

# THE GRAMM-LEACH-BLILEY FINANCIAL MODERNIZATION ACT: WHY REFORM IN THE FINANCIAL SERVICES INDUSTRY WAS NECESSARY AND THE ACT'S PROJECTED EFFECTS ON COMMUNITY BANKING\*

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## I. INTRODUCTION

The financial services industry is constantly evolving and has recently been the subject of tremendous change. The Gramm-Leach-Bliley Financial Modernization Act of 1999<sup>1</sup> (Gramm-Leach-Bliley), which among other provisions includes a repeal of the Glass-Steagall Act,<sup>2</sup> effectively transforms the permissible ownership structure of financial institutions by allowing banks,

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\* The Note author's interest in this subject is based on his membership in the third generation of a community banking family in Iowa.

1. Gramm-Leach-Bliley Financial Modernization Act of 1999, 12 U.S.C. § 1843(c)(3), (k)(1) (Supp. V 1999).

2. 12 U.S.C. § 24 (1994 & Supp. II 1997); 12 U.S.C. §§ 78, 377 (1994), *repealed by* 12 U.S.C. § 1843 (Supp. V 1999); 12 U.S.C. § 378 (1994).

insurance companies, and securities underwriters to affiliate.<sup>3</sup> President Clinton signed the bill into law on November 12, 1999.<sup>4</sup> Gramm-Leach-Bliley represents a dramatic overhaul of banking legislation, restricting the common ownership of banks, insurance companies, and investment firms since the Great Depression.<sup>5</sup>

This dramatic change, which will likely lead to the proliferation of large financial conglomerates, has been traditionally viewed as impacting only large national banks.<sup>6</sup> However, the newly enacted legislation will also directly impact the neighborhood community bank.<sup>7</sup> While community bankers approve of many provisions of the final legislation, there were some provisions, such as those relating to consumer privacy and government regulation of community lending, that delayed the final bill's enactment under the community banking lobby's adamant opposition.<sup>8</sup>

This Note will examine Gramm-Leach-Bliley and discuss its foreseeable impact on the financial services industry as a whole and on the community banking industry. Part II will describe the existing forms of financial institutions in the United States and will discuss the history and significance of the community banking industry. Part III will provide an in-depth analysis of Gramm-Leach-Bliley by discussing the history of American banking legislation and the rise of the modernization legislation. Part IV will look to the future of the financial services industry by analyzing the impact of Gramm-Leach-Bliley on both large financial conglomerates and community banks.

## II. BACKGROUND OF THE FINANCIAL SERVICES INDUSTRY

The financial services industry is comprised of several different business forms, including national and state banks, savings institutions, credit unions, and unitary thrifts.<sup>9</sup> While these entities previously were limited in the services they

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3. Gramm-Leach-Bliley Financial Modernization Act of 1999, 12 U.S.C. § 1843 (Supp. V. 1999); see also *Congress OKs 'Financial Supermarket'*, DES MOINES REG., Nov. 5, 1999, at 1A [hereinafter *Congress OKs*].

4. *Clinton Signs Legislation Overhauling Banking Laws*, N.Y. TIMES, Nov. 13, 1999, at B3.

5. *See id.*

6. *See* Bob Barsness, *The Long Hot Summer*, INDEP. BANKER, Aug. 1999, at 7, 7.

7. *See id.*

8. *See id.*

9. *See* WILLIAM A. LOVETT, BANKING AND FINANCIAL INSTITUTIONS LAW IN A NUTSHELL 120-26, 236 (1997).

could offer based on the form of their respective charters, deregulation has largely melded the industry so that charter type currently has little significance.<sup>10</sup>

#### A. Community Banking Definitions and Statistics

While no single industry-wide definition of a "community bank" exists, several different national organizations have similar definitions. The Independent Community Bankers Association (ICBA), for example, defines a community bank as

a locally owned, locally operated bank. Its deposits come from, and its loans are made in, the area where it is located. It may operate with a single office (a unit bank) or may have a limited number of offices or subsidiaries. In either case, its policies are set locally.<sup>11</sup>

The American Bankers Association defines a community bank as "[a] small local bank that serves the financial needs of one community or a series of communities in a close geographical area."<sup>12</sup> Asset size—for example, a balance sheet with total assets of \$250 million or less—is also commonly used as a measuring stick to define community banks.<sup>13</sup>

Regardless of the definition, statistics related to community banks reveal their significant presence in the financial services industry and, on a broader scale, in the national economy as a whole. Community banks are a critical source of lending for farms and small businesses.<sup>14</sup> According to the Small Business Administration, small businesses currently comprise 50% of the Gross Domestic Product.<sup>15</sup> A 1997 Federal Reserve Bank report revealed banks with less than \$100 million in assets comprise 66% of all United States banking organizations.<sup>16</sup>

There are nearly 9600 community banks with over 36,000 locations in the United States. Despite the widespread proliferation of mergers and consolidations throughout the financial services industry, the number of new community

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10. See C. Dawn Causey, *The Future of Nonbank Depository Financial Institutions*, 3 N.C. BANKING INST. 1, 1-2 ("Delivery channels and consumer convenience, not charter, drive the offering of financial services."); see also *infra* note 83, at B3.

