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ARTICLES

OVERVIEW OF THE GRAMM-LEACH-BLILEY ACT

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I. INTRODUCTION

The Gramm-Leach-Bliley Act (the "Act"),1 signed into law by President Clinton on November 12, 1999, represents the culmination of Congressional financial reform efforts spanning more than 30 years. The Act makes sweeping changes to federal statutes governing the scope of permissible activities and the supervision of banks, bank holding companies, and their affiliates. In particular, the Act lowers (although does not altogether eliminate) barriers between the banking and securities industries erected by the Banking Act of 1933 (popularly known as the "Glass-Steagall Act")2 and between the banking and the insurance industries erected by the 1982 amendments to the Bank Holding Company Act of 1956 (the "Bank Holding Company Act").3 Some have described the Gramm-Leach-Bliley Act as the most important piece of federal banking legislation since the Depression.

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Much of the Act, however, is in part a response to years of financial modernization developments initiated by U.S. bank regulatory agencies at the behest of the banking industry. For example:

Both the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and the Office of the Comptroller of the Currency (the "OCC") have long permitted banks and bank holding companies to engage in retail and institutional securities brokerage, private placement, and investment advisory activities.

In 1987, the Federal Reserve Board construed the Glass-Steagall Act to allow bank holding companies to own a subsidiary engaged in underwriting and dealing in "ineligible" securities, provided the subsidiary was not "engaged principally in" (defined by the Federal Reserve Board as having less than five percent — and later, twenty-five percent — of its revenue derived from) ineligible securities activities.\(^4\)

In 1996, the OCC issued new regulations, permitting a national bank, with prior OCC approval, to own a subsidiary engaged in activities that are impermissible for the bank itself\(^5\) and, in 1997, relied on this regulation to permit a national bank subsidiary to engage in municipal bond underwriting.\(^6\)

In 1998, the Federal Reserve Board permitted Citicorp, at the time the largest bank holding company in the U.S., to become affiliated with Travelers Group, Inc., a diversified financial services firm engaged in insurance and securities activities.\(^7\)

The OCC in particular has aggressively defended, and even expanded, the power of national banks to sell insurance and

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6. OCC Conditional Approval No. 262 (Dec. 11, 1997).
quasi-insurance products (such as annuities and debt cancellation contracts).  

It can be argued, then, that significant U.S. financial modernization has already taken place while federal financial modernization legislation remained a victim of political impasse between the banking, thrift, insurance, and securities industries, public interest groups, and, in some respects, the federal agencies themselves.

In any case, the Gramm-Leach-Bliley Act is undoubtedly significant: the Act expands the statutory powers of banks, bank subsidiaries, and bank holding companies, alters which (and how) federal agencies regulate banks and bank holding company activities through the concept of "functional regulation," curtails the power of the thrift charter, and imposes privacy restrictions on entire industries. This Article summarizes the significant provisions of the Act and, in particular, its effect on the activities and supervision of banks and bank holding companies.

II. EXPANDED POWERS

A. Expanded Powers for Holding Companies

Under the Gramm-Leach-Bliley Act, a bank holding company may elect to become a "financial holding company" and thereby engage, directly or through a nonbank subsidiary, in any activity that is "financial in nature" or other activity that is complimentary or incidental thereto. To qualify for expanded powers, each of a bank holding company's depository institution subsidiaries must be well managed, be well capitalized, and have received a Community Reinvestment Act ("CRA") rating of "Satisfactory" or better at its most recent examination. The bank


holding company must file a certification and declaration with the Federal Reserve Board, and then may directly or indirectly engage in expanded activities, either de novo or by acquisition, beginning March 11, 2000.10

The scope of activities permitted to financial holding companies (i.e., activities that are "financial in nature,") is intended to be significantly broader than the scope of activities permitted to bank holding companies under the Bank Holding Company Act (i.e., activities that are "so closely related to banking . . . as to be a proper incident thereto").12 Certain previously impermissible activities are listed in the Gramm-Leach-Bliley Act as per se "financial in nature" and may be engaged in without prior notice to the Federal Reserve Board, such as:

- Underwriting or dealing in securities (including market-making), without revenue or position limitations;
- Organizing, sponsoring, or distributing a mutual fund;
- Making merchant banking investments in companies, regardless of the activities in which the companies are engaged, if the investment activity is conducted through a securities or insurance affiliate or another appropriate nonbank affiliate13;


13. Merchant banking investments must meet certain non-control criteria set forth in the Act. See Gramm-Leach-Bliley Act § 103. In addition, if a financial holding company's merchant banking investment in a company exceeds 15% of the company's equity capital, the company is presumed to be an "affiliate" for purposes of Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c. See Gramm-Leach-Bliley Act § 121(b). Thus, while a financial holding company may make merchant banking investments in a company engaged in impermissible (e.g., com-
Underwriting insurance (including title insurance) and issuing annuities;

Selling insurance as agent or broker (including title insurance); and

Engaging in the U.S. in any activity which has previously been permissible abroad under the Federal Reserve Board's regulations (known as Regulation K)\(^\text{14}\) or interpretations under the Federal Reserve Act\(^\text{15}\) and the International Banking Act\(^\text{16}\) such as travel agency, real estate brokerage, or management consulting.\(^\text{17}\)

The Federal Reserve Board is permitted, by regulation or order, to authorize other activities that it deems to be "financial in nature" or other activities that are complimentary or incidental thereto, subject to the concurrence of the Department of Treasury (the "Treasury").\(^\text{18}\)

As a result of these expanded activities granted to financial holding companies, the Gramm-Leach-Bliley Act effectively permits affiliation between bank holding companies, insurance companies, and securities firms, under the umbrella of a "financial holding company." However (except in the case of merchant banking investments), the Act continues to bar banking and commerce affiliations, i.e., affiliations between depository institutions and companies engaged in activities that are not "financial

\(^{14}\) See 12 C.F.R. § 211 (1999).
\(^{17}\) See Gramm-Leach-Bliley Act § 103.
\(^{18}\) See id.
in nature." In particular, the Act permits a financial holding company to engage in nonfinancial activities only if the financial holding company was not a bank holding company prior to November 12, 1999 but became a financial holding company (e.g., by acquiring a depository institution) after that date, and even so, permits the financial holding company only to retain commercial activities subject to certain revenue limits, cross-marketing limitations, and grandfathering restrictions set forth in the Act. As a result, if a bank holding company (or a financial holding company that was formerly a bank holding company) is contemplating a merger with a securities or insurance company engaged in part in nonfinancial activities, these nonfinancial activities may be retained only if the insurance or securities firm is the survivor.

