TESTIMONY OF
PHIL GRAMM

BEFORE THE
U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES
AT THE HEARING TITLED

"PROTECTING CONSUMERS AND PROMOTING COMPETITION IN REAL ESTATE SERVICES"

JUNE 15, 2005

Chairman Oxley, Ranking Member Frank, and Members of the Committee, thank you very much for the invitation to testify before your Committee today.

Before continuing, Mr. Chairman, let me commend you and your colleagues for the leadership you exhibit on various issues within this Committee's jurisdiction. The past several years have been marked by events affecting the delivery of financial services to consumer investors, financial accounting and transparency, and the review of numerous issues arising from the implementation of the Sarbanes-Oxley Act. Under your leadership, this Committee has exercised the highest standard of congressional oversight. So, while the distance between our offices is now more than just across the Capitol Plaza, I remain keenly interested in your work and commend you for your diligence in protecting the public interest.

The hearing you hold today is yet another example of this Committee's untiring efforts to address significant public policy issues.

The subject of today's hearing focuses on some of the most important provisions of the Gramm-Leach-Bliley Act (the Act), clearly provisions serving as one of the pillars of financial reform, as my esteemed former colleagues Chairmen Leach and Bliley will, I think, agree. Without the expansion of permissible financial activities, the removal of barriers to affiliation under the Act is rendered meaningless. These provisions were topics of thorough debate and consideration in numerous meetings at which Chairmen Leach, Bliley and I were participants in 1999. I also must

acknowledge the contributions of then Ranking Member LaFalce.

I am confident that Jim and Tom will agree with me that the final agreement of the conferees reached in this very room in late October 1999 evokes poignant, if not fond, memories. The agreement was announced by Chairman Leach and agreed to by all of the conferees, followed by a swift gavel signifying the conclusion of our proceedings at about 3:00 a.m. Upon reflection, I am inclined to believe that Chairman Leach quickly gaveled the conclusion of that meeting not because of the lateness of the hour, but before anyone could have a change of heart.

As a preliminary matter, let me be clear that my testimony solely reflects my personal views, and not necessarily those of my current employer or fellow employees.

General Background.

Under the Act, the Federal Reserve Board was granted umbrella regulatory powers over financial holding companies (FHC's). The expanded powers under the Act may be engaged in by qualifying FHC's and by financial subsidiaries of national banks. The Act reflects the wisdom of the Congress that none of us serving at the time could see into the future or judge what the full scope of financial activities would, or should, encompass. Rather, the Act amended the Bank Holding Company Act and the Revised Statutes to create a process by which the list of financial activities could and would be expanded.

I recall that in testimony before the Senate Banking Committee and before the then House Banking Committee, Federal Reserve Board Chairman Alan Greenspan observed that the landscape of financial activities would change dramatically over the ensuing five to 10 years. We are now six years into that forecast. I believe that Chairman Greenspan's observation is accurate; and I remain convinced that the Bank Holding Company Act and the Revised Statutes, both as amended by the Gramm-Leach-Bliley Act, create the proper framework for the determination of financial activities.

Process for Determining that an Activity is Financial in Nature or Incidental to Such an Activity.

Specifically, The Act created new Subsections (k) through (o) of Section 4 of the Bank Holding Company Act, addressing generally the following: financial activities; coordination between the Federal Reserve Board and the Secretary of the Treasury; conditions for engaging in financial activities; conditions applicable for failure to meet certain requirements; and the retention of limited nonfinancial activities and affiliations. While new Section 4(k)(4) enumerates activities determined to be financial in nature, Section 4(k)(2) establishes a process of coordination and cooperation between the Federal Reserve Board and the Secretary of the Treasury, allowing them to determine jointly that an activity is financial in nature or incidental to a financial activity and, therefore, permissible for FHC's. Neither agency may determine that an activity is financial in nature or incidental to a financial activity if the other agency indicates in writing that an activity is not financial in nature, not incidental to a financial activity, or not otherwise permissible.

Section 121 of the Act (creating a new Section 5136A of the Revised Statutes) creates a parallel provision for the Secretary of the Treasury to determine new financial activities or activities incidental to such activities for financial subsidiaries of national banks.

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Factors for Consideration in Determining that Certain Activities are Financial in Nature or Incidental to Such Activities.