11. E-mail from Susan R. Fournier, Information Center Director, Independent Community Bankers of America, to Robert W. Dixon (Oct. 14, 1999) (on file with author).

12. *Id.*

13. *Id.*

14. Independent Community Bankers Association, *Community Banking in the United States* <<http://www.icba.org/cbanks.html>> (accessed Oct. 14, 1999) [hereinafter *Community Banking in the United States*].

15. *Id.*

16. *Id.* (referring to Report of Condition and Income, Federal Reserve Bank of Dallas).

banks formed in the United States is increasing, rather than following the merger trend of larger banks.<sup>17</sup> According to the ICBA, in 1998, 190 new community bank charters were granted—the largest number of new charters in the decade.<sup>18</sup> This trend continued in 1999, as 205 new charters were granted during the year.<sup>19</sup>

In Iowa, for example, twenty-eight state-chartered banks, three nationally-chartered banks, and three thrift institutions opened since 1991.<sup>20</sup> The majority of these new banks opened in markets where mergers and acquisitions by large financial holding companies removed corporate decision-making to out-of-state headquarters.<sup>21</sup> Hoping to capitalize on bank customers dissatisfied by the loss of local control, bankers chartered new banks during the 1990s at a greater pace than at any other ten-year period in recent history.<sup>22</sup>

### B. The Importance of Preserving Community Banking

From a review of these statistics, one can readily observe the significant role community banks play in our nation's economy. As the primary lender for small businesses and farms, which account for fifty percent of our Gross Domestic Product, community banks assist these businesses in acquiring the capital critical for their survival and growth.<sup>23</sup>

While the statistics depict community banks as thriving and prosperous, a closer look at some isolated economies reveals present economic trends may lead to a less optimistic prognosis for the industry. An observation of the agricultural industry in Iowa and its relationship with community banks provides a useful illustration of the importance of community banks and the potentially sensitive situation both industries currently face in the wake of the poor market conditions facing farmers.

A poor farm economy has plagued Iowa farmers in recent years.<sup>24</sup> Low prices for corn, soybeans, and hogs over the course of three to four years have

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17. Independent Community Bankers Association, *Community Banking Facts* <[http://www.icba.org/about\\_icba/cbfacts.html](http://www.icba.org/about_icba/cbfacts.html)> (accessed Mar. 12, 2000) [hereinafter *Community Banking Facts*]. A dramatic wave of mergers among large banks has occurred in recent years. See *infra* Part IV.A.

18. *Community Banking in the United States*, *supra* note 14.

19. *Community Banking Facts*, *supra* note 17.

20. Kathy Bergtrom, *Banks Sprout Across Iowa*, DES MOINES REG., Jan. 28, 2001, at 1D.

21. *Id.*

22. *Id.* (citing statement of Iowa State Banking Superintendent Holmes Foster).

23. See *Community Banking in the United States*, *supra* note 14.

24. Anne Fitzgerald, *Bankers Expect Farm Finances to Grow Worse*, DES MOINES REG., Jan. 16, 2000, at 4G.

forced farmers to renew debt borrowings, further delaying repayment of existing debts.<sup>25</sup> As a result, the financial stability of some community banks, the primary lending sources for farmers,<sup>26</sup> has slightly deteriorated and may continue to worsen.<sup>27</sup> The American Bankers Association's annual survey of farm lending, for example, revealed that two-thirds of all farm lending in 1999 went towards the refinancing of existing debt.<sup>28</sup> In other words, many farmers have been forced to borrow money to retire old debt, rather than completely paying off existing agriculture loans and acquiring new debt for new ventures.<sup>29</sup>

Farming, like other industries, is experiencing the consolidation prevalent in the business marketplace as a whole.<sup>30</sup> Large corporations have purchased farmland and the family farmer is a dying breed.<sup>31</sup> Consequently, fewer small business owners need to borrow from community banks. The community banking industry, at least in predominantly agricultural regions, may therefore experience attrition. To survive, community banks will need to diversify to maintain their important presence in the financial services industry. Gramm-Leach-Bliley may provide community bankers an opportunity to diversify their product portfolios to remain profitable in the wake of consolidation in the farming industry.

### III. THE FINANCIAL MODERNIZATION ACT OF 1999

The core provisions of Gramm-Leach-Bliley "permit the common ownership of the nation's largest banks, insurance companies, and securities firms."<sup>32</sup> Supporters of the legislation contended that "the financial reform . . . will provide for one-stop shopping for consumers," permitting "affiliations among banks, insurance companies, and securities firms" and replacing outdated legislation that has controlled the banking industry since the 1930s.<sup>33</sup> Opponents

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25. *Id.* (according to a survey released by the American Bankers Association).

26. *Community Banking in the United States*, *supra* note 14.

27. Fitzgerald, *supra* note 24, at 4G.

28. *Id.*

29. *Id.*

30. See, e.g., Matthew M. Harbur, *Anti-Corporate, Agricultural Corporate Laws and the Family Farm*, 4 DRAKE J. AGRIC. L. 385, 386 (1999) (discussing the decline in the numbers of family farms); Matt Spangler, *Can't Find Nothin' On Radio?* <[http://www.radiodiversity.com/nothing\\_onradio.html](http://www.radiodiversity.com/nothing_onradio.html)> (July 31, 1998) (discussing effects of recent consolidation in the radio industry).