Bank holding companies are not compelled to elect "financial holding company" status. Bank holding companies that do not make such an election will continue to be regulated by the Federal Reserve Board as such, and their permissible activities will continue to be limited to those that are "closely related to banking" as prescribed by the Bank Holding Company Act and Federal Reserve Board orders and regulations in effect on November 11, 1999. Thus, the permissible scope of non-electing bank holding company activities is frozen as of the date of enactment of the Act.

Acquisitions and new activities by non-electing bank holding companies will continue to require prior notice to or approval by the Federal Reserve Board, although such transactions will continue to avoid Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") premerger filing requirements (discussed below).

Whether or not a bank holding company elects financial holding company status, the bank holding company and its subsidiaries will become subject to the other provisions of the Act, in

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19. See § 102.
particular, its "functional regulation" and privacy provisions (discussed below).22

B. Reduction in Federal Reserve Board's Prior Approval Requirements for New Nonbanking Activities

The Act drastically reduces the requirement that a financial holding company obtain prior Federal Reserve Board approval before engaging de novo or by acquisition in new nonbanking activities. Under the Bank Holding Company Act and the Federal Reserve Board's Regulation Y, a bank holding company is currently required to provide at least 12 business days' prior notice before engaging in new activities, either de novo or by acquisition, if the bank holding company is eligible for expedited processing and the proposed activity has been previously deemed permissible by Federal Reserve Board order or regulation23; longer periods apply in the case of ineligible bank holding companies or with respect to activities that have not previously been deemed permissible.24 Under the Gramm-Leach-Bliley Act, if the proposed new activity is "financial in nature" because the activity is either listed in the Act or has been previously approved by Federal Reserve Board regulation or order (including Federal Reserve Board orders issued to other holding companies), a financial holding company must simply provide 30 days' after-the-fact notice to the Federal Reserve Board of the new activities or acquisition.25 Thus, with respect to bank holding companies that elect "financial holding company" status, not only has the scope of permissible nonbanking activities been expanded, but the Federal Reserve Board's prior approval requirement for listed or approved activities has been eliminated as well. With respect to nonbanking activities that are unlisted and have not been previously approved by the Federal Reserve Board by order or regulation, a financial holding company must still apply

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22. See Gramm-Leach-Bliley Act Title II.
25. See Gramm-Leach-Bliley Act § 103.
to the Federal Reserve Board for prior approval.

The Act does not affect the Federal Reserve Board's prior approval requirements applicable to bank, bank holding company, or thrift acquisitions. Thus, before acquiring (or establishing de novo) a bank, bank holding company, or thrift, a financial holding company must apply to the Federal Reserve Board for prior approval pursuant to the Bank Holding Company Act and Regulation Y.26

The Act does not eliminate all prior approvals in connection with financial holding company acquisitions, however. If a financial holding company relies on the after-the-fact notice procedures of the Gramm-Leach-Bliley Act to make an acquisition, the financial holding company may be required to file a "pre-merger notification" pursuant to the HSR Act. Currently, for nonbanking acquisitions by bank holding companies subject to Federal Reserve Board notice or approval under Section 4 of the Bank Holding Company Act,27 there is a partial exemption from the HSR Act; the acquiring bank holding company merely must file with the Federal Trade Commission (the "FTC") and the Department of Justice (the "DOJ") a copy of the notice or application to the Federal Reserve Board and is thereby exempted from the HSR Act's 30-day pre-merger waiting period.28 If a financial holding company relies on the Federal Reserve Board's after-the-fact notice procedures pursuant to the Gramm-Leach-Bliley Act, the financial holding company will not be entitled to this exemption from the HSR Act, and may be required to submit a pre-merger notification (accompanied by the required $45,000 filing fee) to the FTC and the DOJ and endure the 30-day waiting period (unless early termination is granted) if the transaction is oth-

erwise subject to the HSR Act. A separate provision of the Gramm-Leach-Bliley Act specifies that premerger notifications will also be required in connection with a financial holding company's acquisition of another holding company, if the holding company to be acquired engages, directly or indirectly, in non-banking activities and that aspect of the acquisition is not subject to Federal Reserve Board approval under Section 4 of the Bank Holding Company Act. Previously, these transactions were exempted from HSR Act premerger notification requirements (by virtue of the Federal Reserve Board's approval requirement) and therefore no premerger notification was required with the FTC and the DOJ (other than a copy of the Federal Reserve Board filing) and no waiting period applied. Thus, financial holding companies that acquire another diversified holding company may be required to file both an application with the Federal Reserve Board and an HSR premerger notification with the FTC and the DOJ.

The Act does not appear to preclude a financial holding company from continuing to rely on Section 4(c)(8) of the Bank Holding Company Act to conduct an acquisition, provided that the activities of the company to be acquired fall within the scope of the "closely related to banking" as previously defined by the Federal Reserve Board. In such cases, the financial holding company could apply for approval to the Federal Reserve Board pursuant to Section 4(c)(8) of the Bank Holding Company Act and therefore avoid the HSR Act premerger notification process altogether. Accordingly, for acquisitions involving companies engaged in traditional bank holding company activities within the scope of Section 4(c)(8), financial holding companies may have the option of either making a pre-acquisition filing with the Fed-

29. As far as most financial holding companies are concerned, generally the HSR Act requires a premerger notification and a 30-day waiting period if the company to be acquired has more than $100 million in sales or $10 million in assets, and the financial holding company will be acquiring more than either (a) 15% of its voting stock or (b) voting stock or assets valued at $15 million or more. See 15 U.S.C. § 18a(a) (1994).
30. See Gramm-Leach-Bliley Act § 133.
eral Reserve Board and avoiding an HSR Act premerger notification, or making an after-the-fact notice to the Federal Reserve Board pursuant to the Gramm-Leach-Bliley Act and complying with the HSR Act’s premerger notification procedures (if the acquisition exceeds HSR thresholds).