Section 4(k)(3) requires the Federal Reserve Board to take into consideration certain factors in determining whether an activity is financial in nature or incidental to a financial activity. Generally, the four factors specified in the law require the Federal Reserve Board to take into account

- The purposes of the Bank Holding Company Act and the Act;
- Changes or reasonably expected changes in the marketplace in which FHC's compete;
- Changes or reasonably expected changes in the technology for delivering financial services; and
- Whether the activity is necessary or appropriate to allow a FHC and its affiliates to compete effectively with any company seeking to provide financial services in the US; efficiently deliver information and services that are financial in nature through the use of technological means; and offer customers available or emerging technological means for using financial services or for the document imaging of data.

The Act, at Section 121 (creating a new Section 5136A of the Revised Statutes), addresses the establishment of financial subsidiaries of national banks and establishes the same factors for consideration by the Secretary of the Treasury for determining whether certain activities are financial in nature or incidental to such activities and, therefore, permissible for the financial subsidiaries of national banks.

Requests by Third Parties for Determinations that Certain Activities are Financial in Nature or Incidental to Such Activities.

Pursuant to Section 4(k)(2) and Section 5136A, third parties are permitted to request that the Federal Reserve Board or the Secretary of the Treasury determine that any activity is financial in nature or incidental to a financial activity. Acting under these provisions, in December 2000 the agencies received a request for a determination that real estate brokerage and real estate management are financial activities.[1] The agencies came to agreement that such activities are financial in nature and on January 3, 2001, issued a joint proposed rule seeking public comment.

Under the joint proposed rule, "real estate brokerage" is defined to mean acting as agent in a real estate transaction; listing and advertising real estate; providing advice in connection with a real estate purchase, sale, exchange, lease or rental; bringing parties together and negotiating on behalf of such parties. FHC's and financial subsidiaries would not be permitted to invest in or develop real estate as principal, or take any financial interest in real estate that they broker.

Under the joint proposed rule, "real estate management" generally is defined to mean procuring tenants; negotiating leases; maintaining security deposits; billing and collecting rent payments; and inspecting and maintaining real estate. FHC's and financial subsidiaries would not be permitted to acquire a financial interest in real estate managed, or directly repair or maintain real estate managed.

[1] Request made by the American Bankers Association and the Fremont National Bank and Trust Company of Fremont, Nebraska.

Nothing in the Act expressly or impliedly deems real estate brokerage or management activities to be impermissible for determination as financial activities. The only real estate related activities expressly mentioned are those at Section 121 of the Act (creating a new Section 5136A of the Revised Statutes). In that Section, financial subsidiaries of national banks are *prohibited* from engaging in *"real estate development or real estate investment activities, unless otherwise expressly authorized by law."* Section 121 was the product of careful negotiation over a substantial period prior to its acceptance at a meeting of the conferees held in the Capitol in the Fall of 1999.

Thus, it appears that the agencies properly exercised their authority under the Bank Holding Company Act and the Revised Statutes to determine that real estate brokerage and real estate management are financial activities, and to solicit public comments on the contours of their proposed regulation. It is my understanding that that process has not been completed since it was initiated in 2001.

Preserving the Framework for Determinations of Permissible Financial Activities and Activities that are Incidental to Such Activities.

It took the Congress approximately 9 months to complete its work on the Gramm-Leach-Bliley Act working with the Federal financial regulators, representatives of public interest groups, industry, and certain State regulatory authorities. This, however, followed some six decades of debate on the need for reforms to update our banking laws. The method established under the Act for determining financial activities and activities incidental to financial activities was one arrived at after lengthy negotiations. In order for our financial industry to remain competitive domestically and globally, our statutory and regulatory regimes must be able to respond to changing market dynamics, and to do so quickly and effectively. When we decided in 1999 upon the method for determining new financial activities going forward, we agreed to do so on the basis that it was imprudent to create a static, fixed definition in the law for permissible financial activities. Instead, we provided flexibility for the Federal Reserve Board and the Treasury to initiate their own proposals or to consider proposals from third parties for new financial activities. It is my hope that we can rely upon this framework and that it can be a sound and fair basis upon which our financial institutions evolve. The rulemaking process contains procedural safeguards, transparency, and the opportunity

for public comment. Hopefully, Section 4(k) of the Bank Holding Company Act and Section 5136A of the Revised Statutes will not become empty provisions of the law, but will be utilized to serve the interests of a competitive industry, the consumers of financial products and services, and the safety and soundness considerations of our financial regulators.

Thank you, again, Mr. Chairman, Ranking Member Frank, and Members of this Committee for the courtesy of your invitation and for your interest in my views.