31. See Harbur, *supra* note 30, at 386.

32. *Bad Financial Reform Bill Nears Enactment*, COMMUNITY BANK DIRECTOR (Independent Community Bankers of America, Sauk Centre, Minn.), July-Aug. 1999, at 1 [hereinafter *Bad Financial Reform*]; see also Gramm-Leach-Bliley Financial Modernization Act of 1999, 12 U.S.C. § 1843 (Supp. V 1999).

33. *Bad Financial Reform*, *supra* note 32, at 1.

of the bill, however—notably the community banking lobby—maintained that the legislation would promote the formation of huge financial conglomerates that, in the end, would reduce consumer choice and concentrate the control over the nation's financial and economic system in the hands of a few large, multi-purpose companies.<sup>34</sup>

This Part of the Note provides an in-depth analysis of Gramm-Leach-Bliley. Part A discusses the Citicorp/Travelers merger, commonly viewed as the catalyst for financial modernization legislation. Part B examines the now-repealed Glass-Steagall Act, while Part C explores how the new economic landscape in the United States rendered the Glass-Steagall Act obsolete and why commentators and legislators felt change was necessary. Finally, Part D highlights key points of the recently enacted Financial Modernization Act of 1999.

#### A. *The Citicorp/Travelers Merger: The Impetus for Change*

The formal movement to modernize financial services legislation began in February of 1998 when Citibank and the Travelers Group agreed to merge.<sup>35</sup> Citibank, previously one of the world's largest banks, and Traveler's Group, a large insurance and investment company, merged and formed the world's largest financial services company, with just under \$700 billion in assets.<sup>36</sup> The merger was announced in anticipation of a change in financial services law, because the law at the time—the 1933 Glass-Steagall Act<sup>37</sup> and the 1956 Bank Holding Company Act<sup>38</sup>—did not permit common ownership of banks and insurance companies.<sup>39</sup> The leaders of Citicorp and Travelers, in announcing a merger not currently legal, hoped that their lobbying power would fuel the enactment of financial modernization legislation.<sup>40</sup> This merger, along with the host of other mergers in the industry spurred by the Citigroup marriage, placed additional pressure on legislators to break down the barriers between the financial

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34. *Id.*

35. Laura J. Cox, *The Impact of the Citicorp-Travelers Group Merger on Financial Modernization and the Repeal of Glass-Steagall*, 23 NOVA L. REV. 899, 921 (1999).

36. David Greising, *Are Megabanks—Once Unimaginable, Now Inevitable—Better for Customers, the Nation's Economy, or Even for the Banks?*, BUS. WK., Apr. 27, 1998, at 32, 32.

37. 12 U.S.C. § 24 (1994 & Supp. II 1997); 12 U.S.C. §§ 78, 377 (1994), *repealed by* 12 U.S.C. § 1843 (Supp. V 1999); 12 U.S.C. § 378 (1994).

38. 12 U.S.C. §§ 1841-1850 (1994 & Supp. II 1997); 12 U.S.C. § 1845 (*repealed* 1966).

39. Cox, *supra* note 35, at 899-900.

40. *Id.* at 922.



industries.<sup>41</sup> Differences among the securities, insurance, and banking industries, however, delayed the legislation's enactment.<sup>42</sup>

### B. The Glass-Steagall Act and the Bank Holding Company Act

The Glass-Steagall Act, otherwise known as the Bank Act of 1933, has been the foundation of banking laws since its enactment in 1933.<sup>43</sup> The provision of the Act recently repealed had prevented the common ownership of banks and insurance companies.<sup>44</sup>

The Glass-Steagall Act was enacted during the Roosevelt administration in response to the breakdown of financial and economic systems in the United States during the Great Depression.<sup>45</sup> Some commentators feel that the demise of financial institutions during this period was largely due to the fact that the law permitted banks to invest in public securities.<sup>46</sup> Armed with this ability, many banks engaged in stock market speculation and invested large sums in risky stocks.<sup>47</sup> Consequently, the stock market crash of 1929 caused a weakening in the financial position of many banks and, along with the depressed economic conditions during the Great Depression, caused the demise of many commercial banks.<sup>48</sup>

In response to these widespread bank failures, Congress created a separation between banks and securities firms with the Glass-Steagall Act in 1933 and later with the Bank Holding Company Act in 1956.<sup>49</sup> The Glass-Steagall Act is the common name associated with sections 16, 20, 21, and 32 of the Banking Act of 1933.<sup>50</sup> These provisions generally prohibited banks from engaging in the business of underwriting or selling securities or affiliating with companies engaged in those businesses.<sup>51</sup> Thus, the primary goal of the Act was to make a clear separation between the businesses of banking and securities dealing and

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41. *Bank Mergers: Reality Check*, ECONOMIST, May 23, 1998, at 70, 70.

42. Robert G. Rowe III & Kenneth A. Guenther, *The Erosion of Glass-Steagall and the Bank Holding Company Act*, 115 BANKING L.J. 663, 663 (1998).

43. Cox, *supra* note 35, at 900; see also 12 U.S.C. § 24 (1994 & Supp. II 1997); 12 U.S.C. §§ 78, 377 (1994), repealed by 12 U.S.C. § 1843 (Supp. V 1999); 12 U.S.C. § 378 (1994).