C. Expanded Powers for National Bank Subsidiaries

The Gramm-Leach-Bliley Act also expands the permissible activities of a subsidiary of a national bank. Currently, national banks may own an “operating subsidiary,” which, for the most part, may engage only in those activities that are permissible for the national bank itself, i.e., activities that are “part of or incidental to the business of banking . . . or other activities that are permissible for national banks or their subsidiaries under other statutory authority.”

By interpretation and regulation, the OCC has permitted a national bank to own a subsidiary engaged in activities that meet the above standard, even though separate statutory authority precludes a national bank from engaging in the same activity directly (referred to as a “Part 5 subsidiary”).

The Gramm-Leach-Bliley Act preserves the existing authority of a national bank to own an operating subsidiary, and in addition permits the bank to own a “financial subsidiary” – a subsidiary that may engage in a broader range of activities that are “financial in nature.” To qualify to own a “financial subsidiary,” the national bank and each of its depository institution affiliates must be well capitalized, well managed, and have a CRA rating of “Satisfactory” or better. In addition, if the national bank is one the 50 largest banks, the national bank must

33. Rules, Policies and Procedures for Corporate Activities, 61 FED. REG. 60,363 (1996). An example of an activity considered by the OCC to be the business of banking, but barred to the national bank itself, is municipal bond underwriting. See, e.g., OCC Conditional Approval No. 262 (Dec. 11, 1997).
34. Because national banks are limited to owning operating subsidiaries or financial subsidiaries, by implication the Act overrides the OCC’s Part 5 regulations and prevents national banks from owning a Part 5 subsidiary unless it qualifies as a “financial subsidiary.”
35. See Gramm-Leach-Bliley Act § 121(a).
have outstanding at least one publicly held long-term unsecured debt issue that is rated within the three highest investment grade categories. The national bank is not required to be part of a "financial holding company" in order to own a financial subsidiary.

The creation (or acquisition) of a financial subsidiary requires the prior approval of the OCC. Unlike the procedure available for expanded activities for holding company subsidiaries, there is no after-the-fact notice procedure available for financial subsidiaries.

A financial subsidiary of a national bank may engage in any activity that either (i) is permissible for the bank itself, (ii) is listed as "financial in nature" under the Act, (iii) has been determined by the Treasury to be "financial in nature" (and the Federal Reserve Board has not disagreed), or (iv) is "incidental" to a financial activity. However, a financial subsidiary may not engage in:

- Underwriting insurance (other than credit insurance) or issuing annuities;
- Real estate development or investment; or
- Merchant banking (although five years after enactment, a financial subsidiary may engage in merchant banking if the Federal Reserve Board and the Treasury concur).

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36. See Gramm-Leach-Bliley Act §§ 101, 121(a). If the national bank is among the second 50 largest banks, the national bank must meet a comparable requirement to be established jointly by the Federal Reserve Board and the Treasury.

37. Curiously, the Act permits a financial holding company to engage in activities that are deemed by the Federal Reserve Board to be "complimentary" to financial-in-nature activities. See § 103. The Act does not, however, confer similar interpretive authority on the Treasury with respect to national bank financial subsidiaries. See § 121. Thus, the Federal Reserve Board has somewhat greater latitude to expand holding company activities than does the Treasury with respect to national bank financial subsidiary activities. Nonetheless, the OCC still has broad discretion under the National Bank Act to determine that an activity is "the business of banking" or "incidental" thereto, and therefore permissible for a national bank or its operating subsidiary.

38. See Gramm-Leach-Bliley Act §§ 121(a), 122.
A financial subsidiary therefore may engage in a wide range of activities previously barred to a national bank or its operating subsidiaries, such as:

- Underwriting or dealing in securities (including market-making);
- Organizing, sponsoring, or distributing a mutual fund;
- Selling insurance (including title insurance) outside a "place of 5,000";
- Engaging in real estate lease financing;
- Engaging in real estate brokerage;
- Operating a travel agency; and
- Providing management consulting services.

To protect the deposit insurance system from the increased risk posed by the expanded activities permitted to financial subsidiaries, a financial subsidiary and its parent national bank are subject to certain "firewalls," in particular:

- A financial subsidiary is treated as an "affiliate" for purposes of the affiliate transaction restrictions of Sections 23A and 23B of the Federal Reserve Act,\(^3\) and a national

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39. See 12 U.S.C. §§ 371c, 371c-1 (1994); Gramm-Leach-Bliley Act § 121(b). However, Section 23A's 10% limit - capping a national bank's "covered transactions" with (generally, extensions of credit to or purchases of assets from) any individual nonbank affiliate at 10% of the bank's capital stock and surplus, see 12 U.S.C. § 371c(a)(1)(A), will not apply to transactions between a bank and its financial subsidiary. See Gramm-Leach-Bliley Act § 121(b)(1).
bank's equity investment in the financial subsidiary (excluding retained earnings) counts against the bank's aggregate Section 23A "capacity";  

- The bank's equity investment in its financial subsidiaries (including retained earnings) must be deducted from its equity capital;  

- The financial subsidiary's assets and liabilities may not be consolidated with the national bank's assets and liabilities;  

- The assets of all of the bank's financial subsidiaries, on a combined basis, may not exceed $50 billion (indexed for inflation) or 45% of the bank's total assets, whichever is less; and  

- A financial subsidiary is treated as a holding company affiliate rather than a bank subsidiary for purposes of the antitying provisions of the Bank Holding Company Act.  

The Act also permits FDIC-insured state-chartered banks to own a financial subsidiary, subject to generally the same requirements, conditions, and firewalls applicable to national banks. Of course, a state bank could not own a financial subsidiary unless permitted to do so by the law of the state in which the bank is chartered, although many states have adopted "wild

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40. Under section 23A, a national bank's total outstanding "covered transactions" with (generally, extensions of credit to or purchases of assets from) all of its non-bank affiliates may not exceed 20% of the bank's capital stock and surplus. See 12 U.S.C. § 371c(a)(1)(B) (1994).  
42. See Gramm-Leach-Bliley Act § 121(d).
card" statutes that would permit state bank ownership of a subsidiary if a similarly situated national bank could do so.

