banks and the traditional insurance providers who affiliate with them. The public interest would not be served with that outcome.

Sincerely,

George M. Reider, Jr.
President, NAIC

George Nichols III
Chairman, NAIC Committee on Financial Services Modernization

cc: Honorable Michael G. Oxley, Chairman
Honorable Edolphus Towns, Ranking Minority Member
Subcommittee on Finance and Hazardous Materials

Members of the Committee on Commerce

ABA SECURITIES ASSOCIATION

April 21, 1999

The Honorable Thomas J. Bliley, Chairman
The Committee on Commerce
2125 Rayburn House Office Building
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Bliley:

In this letter, the ABA Securities Association ("ABASA") respectfully submits its views on the capital markets provisions in H.R. 10, the "Financial Services Act of 1999," which the Commerce Committee is scheduled to consider during the next month. ABASA is a separately-chartered subsidiary of the American Bankers Association ("ABA") that represents the banking organizations that are most actively involved in securities and capital markets.

In general, ABASA strongly supports the existing capital markets provisions of H.R. 10. Among its many positive provisions are full securities underwriting and dealing authority for affiliates and subsidiaries of banks; removal of the existing prohibition on director, officer, and employee interlocks between banks and securities firms; broadened "merchant banking" investment authority; increased authority for banks to underwrite and deal in municipal bonds; and an expanded definition of the types of financial activities in which bank holding companies would be permitted to engage.

At the same time, H.R. 10 would significantly roll back the existing securities law exemption from broker-dealer regulation that is now expressly applicable to all banks. The result would be that certain lawful banking activities would be "pushed out," or exposed to push-out, from the bank to a separate affiliate that was registered and regulated as a securities broker-dealer. However, H.R. 10 recognizes that many of the traditional banking activities should not trigger brokerage registration. H.R. 10 does this through a series of narrowly drawn exemptions from push-out for specific types of activities in which banks currently engage.

ABASA has long opposed push-out provisions as costly, unnecessary, and inconsistent with the fundamental purposes of financial services modernization. Despite this long-held position, ABASA has continually worked hard and in good faith to support a constructive compromise on push-outs that would help lead to passage of an overall bill that included the positive capital markets provisions described above. These efforts have included many worthwhile exchanges with your Committee, the House Banking Committee, the Senate Banking Committee, the federal banking regulators, the Securities and Exchange Commission, and the Treasury Department. In addition, at the request of House leadership in the 105th Congress, ABASA participated with our colleagues at the Securities Industry Association ("SIA") in compromise discussions regarding this same issue.

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ABA Securities Association is an affiliate of the American Bankers Association

After many years of these intensive discussions and negotiations, the result has been an extremely hard-fought and carefully-balanced compromise involving substantial concessions from all parties involved. The compromise replaces the existing blanket exemption from push-out for all banking activities with a set of specific statutory exemptions for particular types of banking activities that have been and will continue to be more appropriately regulated under the banking laws than the securities laws. Other existing banking activities not covered by the exemptions – such as retail securities brokerage – would be pushed out to a broker-dealer. All of these new exemptions are spelled out in detail in statutory language in order to provide market participants with some high degree of certainty.

In this context, ABASA strongly supports the push-out provisions in the Senate Banking Committee's version of financial reform legislation. ABASA also continues to support the push-out provisions of H.R. 10 as reported by the House Banking, which, although involving more push-outs than the Senate version, is nevertheless consistent with the fundamental compromise described above. Indeed, it is our understanding that the H.R. 10 provisions are nearly identical to those included in the financial services legislative compromise that resulted at the end of 1998 from last year's negotiations among you and the Chairmen of the House and Senate Banking Committees, and that the SEC, while not agreeing to this version, made clear at the end of last year's debate that they would not strongly oppose the final compromise bill that included these provisions.

Accordingly, ABASA urges the Commerce Committee to adopt the securities and capital markets provisions in H.R. 10, including the push-out provisions reflecting the compromise discussions from last year. We firmly believe that the hard-fought compromise it reflects is an extremely delicate one, and that any significant departure from it would jeopardize critical support for the overall legislation.

Thank you for considering our views. We look forward to working with you and your staff, and answering any questions you may have.

Sincerely,

The ABA Securities Association

cc: The Honorable John D. Dingell, Ranking Minority Member, Committee on Commerce
The Honorable Michael G. Oxley, Chairman, Subcommittee on Finance and Hazardous Materials
The Honorable Edolphus Towns, Ranking Minority Member, Subcommittee on Finance and Hazardous Materials

ABA INSURANCE ASSOCIATION™

April 15, 1999

The Honorable John D. Dingell
Ranking Minority Member
The Committee on Commerce
2322 RHOB
U.S. House of Representatives
Washington, DC 20515

Dear Rep. Dingell:

The American Bankers Association Insurance Association, Inc., is writing regarding the insurance provisions in H.R. 10, which has been approved by the House Banking and Financial Services Committee and is now pending in the House Commerce Committee. The ABA Insurance Association (ABAIA) is an affiliate of the American Bankers Association. Its members are the leading banking organizations in the United States involved in the business of insurance.

While the insurance provisions in H.R. 10 are not perfect, ABAIA supports them. As approved by the House Banking Committee, the bill would permit banks to affiliate with an insurance company or insurance agency. Such affiliates would be regulated principally by the states, subject to an anti-discrimination standard intended to ensure that banks and their insurance affiliates are treated fairly. States would have the right to review affiliations between banks and insurance firms, and the federal banking regulators would be required to defer to the states in the examination and supervision of insurance affiliates.

The insurance provisions in H.R. 10 reflect a fragile compromise between the interests of the banking and insurance industries, state and federal regulators, and consumers. These provisions, particularly Section 104, reflect months of negotiations between interested parties, including ABAIA, and we fear that a departure from them could cause the entire bill to unravel. Therefore, we urge you to maintain the compromise as it stands.

We would, however, like to raise two matters, which are not within the scope of the insurance compromise. First, Section 176 of the bill directs the federal banking regulators to establish an "appropriateness" standard applicable to the sale of insurance by a bank. This is an undefined standard, which we fear could lead to significant litigation. Furthermore, it is a

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standard that would be applicable only to banks engaged in the sale of insurance, not to insurance companies or agencies unaffiliated with banks. Consumer confusion would be inevitable. Therefore, we recommend the elimination of this requirement.

Second, Section 305 prohibits a national bank or a subsidiary of a national bank from underwriting or selling title insurance, unless the bank or subsidiary was engaged in the activity prior to the date of enactment of the bill. This is an anti-competitive provision that simply has no place in a financial modernization bill. Title insurance sales, in particular, pose no safety and soundness threat to a bank or its depositors. With this provision in place, a mortgage banking subsidiary of a national bank could not sell title insurance lawfully underwritten by a holding company affiliate. We urge the elimination of this anti-competitive, anti-consumer provision.

Thank you for your consideration of these views.

Sincerely,

ABA Insurance Association