44. *Congress OKs*, *supra* note 3, at 1A.

45. Cox, *supra* note 35, at 902. During the Great Depression, from 1930 to 1933, more than 9000 commercial banks failed. *Id.*

46. *Id.* at 904.

47. *Id.* at 903-04.

48. *Id.* at 904.

49. *Id.* at 901.

50. *Id.* at 906.

51. *Id.* at 906-07.

underwriting in an effort to prevent a reoccurrence of the widespread bank failures experienced during the Great Depression.<sup>52</sup>

A 1971 United States Supreme Court decision interpreting the Glass-Steagall Act provided additional insight into the limitations placed on banks.<sup>53</sup> In *Investment Co. Institute v. Camp*,<sup>54</sup> the Court decided whether the Glass-Steagall Act permitted national banks to operate mutual funds.<sup>55</sup>

In 1970, the Comptroller of the Currency had authorized First National City Bank of New York to establish and operate a mutual fund.<sup>56</sup> Fearing an increase in competition within the investment industry posed by this authorization, the National Association of Securities Dealers had filed suit, seeking review of the Comptroller's authorization under the Glass-Steagall Act and the Investment Company Act of 1940.<sup>57</sup> In *Camp*, the Supreme Court held that, by granting this authority to the First National City Bank, the Comptroller essentially conferred a power to banks not permitted under the Glass-Steagall Act.<sup>58</sup>

The Court emphasized that commercial banks were specifically prohibited from entering the investment banking industry and forming affiliations with securities underwriting firms due to congressional fears of future bank failures following those of the Great Depression.<sup>59</sup> "The Glass-Steagall Act reflected a determination that policies of competition, convenience, or expertise which might otherwise support the entry of commercial banks into the investment banking business were outweighed by the 'hazards' and 'financial dangers' that arise when commercial banks engage in the activities proscribed by the Act."<sup>60</sup> These "hazards" to which the Court referred were future downturns in the stock market and the potential detrimental effect on the public's confidence in banks when banks maintain a close relationship with the securities industry.<sup>61</sup> After analyzing the Glass-Steagall Act and its legislative history, the Court concluded that banks could not operate mutual funds and overturned the decision of the Comptroller of the Currency.<sup>62</sup>

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52. *Id.* at 902.

53. *Inv. Co. Inst. v. Camp*, 401 U.S. 617 (1971).

54. *Inv. Co. Inst. v. Camp*, 401 U.S. 617 (1971).

55. *Id.* at 618.

56. *Id.* at 619.

57. *Id.*

58. *Id.* at 628.

59. *Id.* at 629-30.

60. *Id.* at 630.

61. *Id.* at 631.

62. *Id.* at 638.



C. *Glass-Steagall: An Outdated Law in the Modern Economy*

The modernization of financial legislation has had widespread support from many in Congress and the financial services industry for several years, and Gramm-Leach-Bliley is the product of four years of negotiations.<sup>63</sup> Many, including the bill's sponsor, Congressman Jim Leach of Iowa, and Federal Reserve Chairman Alan Greenspan, believed that a repeal of the Glass-Steagall Act was long overdue because of the revolution in technology, the proliferation of new products in capital markets, and the globalization of the financial services industry.<sup>64</sup> Greenspan noted:

Technologically driven proliferation of new financial products that enable risk unbundling have been increasingly combining the characteristics of banking, insurance, and securities products into single financial instruments. These changes, which are occurring all over the world, have also dramatically altered the way financial services providers operate and the way they deliver their products. In the United States, our financial institutions have been required to take elaborate steps to develop and deliver new financial products and services in a manner that is consistent with our outdated laws. The costs of these efforts are becoming increasingly burdensome and serve no useful public purpose. Unless soon repealed, the archaic statutory barriers to efficiency could undermine the global dominance of American finance, as well as the continued competitiveness of our financial institutions and their ability to innovate and to provide the best and broadest possible services to U.S. consumers.<sup>65</sup>

Another commentator, recognizing that the financial boom of the 1990s revolved largely around the soaring stock market, stated that major financial institutions lobbied for over twenty years for Glass-Steagall's repeal in order to court the mass of private investors who have transferred their savings from bank savings accounts to mutual funds, 401(k) plans, and publicly-held stocks.<sup>66</sup> In order to compete with the securities market, commercial banks argued for Glass-Steagall's repeal so that they, too, could sell products to stock investors.<sup>67</sup>

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63. *The Financial Services Modernization Act of 1999: Hearings on H.R. 10 Before the Comm. on Banking and Financial Servs. of the U.S. House of Representatives*, 106th Cong. 254 (1999) [hereinafter *Hearings*] (statement of James A. Leach, Chairman).

64. *Id.* at 102 (statement of Alan Greenspan, Chairman, Federal Reserve Board of Governors).