The financial subsidiary provisions of the Act become effective on March 11, 2000.\(^4^3\)

D. National Banks May Underwrite Municipal Bonds

Well-capitalized national banks (and their subsidiaries) are permitted to engage in municipal bond underwriting, beginning March 11, 2000.\(^4^4\) Under existing law, national banks are prohibited from engaging directly in municipal bond underwriting by virtue of Section 16 of the Glass-Steagall Act\(^4^5\) (although the OCC has permitted national banks to own a "Part 5 subsidiary" that engages in municipal bond underwriting).\(^4^6\)

E. Streamlined Supervision and Functional Regulation of Holding Company Affiliates

The Act confers on the Federal Reserve Board the primary authority to examine and supervise a bank holding company, financial holding company, and their respective affiliates, other than its depository institution and "functionally regulated" affiliates. The "functionally regulated affiliates" (and their respective functional regulators) are:

- For a registered broker-dealer, investment adviser, or an investment company, the Securities and Exchange Commission (the "SEC");

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\(^{4^3}\) See §§ 121(a), 161. Although the OCC has an additional 150 days to promulgate regulations governing financial subsidiaries, the OCC issued proposed regulations on January 20, 2000, to be effective March 11, 2000. See Proposed Rulemaking, Financial Subsidiaries and Operating Subsidiaries, 65 Fed. Reg. 3157 (2000).

\(^{4^4}\) See Gramm-Leach-Bliley Act § 151.


\(^{4^6}\) See, e.g., OCC Conditional Approval No. 262 (Dec. 11, 1997).
For a state-regulated insurance company, the state insurance authority; and

For a CFTC regulated firm, the Commodity Futures Trading Commission.\textsuperscript{47}

The Federal Reserve Board’s authority to require reports from, examine, or impose capital requirements on a functionally regulated affiliate of a bank holding company or financial holding company is significantly restricted.\textsuperscript{48} Similarly, the authority of the SEC or a state insurance authority to require reports from or examine a holding company or a nonbank subsidiary is restricted as well (unless such nonbank subsidiary is functionally regulated by the SEC or the state insurance authority).\textsuperscript{49}

\textbf{F. Derivative and Intra-Day Extensions of Credit Subject to Section 23A}

Under the Act, the Federal Reserve Board is required to adopt regulations to address, as covered transactions, credit exposures arising out of derivative transactions between banks and their affiliates as well as intra-day extensions of credit by banks to their affiliates.\textsuperscript{50} Currently, these transactions generally are not considered “covered transactions” and are not subject to the collateral and arms’ length requirements and covered transaction limits of Sections 23A of the Federal Reserve Act.\textsuperscript{51}

\textsuperscript{47} See Gramm-Leach-Bliley Act § 111.
\textsuperscript{48} See §§ 111, 113, 115.
\textsuperscript{49} See §§ 111, 112, 115.
\textsuperscript{50} See § 121(d).
III. Securities Activities

A. Repeal of Bank Exemption from Broker-Dealer Registration and "Push Out" of Securities Activities

Banks currently enjoy an exemption from regulation as a broker-dealer under federal securities laws. The Act’s functional regulation provision repeals these exemptions effective May 12, 2001. Because it is impracticable in many cases for a bank itself to register as a broker-dealer, many of the securities activities traditionally conducted by banks – including certain derivative activities – must be “pushed out” into an affiliated securities firm that is otherwise registered as a broker-dealer.

The Act contains certain exceptions to the general definition of “broker,” allowing the bank to continue to effect transactions in certain “identified banking products” without the risk of SEC regulation or securities law registration – and thereby avoiding a push out. The permissible banking products include:

- Deposits,
- Banker’s acceptances,
- Letters of credit and loans,
- Debit accounts,
- Loan participations to qualified investors or other sophisticated investors, and
- Swaps (except equity swaps sold directly to

54. The definition of “qualified investor” includes any organization or natural person that owns and invests on a discretionary basis not less than $25 million in investments. This amount is reduced to $10 million for loan participations. See Gramm-Leach-Bliley Act § 206.
persons that are not qualified investors).\textsuperscript{55}

Subject to certain limitations, a bank may also continue in certain securities activities involving products other than "identified banking products," without registration as a broker (and therefore without push out), including:

- Third party brokerage arrangements with a broker/dealer offering services on or off the premises of the bank, subject to the following:
  
  o the broker/dealer is clearly identified as the person performing the brokerage services;

  o the broker/dealer performs the brokerage services in an area that is clearly marked and, to the extent practicable, physically separate from the routine deposit taking activities of the bank;

  o any materials used by the bank to advertise or generally promote the availability of brokerage services under the arrangement clearly indicate that the brokerage services are being provided by the broker/dealer and not by the bank;

  o any materials used by the bank to advertise or generally promote the availability of brokerage services are in compliance with federal securities laws before distribution;

\textsuperscript{55} See id.
• bank employees (other than associated persons of a broker/dealer who are qualified pursuant to rules of a self-regulatory organization (an "SRO") perform only clerical or ministerial functions in connection with brokerage transactions including scheduling appointments with associated persons of a broker/dealer, except that bank employees may forward customer funds or securities and may describe in general terms the types of investment vehicles available from the bank and the broker/dealer under the arrangement;

• bank employees do not receive incentive compensation for any brokerage transaction unless such employees are associated persons of a broker/dealer and are qualified pursuant to the rules of an SRO, except that bank employees may receive compensation for the referral of any customer if the compensation is a nominal one time cash fee of a fixed dollar amount and the payment of the fee is not contingent on whether the referral results in a transaction;⁵⁶;

• the services provided by the broker/dealer are on a basis in which all customers that receive any services are fully disclosed to the broker/dealer;

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⁵⁶. The Act does not address what compensation, if any, may be paid to the bank itself for the services rendered in connection with activities conducted under a third party brokerage arrangement, e.g., percentage lease payments, etc.
the bank does not carry a securities account of the customer; and

the bank or broker/dealer informs each customer that the brokerage services are provided by the broker/dealer and not by the bank, the securities are not deposits or obligations of the bank, are not guaranteed by the bank, and are not insured by the Federal Deposit Insurance Corporation (the “FDIC”).