65. *Id.*

66. Ron Chernow, *The New Deal's Gift to Wall Street*, WALL ST. J., Nov. 11, 1999, at A26.

67. *Id.*

While many feel that the repeal of the Depression-era legislation was an essential step towards increased efficiency and competition in the financial marketplace, others feel that the motives of those who urged for the repeal of Glass-Steagall were less than noble and pure.<sup>68</sup> Robert Kuttner, the author of the Community Reinvestment Act, stated that although portions of Glass-Steagall are now moot, the core premise of the sixty-six year-old bill—that depository bank institutions and securities firms or investment banks should remain separate entities—is still sound.<sup>69</sup> While the stock market boom of the 1990s exponentially increased the desirability of investing in the securities market, commentators such as Kuttner feel that Glass-Steagall was a safe check on the ability of depository institutions to speculate with other people's money, which led to the problems of the 1930s.<sup>70</sup> Kuttner further asserts the primary motivation behind the repeal of Glass-Steagall was not to increase the efficiency of markets or to benefit consumers, as many politicians asserted.<sup>71</sup> Rather, he claims, the repeal of Glass-Steagall was largely the result of the high-dollar lobbying efforts of huge financial conglomerates such as Citicorp and Travelers Group, who desired the repeal in order to pave the way for more "megamergers."<sup>72</sup> More megamergers, claims Kuttner, means more money for senior executives and fewer market choices for the average consumer.<sup>73</sup>

Other fears surrounding Gramm-Leach-Bliley are the concentration of economic power in the hands of a few huge financial conglomerates, the resulting lack of consumer choice among financial institutions, and the deterioration of consumer privacy.<sup>74</sup> Ralph Nader, in testimony offered before the House Committee on Banking and Financial Services, noted that while proponents of financial modernization have attempted to sell the legislation as making possible "one stop shopping centers where consumers can play the stock market, be sold insurance products and have access to a variety of banking products," the financial services industry provided no evidence that such a one stop shopping center is even desired by consumers.<sup>75</sup> Nader, in his work with consumers, has instead garnered complaints about the deteriorating quality of

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68. Robert Kuttner, *A Requiem for Glass-Steagall*, BUS. WK., Nov. 15, 1999, at 28, 28.

69. *Id.*

70. *Id.* See also discussion *supra* notes 45-49 and accompanying text.

71. Kuttner, *supra* note 68, at 28.

72. *Id.*

73. *Id.*

74. See generally *Hearings supra* note 63, at 558 (statement of Ralph Nader, Consumer Advocate) (expressing concerns about the anti-consumer effects of the legislation).

75. *Id.* at 560.

service provided by financial institutions and widespread fear of increased fees to be imposed on consumers.<sup>76</sup>

The greatest potential risk of removing the legislative barriers created by Glass-Steagall and allowing commercial banks, investment banks, insurance companies, and securities underwriters to combine under one corporate entity, according to Nader, is the concentration of economic power in the hands of a few huge financial conglomerates.<sup>77</sup> In the event of a severe economic downturn and the failure of one or more of these huge financial conglomerates such as Citigroup, taxpayers could be called upon to finance the bailout of these institutions through the Federal Deposit Insurance Corporation (FDIC).<sup>78</sup> Taxpayers were required to do the same following the savings and loan crisis of the 1980s, and commentators such as Nader fear the potential risk imposed on taxpayers of funding such bailouts of failed conglomerates the size of Citigroup could dwarf those required to bail out the savings and loans in the 1980s.<sup>79</sup>

Chairman Greenspan, however, does not share Mr. Nader's gloomy prediction of the impending doom of the American banking system.<sup>80</sup> Because of the intensely competitive nature of the United States economy and the improvement of technology in the financial services industry, Greenspan does not feel that the failure of a financial conglomerate will place a tremendous burden on American taxpayers.<sup>81</sup> In the event of the failure of a conglomerate like Citigroup, Greenspan testified that these problems would likely be realized by shareholders, rather than a federal bailout fund, in contrast to the bailout of the savings and loan institutions in the 1980s.<sup>82</sup>

Although some commentators have reservations about the potential implications of Gramm-Leach-Bliley, the majority of banking and economics experts felt that the Glass-Steagall Act was ripe for change.<sup>83</sup> Respected commentators, like Chairman Greenspan, feel that the new law is vital to the preservation of the competitiveness of financial institutions in our stock market-driven economy.<sup>84</sup>

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76. *Id.*

77. *Id.* at 558.

78. *Id.* at 562.

79. *Id.*

80. *Id.* at 118 (statement of Alan Greenspan, Chairman, Federal Reserve Board of Governors).

81. *Id.*

82. *Id.*

83. *See generally Clinton Signs Legislation Overhauling Banking Laws*, N.Y. TIMES, Nov. 13, 1999, at B3 (noting the legislative overhaul will modernize American banking and financial services to benefit consumers).

84. *Hearings, supra* note 63, at 118 (statement of Alan Greenspan, Chairman, Federal Reserve Board of Governors).

#### D. Highlights of Gramm-Leach-Bliley

This Part of the Note will turn to the content of Gramm-Leach-Bliley and highlight those provisions that will have the greatest impact on the financial services industry as a whole and those that are important in the eyes of the community banking industry. Because the bill is large and complex, this Part will only summarily discuss those provisions that represent important changes in the regulation of the financial services industry.

The most notorious provision of Gramm-Leach-Bliley, which also represents the most radical change brought about by the new legislation, allows a bank holding company to engage in virtually any type of financial activity.<sup>85</sup> In the words of the statute, "a financial holding company may engage in any activity, and may acquire and retain the shares of any company engaged in any activity, that the Board . . . determines to be financial in nature or incidental to such financial activity."<sup>86</sup> The crucial language that constitutes a repeal of the Glass-Steagall Act and a substantial modification to the Bank Holding Company Act of 1956 lies in section 103(a)(4).<sup>87</sup> In this section "activities that are financial in nature" are defined as follows:

(A) Lending, exchanging, transferring, investing for others, or safeguarding money or securities.