- Trust activities, so long as the income from those activities is an administration or annual fee, a percentage of assets under management or a flat or capped per order processing fee, equal to not more than cost, or a combination of the foregoing, so long as the fee is not chiefly incentive compensation and the bank does not publicly solicit brokerage business, other than by advertising that it effects transactions in securities in conjunction with advertising its other trust activities. Trading activities resulting from trust activities must be conducted through a registered broker-dealer.

- Transactions in commercial paper, bankers acceptances or commercial bills, exempted securities, certain qualified Canadian government obligations and obligations of the North America Development Bank, and so-called “Brady Bonds”.

- As part of the bank’s transfer agency activities, transactions in the securities of an issuer for certain employee benefit plans, dividend reinvestment plans and issuer
plans.

- Transactions in securities for the bank's affiliates (other than a securities or merchant banking affiliate). Trading activities must be conducted through a registered broker-dealer, however.

- Sweep accounts, in which deposits are swept into no-load money market mutual funds.

- Services in which the bank, as part of its customary banking services, provides safekeeping or custody services, facilitates the transfer of funds or securities in connection with the clearance and settlement of securities transactions, or effects securities lending or borrowing transactions for customers, provided the bank does not act as a carrying broker except with respect to government securities, as defined. Trading activities must be conducted through a registered broker-dealer.

- Private placement activities, but only if the bank is not affiliated with a broker-dealer engaged in underwriting, dealing, or market making in any securities, other than exempted securities.

- Municipal securities transactions.

- Certain de minimis transactions (totaling less than 500 transactions per year not otherwise
Similarly, the Act contains exceptions for banks to the general definition of "dealer," including buying and selling securities for a person's own account, either individually or as fiduciary (but not as part of a regular business), and for investment purposes (as principal or as trustee or fiduciary). The definition of "dealer" also contains an exception permitting a bank to issue and sell asset-backed securities to qualified investors if the underlying obligations were originated by the bank or its affiliates or a syndicate of banks of which the bank is a member.58

B. Regulation of New Hybrid Products

The Act prescribes a procedure for determining whether a new "hybrid product" should be treated as a securities product (and functionally regulated by the SEC and pushed out from the bank) or a banking product (and functionally regulated by the banking agencies and not pushed out). Generally, the Act requires that the SEC consult with the Federal Reserve Board before determining a "hybrid" product is a "security" subject to SEC regulation, and provides the Federal Reserve Board with the opportunity to object to the SEC's determination and to seek judicial review in the United States Court of Appeals for the D.C. Circuit.59

C. Repeal of Bank Exemption from Investment Adviser Registration

Banks also lose their exemptions under the Investment Advisers Act60 and the Investment Company Act61 so that they must comply with the same general regulatory structure as do others when advising and providing other services to mutual

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57. See Gramm-Leach-Bliley Act § 201.
58. See § 202.
59. See § 205.
funds and unit investment trusts. Banks may, however, elect to conduct their mutual fund advisory and related activities in a separately identifiable department or division ("SIDD") and thereby limit the regulatory impact to only that portion of the bank. As a result, either the bank (or its SIDD) must registered under the Investment Advisers Act, or the bank's advisory activities must be pushed out to an affiliated registered adviser.

D. Other Restrictions on Investment Company and Investment Advisor Activities

The Act requires any person selling a bank-advised mutual fund to prominently disclose that the fund is not insured by the FDIC or any other government agency. Also, banks (and their affiliates) will be prohibited from lending money to bank- (or holding company-) sponsored funds, except in accordance with such rules, regulations, or orders as the SEC may, after consultation with and taking into consideration the views of the Federal banking agencies, prescribe or issue consistent with protection of investors.

The Act imposes more stringent independence requirements on the composition of bank- or holding company-advised investment companies than under current law. The Act expands the definition of "interested person" for an investment company or investment advisor to include a person who lends money to or executes a portfolio transaction for, engages in a principal transaction with or distributes shares for a mutual fund, another fund with the same advisor or otherwise related or an account over

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63. See § 214. Similar requirements currently exist in the Interagency Statement on Retail Sales of non-deposit Investment Products (Feb. 15, 1994).

64. See § 212. Currently, section 23A of the Federal Reserve Act requires that bank extensions of credit to bank- or holding company-sponsored funds be collateralized, at arms' length terms, and within the individual and aggregate lending limits of section 23A, but does not altogether prohibit such extensions of credit. Nor does section 23A bar extensions of credit by non-banks to bank- or holding company-sponsored funds. See 12 U.S.C. § 371c (1994).
which the fund's adviser has discretion. In addition, the Act expands the provisions that bar a majority of directors of a mutual fund from being employees, officers or directors of a bank to now bar such mutual fund directors from being employees, officers, or directors of a bank's subsidiaries and affiliates as well.65

The Act narrows the exemption from Investment Company Act registration for bank common trust funds; under the Act, the exemption will continue to be available only to those bank common trust funds that are not advertised or offered to the general public except in connection with the ordinary advertising of the bank's fiduciary services.66 As a result, banks will be unable to advertise or offer such funds to the general public except in connection its fiduciary services unless the common trust fund complies with applicable investment company registration requirements.

IV. INSURANCE ACTIVITIES

As mentioned above, the Gramm-Leach-Bliley Act deems insurance agency and underwriting activities to be "financial in nature." State anti-affiliation laws or state laws regulating the underwriting of insurance that discriminate based on bank holding company or financial holding company affiliation are expressly preempted (subject to certain exceptions). As a result, a financial holding company may freely engage in insurance agency or underwriting activities on or after March 11, 2000.67

A bank may also engage in general insurance agency activities on or after March 11, 2000 through a "financial subsidiary," without regard to the "place of 5,000" location requirements; however, a bank may not engage in insurance underwriting (other than credit insurance) either in its own capacity or through an operating subsidiary or a financial subsidiary.68 Once again, state anti-affiliation laws that discriminate based on

65. See Gramm-Leach-Bliley Act § 213.
66. See § 221.
67. See § 103.
68. See §§ 121, 302.
bank affiliation are expressly preempted. The Act does not affect a national bank's (or operating subsidiary's) existing authority to sell credit insurance, or to sell general insurance in a "place of 5,000" location. Likewise, the Act does not affect the power of State banks to engage in insurance agency activities under state law, subject to FDIC approval.