(B) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent or broker for purposes of the foregoing, in any State.

(C) Providing financial, investment, or economic advisory services, including advising an investment company. . . .

(E) Underwriting, dealing in, or making a market in securities . . . .<sup>88</sup>

Although Gramm-Leach-Bliley significantly broadens a bank's ability to affiliate with any financial company, it also reinforces the legislative barrier precluding affiliation between banks and commercial companies.<sup>89</sup> As a result, a commercial company may not acquire a thrift institution.<sup>90</sup> A financial company may acquire an affiliate with a thrift, but a commercial company may not.<sup>91</sup>

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85. AM. BANKERS ASS'N, FINANCIAL MODERNIZATION: THE GRAMM-LEACH-BLILEY ACT SUMMARY 9 (1999).

86. Gramm-Leach-Bliley Financial Modernization Act of 1999, 12 U.S.C. § 1843 (Supp. V 1999).

87. AM. BANKERS ASS'N, *supra* note 85, at 1.

88. Gramm-Leach-Bliley Financial Modernization Act of 1999, 12 U.S.C. § 1843.

89. AM. BANKERS ASS'N, *supra* note 85, at 18.

90. *Id.* A "thrift" institution is a financial institution without a state bank charter. LOVETT, *supra* note 9, at 238. Examples of thrift institutions are mutual savings banks, savings and

This provision was included at the urging of banking industry lobbyists who feared the competition and market-related issues that would arise if a non-financial company were permitted also to own financial institutions.<sup>92</sup> These fears arose in July of 1999 when Wal-Mart attempted to purchase an existing savings and loan institution and effectively entered the banking business.<sup>93</sup> Bankers opposed Wal-Mart's entry into the financial services industry because of the foreseeable unfair competition that could have arisen in the rural communities where Wal-Mart's presence is strongest.<sup>94</sup>

Federal Reserve Chairman Alan Greenspan, in a statement before the House of Representatives Committee on Banking and Financial Services, reinforced the importance of preventing commercial firms from owning financial institutions when he stated:

The Asian crisis last year highlighted some of the risks that can arise if relationships between banks and commercial firms are too close, and make caution at this stage prudent in our judgment. In line with these considerations, the Federal Reserve Board continues to support elimination of the unitary thrift loophole, which currently allows any type of commercial firm to control a federally-insured depository institution.<sup>95</sup>

Another important provision of the Gramm-Leach-Bliley "significantly expands a customer's ability to protect the privacy of information provided to

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loan associations, and credit unions. *See id.* at 236-41. In today's market, because of deregulation in the financial services industry, the services offered by thrift institutions are virtually identical to those offered by a state chartered bank, rendering these different types of financial institutions largely indistinguishable. *Id.*

91. AM. BANKERS ASS'N, *supra* note 85, at 18.

92. *Hearings*, *supra* note 63, at 44 (statement of William L. McQuillan, President, Independent Bankers Association of America).

93. Barsness, *supra* note 6, at 7.

94. *Id.* To illustrate the potential harmful effects on small businesses in rural communities that would have arisen if Wal-Mart was permitted to purchase financial institutions, consider a hypothetical example of a local hardware store in need of an inventory loan. If Wal-Mart owned the only financial institution in the community, it would have very little motivation to lend money to a direct competitor of its own hardware department. In this situation, it would be in the lender's best interest to either deny the hardware store owner a loan or grant him less than favorable terms so as not to assist his business. *See Bad Financial Reform Bill Nears Enactment*, *supra* note 32, at 1.

95. *Hearings*, *supra* note 63, at 104 (statement of Alan Greenspan, Chairman, Federal Reserve Board of Governors). The rapid opening of Asian capital markets to foreign investment, without due regard to proper economic regulation, caused the Asian financial crisis. *The Anxiety Behind Globalization*, BUS. WK., Dec. 20, 1999, at 188, 188. As a result, several Asian countries experienced currency depreciation, capital flight, and recession. *Id.*

any kind of financial services" company.<sup>96</sup> A substantial amount of debate in Congress highlighted the importance of increased consumer privacy protections because of the likelihood of cross-industry mergers and the technological advances that make information readily accessible.<sup>97</sup> Because a large financial conglomerate will soon have access to information, ranging from health records and family information for insurance purposes to financial account information for banking and investment purposes, consumer groups were adamant about including provisions in Gramm-Leach-Bliley that restrict the financial institution's ability to access and distribute a consumer's personal information.<sup>98</sup>

In response to consumer public concerns, Gramm-Leach-Bliley requires financial institutions to: (1) annually establish and disclose its privacy policy; (2) give customers the opportunity to "opt out" of disclosures to non-affiliated third parties; (3) disclose customer account information to third-party marketers; and (4) "[a]bide by regulatory standards to protect the security and confidentiality of consumer information."<sup>99</sup> The fraudulent use of private customer information can subject one to federal criminal penalties.<sup>100</sup>

Since 1977, banks have been required to comply with the Community Reinvestment Act (CRA).<sup>101</sup> Congress enacted the CRA to eliminate discriminatory lending practices by banks and encourage them to solicit loans in low-income and minority neighborhoods so that all sections of communities would be equally served.<sup>102</sup> Coupled with the CRA's requirement to solicit loans in low-income neighborhoods is a sometimes burdensome documentation and inspection process with which banks must comply.<sup>103</sup> Gramm-Leach-Bliley, however, provides relief from CRA's regulatory requirements for community banks with assets of \$250 million or less.<sup>104</sup> Instead of being subjected to CRA examinations annually or biannually, these community banks will now only be subjected to exams every four or five years, depending on the bank's level of compliance with CRA.<sup>105</sup>

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96. AM. BANKERS ASS'N, *supra* note 85, at 22.