With respect to title insurance, underwriting by nonbank affiliates is permitted; underwriting by national banks and their subsidiaries is expressly prohibited (with certain grandfathered exceptions). Sale of title insurance by nonbank affiliates is expressly permitted, while national banks and their operating subsidiaries may sell title insurance only in those states in which state-chartered banks are permitted to sell title insurance. A "financial subsidiary" of an eligible national bank may sell title insurance in any state. State banks may continue to sell title insurance under applicable state law, subject to FDIC approval.

As mentioned above, insurance activities are considered "functionally regulated," with the state insurance authorities having primary authority over insurance activities, whether conducted in or under a holding company or a bank.

A. Preemption of State Insurance Laws

The Act effectively provides that insurance activities, whether conducted in a nonbank subsidiary, a national bank, or a national bank operating or financial subsidiary (to the extent permissible), be regulated under federal and state law in generally the same fashion. In particular, the Act extends the preemption standard reiterated by the Supreme Court of the United States in Barnett Bank of Marion County, N.A. v. Nelson (i.e., preemptioning state laws that "prevent or significantly interfere") to both banks and nonbank subsidiaries alike. State laws enacted

71. See Gramm-Leach-Bliley Act §§ 103, 121, 303.
72. See §§ 104, 111, 112.
after September 3, 1998 regulating the sale, solicitation or cross-marketing of insurance are preempted if discriminatory on their face or as applied (subject to 13 safe harbors). When determining whether a state sales, solicitation, or cross-marketing law "restricts or significantly interferes with" or discriminates against a national bank or its subsidiary, OCC deference applies with respect to laws enacted prior to September 3, 1998; otherwise, equal deference applies.

The Act provides for direct federal appellate court jurisdiction and expedited review of a determination by a state insurance or a federal bank regulator whether a state insurance law is preempted by federal law. The standard of judicial review is neutral, i.e., "without unequal deference" to the federal bank regulator and the state insurance regulator.

B. Insurance Customer Protection Regulations

The Act requires that the banking agencies adopt federal consumer protection regulations relating to the sale of insurance, such as:

- Prohibited sales practices (such as anti-tying and anti-coercion rules);

- Mandatory disclosure requirements (such as the noninsured nature of the product, its investment risk, and that a purchase is not mandatory to obtain credit);

- The requirement that the insurance agent obtain a customer acknowledgment that the disclosures have been received;

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74. See Gramm-Leach-Bliley Act § 104. State laws enacted prior to that date would be preempted, insofar as they apply to a national bank or its subsidiary, subject to the criteria set forth by the Supreme Court in Barnett.
75. See § 104.
76. See § 304.
• The physical segregation of the retail deposit and insurance sales areas within the branch;

• The payment of referral fees; and

• Qualification and licensing requirements.

These federal regulations would apply only to insurance sales either (i) by a depository institution, or (ii) by third parties conducting sales at an office of or on behalf of a depository institution. Conflicting state laws or regulations are preempted, and the banking agencies are required to inform the state that its laws are preempted. States may override the preemption if the state adopts legislation to override the preemption within three years after receipt of such a notice.77

The Act also prohibits discrimination in the sale, underwriting, pricing, renewal, or scope of coverage of insurance based on the insured’s status as a victim of domestic violence, and requires the banking agencies to establish a consumer grievance procedure to resolve complaints.78

V. ELIMINATION OF UNITARY THRIFT HOLDING COMPANY LOOPHOLE

The Act prohibits the formation of “unitary thrift holding companies,” which previously were not required to limit the scope of their activities to those permitted under the Home Owners’ Loan Act of 1933 (the “HOLA”).79 All newly established unitary thrift holding companies must now conform their activities to those permitted under the HOLA. Existing unitary thrift hold-
ing companies (including any unitary thrift holding company applicant as of May 4, 1999) are grandfathered and may continue to engage in non-HOLA activities, although their grandfathered status will not survive a change in control. As a result, the Act significantly diminishes the value of the thrift charter to commercial firms that had previously considered chartering or acquiring a thrift to obtain certain powers conferred on financial institutions (e.g., deposit-taking capability, interest rate exportation rights, fiduciary powers, etc.) without becoming subject to bank or thrift holding company activity restrictions. The Act also diminishes the value of existing thrifts by making them unmarketable to companies other than a thrift holding companies.

VI. Privacy

In terms of overall effect, the most significant provisions of the Gramm-Leach-Bliley Act may be found in Title V, its privacy provisions. The Act's privacy provisions apply to any "financial institution," which, for purposes of those provisions, is broadly defined to mean any institution the business of which is engaging in "financial activities" as described in Section 103 of the Act (adding new Section 4(k) of the Bank Holding Company Act). Significantly, because the definition of "financial institution" does not require that the institution be engaged in these financial activities "pursuant to" Section 4(k), the Act's privacy provisions extend to any entity engaged in financial activities permissible under Section 4(k), regardless whether the entity is affiliated with a bank, bank holding company, or financial holding company. Thus, for example, because extending credit is a financial activity described in Section 4(k), a retailer that provides open-end credit accounts or sales finance to its customers will be a "financial institution" and subject to the privacy provisions in Title V. Similarly, the Act's privacy provisions will extend to finance companies, mortgage brokers, loan servicers, credit bu-

80. See Gramm-Leach-Bliley Act § 401.
81. See § 509.
reaus, securities underwriters, broker-dealers, investment advisers, mutual funds, trust companies, travel agents, insurance underwriters and agents, management consultants, financial couriers, data processors, to name a few, regardless of their affiliation with a financial holding company. As the scope of "financial activities" under Section 4(k) expands over time (through Federal Reserve Board interpretation and regulation), the reach of the Act's privacy provisions will expand as well.

A. Permissible Activity

The Act imposes three broad privacy restrictions on "financial institutions": First, unless a disclosure is pursuant to an exception described below, a financial institution may not disclose to a nonaffiliated third party any "nonpublic personal information."82 "Nonpublic personal information" means personally identifiable financial information which is (i) provided by a consumer to a financial institution, (ii) results from any transaction with the consumer or any service performed for the consumer; or (iii) is otherwise obtained by the financial institution. Thus, the privacy provisions do not apply to non-consumer customers and accounts. The definition specifically excludes publicly available information as that term may be defined in appropriate regulations.83

Second, a financial institution may not disclose (other than to a consumer reporting agency) an account number or similar access number or code for a credit card or deposit account of a consumer to any nonaffiliated third party for use in telemarketing, direct mail marketing, or other marketing through electronic mail.84

Third, a financial institution must provide annual disclosures describing its privacy policy to consumers and whenever the institution establishes a customer relationship with a con-

82. See § 502(a).
83. See § 509.
84. See § 502(d).
The disclosures must describe the institution's policies and practices with respect to:

- the dissemination of nonpublic personal information to both affiliates and nonaffiliated third parties, including the categories of information that may be disclosed;

- the dissemination of nonpublic personal information of persons who have ceased to be customers of the institution; and

- the protection of nonpublic personal information of consumers.

The disclosures must set forth:

- the categories of persons to whom the information is or may be disseminated, other than the persons to whom the general exceptions described below apply;

- the categories of nonpublic personal information that are collected by the financial institution, regardless of whether it is disseminated to affiliated or nonaffiliated third parties;

- the institution's policies to protect the confidentiality and security of nonpublic personal information;

- the disclosures required under the Fair Credit Reporting Act (the "FCRA"),

the disclosures that are used, if any, by the institution to exclude information sharing with affiliates from the definition of "consumer report" under the FCRA.\textsuperscript{86}

The Act creates several exceptions to the general ban on disseminating nonpublic personal information to nonaffiliated third parties:

1. Disclosure Pursuant to Opt Out

A financial institution may disclose nonpublic personal information to a third party if:

- the institution discloses in writing or electronic form (or otherwise as permitted by regulations to be promulgated), that the information may be disclosed to a third party;

- the consumer is given the opportunity before the information is initially disclosed to direct that the information not be disclosed; and

- the consumer is given an explanation of how to exercise that non-disclosure option.\textsuperscript{87}

2. Services Provided By Nonaffiliated Third Parties

A financial institution may provide nonpublic personal information to a nonaffiliated third party to perform services for or functions on behalf of the financial institution. These can include marketing of the institution's own products or services, or financial products or services offered pursuant to joint agreements between two or more financial institutions. The institution must

\textsuperscript{86} See Gramm-Leach-Bliley Act § 503.
\textsuperscript{87} See § 502(b)(1).
disclose the arrangement to consumers whose information is disclosed, and the third party must agree to maintain the confidentiality of the information.\textsuperscript{88}

3. Other Exceptions

A financial institution may disclose nonpublic personal information to nonaffiliated parties without complying with the notice and opt-out provisions under the following circumstances:

- as necessary in connection with servicing or processing a financial product or service requested or authorized by the consumer, or in connection with maintaining or servicing the consumer's account with the institution, or in connection with a securitization, secondary market sale (including sales of servicing rights), or similar transaction related to a transaction of the consumer;

- with the consent or at the direction of the consumer;

- to protect the confidentiality or security of the institution's records;

- to protect against fraud, unauthorized transactions, claims, or other liability;

- for required institutional risk control, or for resolving customer disputes or inquiries;

- to persons holding a legal or beneficial interest relating to the consumer;

- to persons acting in a fiduciary or representative

\textsuperscript{88} See § 502(b)(2).
capacity on behalf of the consumer;

- to provide information to insurance rate advisory organizations, guaranty funds or agencies, applicable rating agencies of the financial institution, persons assessing the institution’s compliance with industry standards, and the institution’s attorneys, accountants, and auditors;

- to the extent specifically permitted or required under other provisions of law, and in accordance with the Right to Financial Privacy Act of 1978, to law enforcement agencies, self-regulatory organizations, or for an investigation on a matter related to public safety;

- to a consumer reporting agency in accordance with the FCRA, or from a consumer report reported by a consumer reporting agency;

- in connection with a proposed or actual sale, merger, transfer, or exchange of a business or operating unit;

- to comply with Federal, State, or local laws, rules, and other applicable legal requirements; to comply with a properly authorized civil, criminal, or regulatory investigation or subpoena or summons by Federal, State, or local authorities; or to respond to judicial process or appropriate government regulatory authorities.

Significantly, the Act imposes no restrictions on a financial institution sharing nonpublic personal information with its affili-
ates, other than the requirement that the financial institution disclose its information sharing privacy policy. Sharing account numbers for marketing purposes, however, is not permitted among affiliates.

B. Privacy Rulemaking

The Federal banking agencies as well as other Federal agencies are charged with prescribing regulations as may be necessary to carry out the purposes of the statute. Such regulations must be issued in final form not later than May 12, 2000.\textsuperscript{91} The statutory privacy provisions will then take effect six months after the date of the promulgation of final regulations, unless the regulations themselves prescribe a later date.\textsuperscript{92}

C. Relationship to State Privacy Laws

The federal privacy provisions of Title V of the Gramm-Leach-Bliley Act do not preempt any state statute, regulation, order, or interpretation, except to the extent that the statute, regulation, order, or interpretation is inconsistent with the federal privacy provisions. However, the Act specifically states that a state privacy statute regulation, order, or interpretation will not be inconsistent to the extent it provides greater protections to consumers than provided under Title V.\textsuperscript{93} Thus, efforts in the states to provide more stringent privacy protections to consumers can be expected.

VII. ADDITIONAL PROVISIONS

A. ATM Fee Disclosures

The Act amends the Electronic Fund Transfer Act (the

\textsuperscript{91} See § 504.
\textsuperscript{92} See § 510.
\textsuperscript{93} See § 507.
“EFTA”\textsuperscript{94} to require automated teller machine ("ATM") operators who impose a fee for use of the ATM by a non-customer to post a notice on the machine and on the screen that a fee will be charged and the amount of the fee. The notice must be posted before the consumer is irrevocably committed to completing the transaction. A paper notice issued from the machine may be used in lieu of a posting to the screen. No charge may be imposed unless the notices are made and the consumer elects to proceed with the transaction. ATM operators are exempt from liability if properly placed notices on the machines are subsequently removed, damaged, or altered by anyone other than the ATM operator. These disclosure requirements will become effective upon the promulgation of appropriate regulations by the Federal Reserve Board.\textsuperscript{95}

The Act also amends the EFTA to require that an issuer of ATM cards must provide notice upon issuance of a card that surcharges may be imposed by other parties when transactions are initiated from ATMs not operated by the card issuer. This provision will also become effective upon promulgation of regulations by the Federal Reserve Board.\textsuperscript{96}

While most banks already provide similar notices pursuant to requirements under state law, banks will need to ensure that their disclosures meet these federal standards.