97. *Id.*

98. *Id.*

99. *Id.*; see 15 U.S.C. §§ 6801-6803 (Supp. V 1999).

100. AM. BANKERS ASS'N, *supra* note 85, at 43; see also 15 U.S.C. § 6804(a)(1) (Supp. V 1999) (granting Federal Trade Commission and federal banking agencies administrative enforcement power).

101. 12 U.S.C. §§ 2901-07 (1994 & Supp. V 2000); see also LOVETT, *supra* note 9, at 183.

102. LOVETT, *supra* note 9, at 182-83.

103. See *id.*

104. AM. BANKERS ASS'N, *supra* note 85, at 23.

105. *Id.*



Another section of Gramm-Leach-Bliley addresses the federal regulation of financial institutions.<sup>106</sup> Federal agencies heavily regulate financial institutions.<sup>107</sup> For example, the Office of the Comptroller of Currency (OCC) regulates national banks, and the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve regulate FDIC insured state banks.<sup>108</sup> State insurance agencies regulate insurance companies, and the Securities and Exchange Commission (SEC) regulates securities brokers.<sup>109</sup> The new ability of each of the above institutions to affiliate could result in a regulatory compliance quagmire, as a single company could foreseeably be answerable to four or five separate regulatory bodies.<sup>110</sup>

In response to this potentially complex regulatory situation, Congress established the Federal Reserve as the primary regulator of bank holding companies.<sup>111</sup> As for the subsidiary entities owned by the bank holding company, however, those engaged in dealing securities, for example, will continue to be subject to regulation by the SEC, and those involved in insurance will continue to fall under state insurance regulators.<sup>112</sup> In sum, the primary regulator for bank holding companies will be the Federal Reserve, and the primary regulator for its subsidiaries will depend on the function of the subsidiary.<sup>113</sup>

#### IV. PROJECTED EFFECTS OF GRAMM-LEACH-BLILEY

This Part of the Note will analyze the foreseeable impact of Gramm-Leach-Bliley on financial institutions from the perspective of community banks in Iowa. This Part also will present one community bank CEO's views about the

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106. See *id.* at 24 (stating Gramm-Leach-Bliley establishes the Federal Reserve to regulate these consolidated FHC-owned entities).

107. *Id.*; see also Legal Formation Institute, *Banking: An Overview* <<http://www.law.cornell.edu/topics/banking.html>> (accessed Mar. 8, 2001) (indicating that financial institutions are regulated by the laws under which they were established).

108. AM. BANKERS ASS'N, *supra* note 85, at 23; see also Comptroller of the Currency Administrator of National Banks, *Regulatory Information* <<http://www.occ.treas.gov/law.htm>> (accessed Mar. 8, 2001) (listing regulatory divisions of the OCC); Federal Deposit Insurance Corporation, *Regulation Examination* <<http://www.fdic.gov/regulations/index.html>> (accessed Mar. 8, 2001) (indicating regulations issued by the FDIC govern the procedures and performance of financial institutions); The Federal Reserve Board, *Regulations* <<http://www.federalreserve.gov/Regulations/default.htm>> (accessed Mar. 8, 2001) (describing the Board's regulations pertaining to financial institutions).

109. AM. BANKERS ASS'N, *supra* note 85, at 23.

110. See *id.*

111. *Id.*

112. *Id.*

113. *Id.*

advantages and disadvantages of Gramm-Leach-Bliley and his predictions about the Act's impact on financial institutions.

*A. Positive Aspects of the Act: A Community Banker's Perspective*

Robert J. Dixon, CEO and president of a bank holding company in rural Iowa that owns and operates two community banks, views Gramm-Leach-Bliley as largely a positive piece of legislation for both large financial institutions and for community banks, but notes some aspects of the new legislation are a cause for concern.<sup>114</sup> In retrospect, Mr. Dixon believes the repeal of the Glass-Steagall Act was largely the result of high-powered lobbying efforts of large banks and insurance companies that desired the removal of legislative barriers to realize increased efficiency and profits through mergers.<sup>115</sup> Any beneficial provisions for community banks were included as a result of a "political give and take" meant to appease the community banking lobby to ensure passage of the legislation.<sup>116</sup>