\textbf{B. Community Reinvestment Act Reforms}

The Act contains several significant provisions affecting bank's compliance with the Community Reinvestment Act (the "CRA").\textsuperscript{97} The CRA requires that depository institutions help meet the credit needs of the local communities (especially low- to moderate-income areas) in which the institutions operate, and requires bank regulators to assess a depository institution's performance under the CRA before approving "an application for a

\textsuperscript{95} See Gramm-Leach-Bliley Act § 702.
\textsuperscript{96} See § 703.
deposit facility" – including bank branch, bank merger, and bank holding company acquisition applications. A bank’s CRA rating also affects a bank’s or bank holding company’s ability to engage in interstate transactions under the Riegle-Neal Interstate Banking and Branching Efficiency Act and, as mentioned above, the bank’s ability to establish a "financial subsidiary" or a bank holding company’s election to "financial holding company" status pursuant to the Gramm-Leach-Bliley Act. Community groups often rely on the CRA as a basis for protesting bank and bank holding company transactions if the groups believe that the banks have invested too little in their communities.

To ensure that the CRA’s requirements are not being abused, the Gramm-Leach-Bliley Act imposes certain requirements on any "agreement" made pursuant to or in connection with the CRA, entered into after November 12, 1999, between an insured depository institution (or its affiliate) and any nongovernmental entity or person, if such agreement involves the annual payment of more than $10,000 or the loan of more than $50,000 (with certain exceptions). For purposes of the Act, an "agreement" does not include any agreement entered into by a depository institution with a non-governmental entity or person who has not commented on, testified about, or discussed with the bank or otherwise contacted the bank concerning the CRA. Nor is the term intended include individual mortgage loans or other loans made at rates not substantially below market rates where the proceeds will not be re-lent.

Such agreements must be disclosed to the public and to the appropriate federal banking agency both by the depository institution (or its affiliate) and by the recipient. In addition, the recipient must provide to the appropriate federal bank regulatory agency an annual accounting of its use of the funds received from the depository institution (or its affiliate). Because these CRA

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100. See Gramm-Leach-Bliley Act § 711.
101. See § 711. However, the annual accounting requirements apply only to
“sunshine” provisions apply only to individuals and entities that have commented on, testified about, discussed with the institution, or otherwise contacted the institution concerning the CRA, it will conceivably be challenged by various groups on First Amendment grounds.

In an effort to reduce regulatory burden on small banks, a separate provision of the Act alters the CRA examination schedule for banks having assets of less than $250 million. Small banks with a CRA rating of “Outstanding” from its most recent CRA examination will be examined not more than once every five years; small banks with a rating of “Satisfactory” will be examined not more than once every four years; small banks with a rating of less than “Satisfactory” must be examined as deemed necessary by its federal regulator. Currently, the typically CRA examination cycle for these banks is considerably shorter.

C. Thrift Conversion

The Act amends the HOLA to permit any federal thrift in existence on November 12, 1999 to convert into a national bank or state-chartered bank, with the approval of the OCC or the state banking supervisor, as appropriate. The converting thrift is permitted to retain, as bank branches, all of its thrift branches then in existence. The branches may be retained notwithstanding any restrictions otherwise contained in federal banking law, in particular, the McFadden Act (which permits interstate national bank branch retention upon conversion only if the state in which the branch is located expressly permits de novo interstate bank branching). Because federal thrifts are currently permitted to branch interstate without regard to state restrictions, the Act creates an opportunity for an existing thrift to establish multistate branches and then convert into a national bank, notwithstanding

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"agreements" entered into after May 12, 2000. See id.

102. See § 712. The federal banking agencies are permitted to deviate from this prescribed examination cycle “for reasonable cause.” Id.

103. See § 739.


remaining restrictions on national bank interstate bank branching.

D. Miscellaneous Provisions

The Act repeals the restrictions in the Federal Reserve Act on loans by Federal Reserve member banks that are secured by stock or bond collateral.\textsuperscript{106} Limitations on loans to one borrower imposed pursuant to other statutory authority (e.g., the National Bank Act) are not affected. This provision removes an anomaly that prevented member banks from taking stock and bond collateral even when done so out of an abundance of caution.

The Act also amends Section 23B of the Federal Reserve Act.\textsuperscript{107} Section 23B currently prohibits a bank, either as principal or fiduciary, from purchasing a security during the existence of an underwriting if an affiliate is a principal underwriter of that security, with an exception permitting such purchases if approved by a majority of the bank’s outside directors.\textsuperscript{108} Banks that have no outside directors (which is not uncommon in the case of banks in a holding company structure) have been unable to utilize that exception. The Gramm-Leach-Bliley Act revises the exception to require such purchases be approved only by a majority of directors, whether inside or outside.\textsuperscript{109}

VIII. CONCLUSION

The Gramm-Leach-Bliley Act will likely result in significant changes in the delivery of financial services in the U.S. marketplace. The Act, signifying the completion of financial modernization efforts started decades earlier by the U.S. bank regulatory agencies, eliminates many of the remaining barriers to affiliation between the banking, insurance, and securities industries. The Act eliminates these barriers without imposing signifi-

\textsuperscript{106} See Gramm-Leach-Bliley Act § 735.
\textsuperscript{109} See Gramm-Leach-Bliley Act § 738.
cant obstacles to customer information sharing among these affiliated entities, thereby enabling a financial holding company efficiently to provide a broader range of services to its overall customer base. By allowing most "financial in nature" activities to be conducted either in the holding company or in a bank's financial subsidiary, the Act confers on holding companies some degree of flexibility in structuring these new activities. At the same time, the Act's functional regulation provisions provide for a common supervisory scheme for these new activities, wherever conducted. The long range impact of the Act, however will become evident only after the bank regulatory agencies define the scope of permissible activities under the "financial in nature" test, and as these agencies - as well as the SEC and state insurance regulators - adopt regulations implementing the Act and imposing conditions, procedures, and examination practices for the newly unified financial services industry.