Of those provisions beneficial to community banks, Mr. Dixon believes that the reinforcement of the barrier between financial and commercial companies is most important to the preservation of community banking in rural markets such as his.<sup>117</sup> This issue united community bankers in support of Gramm-Leach-Bliley because of their collective fear of the adverse effect on the industry that would have surfaced had Wal-Mart been permitted to purchase existing thrift institutions and enter the financial services industry.<sup>118</sup> According to Dixon, community bankers felt the passage of Gramm-Leach-Bliley may have been the only opportunity to have the legislative barrier between financial and commercial companies reinforced, so they supported the passage of the Act, notwithstanding its other unsettling aspects.<sup>119</sup>

Another provision of Gramm-Leach-Bliley considered beneficial to community banks is the relaxation of membership privileges to the Federal Home Loan Bank (FHLB) because community banks now have easier access to an alternative source of funds for lending purposes.<sup>120</sup> Under previous law, in order for community banks to borrow low-cost funds from the FHLB, at least ten

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114. Telephone Interview with Robert J. Dixon, CEO and President, Dixon Bancshares, Inc., Citizens State Bank of Sheldon, Iowa, and Rolfe State Bank of Rolfe, Iowa (Jan. 23, 2000).

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*; see discussion *supra* note 94.

119. Telephone Interview with Robert J. Dixon, *supra* note 114.

120. *Id.*

percent of the bank's assets were required to be housing-related loans.<sup>121</sup> Gramm-Leach-Bliley, however, waives this requirement for an estimated 2500 rural community banks.<sup>122</sup>

A final provision of interest to community bankers is the reduction of the frequency of federal CRA exams.<sup>123</sup> According to Mr. Dixon, a revision of the existing CRA legislation, requiring annual or semi-annual exams of community banks, was long overdue.<sup>124</sup> Community banks, by nature, must be community-oriented and interested in the preservation of their communities in order to survive.<sup>125</sup> A federal law requiring annual or biannual exams of a community bank's CRA compliance is inefficient, unnecessary, and burdensome to community banks.<sup>126</sup> As stated above, Gramm-Leach-Bliley will only subject community banks to CRA exams every four or five years.<sup>127</sup>

### B. *Negative Aspects of the Act*

Although Gramm-Leach-Bliley contains provisions that will benefit community banks, the broader economic implications of the Act are a cause for concern among members of the community banking industry.<sup>128</sup> The strong likelihood of more mergers in the financial institutions industry is disconcerting to Mr. Dixon, as he believes further concentration of economic power in the hands of fewer competitors is potentially harmful for the economy and for the American public.<sup>129</sup>

Although the proliferation of mergers will not have as much impact in rural Iowa as it will in the urban areas where large banks dominate, the aggressive direct marketing campaigns of large financial institutions, most likely for the solicitation of insurance, may chip away at the deposit base of the community bank.<sup>130</sup> The large economies of scale and corresponding ability to offer highly competitive interest rates and insurance premiums may allow large financial conglomerates to lure away some community bank customers, even without a physical presence in the community.<sup>131</sup>

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121. AM. BANKERS ASS'N, *supra* note 85, at 19.

122. *Id.*

123. Telephone Interview with Robert J. Dixon, *supra* note 114.

124. *Id.*

125. *Id.*

126. *Id.*

127. *See supra* discussion Part III.D.

128. Telephone Interview with Robert J. Dixon, *supra* note 114.

129. *Id.*

130. *Id.*

131. *Id.*

### C. An Opportunity for Business Expansion

While the removal of legislative barriers in the financial services industry will provide banks with the ability to sell a broad range of new products, the most likely expansion of services offered by community banks will be insurance products.<sup>132</sup> Under Gramm-Leach-Bliley, bank holding companies are permitted to own insurance agencies.<sup>133</sup> A bank can then offer insurance products to its customers, which can be purchased through the agency owned by the holding company.<sup>134</sup> In contrast to soliciting securities, this product-line expansion is easily implemented and thus may be undertaken by many community banks.<sup>135</sup>

### V. CONCLUSION

Time will be the best judge of the effects of Gramm-Leach-Bliley on our nation's financial services industry. In the first year since Gramm-Leach-Bliley's enactment, the forecasted banking revolution has not materialized.<sup>136</sup> Depressed stock market conditions, the hesitancy of insurance companies to subject themselves to federal banking regulations, and the steep learning curve associated with the complex new law have so far deterred financial companies from taking advantage of Gramm-Leach-Bliley.<sup>137</sup> Most agree, however, that merger activity among financial service companies will increase as market conditions improve and executives and their attorneys become more familiar with the new law.<sup>138</sup>

Gramm-Leach-Bliley provides banks, insurance companies, and securities firms the legislation necessary to merge under one roof. The Act also provides community banks the opportunity to diversify their product portfolios. While varied opinions and predictions about the Act's long-term effects exist among commentators, none would disagree over its breadth and significance. The final version of Gramm-Leach-Bliley is the result of many years of intense lobbying and political debate, and it undoubtedly will change the landscape of America's financial services industry.

*Robert W. Dixon*

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132. *Id.*

133. *See supra* discussion Part III.D.

134. Telephone Interview with Robert J. Dixon, *supra* note 114.

135. *Id.*

136. Tamara Loomis, *The Banking Revolution that Wasn't* <<http://www.law.com/cgi-bin/gx.cgi/AppLogic+FTContentServer?pagename=law/View&c=Article&cid=ZZZBR7DQ5GC&live=true&cst=1&pc=0&pa=0>> (accessed Nov. 30, 2000).

137. *Id.*

138. *Id.*