2001

Financial Modernization: The Effect of the Repeal of the Glass-Steagall Act on Consumers and Communities

Richard D. Marsico
New York Law School, richard.marsico@nyls.edu

Recommended Citation
New York Law School Journal of Human Rights, Vol. 17, pp. i-x

SYMPOSIUM 2000

Financial Modernization: The Effect of the Repeal of the Glass-Steagall Act on Consumers and Communities

Foreword

Richard D. Marsico[1]

What is a human rights law journal doing hosting a symposium on financial modernization law? Organizers of this Symposium, *Financial Modernization: The Effect of the Repeal of the Glass-Steagall Act on Consumers and Communities,*[2] certainly heard this question more than once. Perhaps the answer can best be summed up in two words: access and control. By offering loans, banks provide access to capital and meaningful participation in the economy. By gathering and maintaining the personal information that is necessary to make loans and provide other financial services, banks gain vast amounts of personal information about their customers, the sharing of which their customers do not necessarily control.

In November, 1999, Congress repealed and amended significant portions of two pillars of the bank regulatory system, the Glass-Steagall Act and the Bank Holding Company Act (BHCA).[3] Together, these laws served to create a wall between commercial banking and insurance and investment banking.[4] The law that replaced them, known as the

Gramm-Leach-Bliley Act (GLBA)[5] now permits financial institutions to engage in all three of these businesses. As a result, banks can now function as financial conglomerates, offering, as

---

[1] Professor of Law, New York Law School.

[2] 17 N.Y.L. SCH. J. HUM. RTS. 1–126 (2001).

[3] David L. Glass, *The Gramm-Leach Bliley Act: An Overview of the Key Provisions*; *Presentation Before the State of New York Banking Department,* 17 N.Y.L. SCH. J. HUM. RTS. 1 (2001).

[4] *Id.*

[5] Pub. L. No. 106-102, 113 Stat. 1338 (1999).

GLBA supporters put it, "one-stop shopping" for financial services.[6]

The potential for larger and more diversified banks raises several questions about access to capital and control over the dissemination of personal information. Will such banks be responsive to the credit needs of their communities? Particularly low and moderate-income neighborhoods within their communities? Will they share private consumer information with other companies? Will consumers have control over whether a bank can do this? In short, what, as this Symposium asks, will the repeal of the Glass-Steagall Act mean for consumers and communities?

SETTING THE STAGE

To set the stage for examining these issues, David L. Glass' overview of the GLBA describes the legal landscape prior to the GLBA and afterwards.[7] The Glass-Steagall Act (for which David Glass accepts no responsibility) separated commercial banking from investment banking. It prohibited banks from underwriting securities or affiliating with any company that was engaged principally in underwriting securities, it forbade firms engaged in underwriting from taking deposits, and it prohibited interlocking directorates and management personnel between banks and securities firms.[8] The BHCA prohibited banks from engaging in any business not closely related to banking, and defined insurance as not closely related to banking.[9]

As the overview points out, the GLBA could have done away with these restrictions in just a few sentences.[10] Nevertheless, the GLBA covers 380 pages, reflecting a law that addresses the concerns of several competing constituencies and does much more than simply

---

[6] Lawrence J. White, *Financial Modernization: What's in it for Communities?*, 17 N.Y.L. *Sch. J. Hum. Rts.* 122 (2001).

[7] *See* Glass, *supra* note 3.

[8] *Id.* at 7.

[9] *Id.* at 11.

[10] *Id.* at 1.

permit banks to engage in the securities and insurance businesses.[11] David Glass describes much of the "more" that the GLBA does; the rest of this Symposium is concerned with the part of the "more" dealing with access to capital and control over the dissemination of personal information.

The starting point for analyzing GLBA's impact on access to capital is the Community Reinvestment Act ("CRA"), which states that banks have an affirmative obligation to meet the credit needs of their local communities in general, and low- and moderate-income neighborhoods in particular.[12] The CRA requires four federal banking regulatory agencies to examine banks periodically to assess their performance at meeting local credit needs, to issue a written examination report with one of four performance ratings, and to take a bank's CRA record into account when considering its applications to expand its business.[13] Members of the public can comment on a bank's applications, and a bank with a poor CRA rating risks denial of the application.[14]

There are three key provisions related to the CRA in the GLBA, and two "non-provisions." First, a state chartered bank that wants to engage in the insurance and securities businesses must first become a financial holding company (FHC), and a national bank that wants to engage in these businesses must first create a "financial subsidiary."[15] In order to become an FHC, all of the institution's bank subsidiaries must be well-capitalized, well-managed, and have at least a "satisfactory" CRA rating.[16] Once an entity is an FHC, its bank subsidiaries must maintain at least a satisfactory CRA rating, otherwise it will not be permitted to enter into the securities or

[11] *Id.* at 1–2.

[12] 12 U.S.C.A. §§ 2901–2908 (West Supp. 2000).

[13] 12 U.S.C.A. §§ 2903, 2906. The ratings are "outstanding," "satisfactory," "needs to improve," and "substantial non-compliance." *Id.* at § 2906 (b) (2).

[14] Procedures for members of the public to comment on applications are published at 12 C.F.R. Parts 5, 225, 262, 303, and 516 (2000). The federal banking agencies' authority to deny bank applications appears at 12 C.F.R. §§ 5.13, 25.29, 222.29 (c), 345.29 (d), and 563e.29 (2001).

[15] *See* Glass, *supra* note 3, at 3.

[16] *Id.* at 4, 9.

insurance businesses.[17] The requirements for financial subsidiaries are similar.[18] Second, the GLBA provides for less frequent examinations of smaller banks if they have at least a satisfactory CRA rating.[19] Third, the GLBA creates a so-called "sunshine" provision, which requires lenders and community groups to disclose the provisions of CRA-related lending agreements they enter into.[20] As for the two "non-provisions," the GLBA does not require banks to apply to create an FHC or financial subsidiary, but rather permits them to elect to do so and to submit a filing indicating their intention to do so.[21] The GLBA does not permit public comment on filings to become on FHC or financial subsidiary, thus precluding advocates from commenting on a bank's CRA record in connection with the bank's plan to engage in the securities or insurance businesses. Second, the GLBA does not extend the CRA to the insurance or securities aspects of a financial institution's business.

Three important provisions of the GLBA relate to a consumer's ability to control private information. First, the GLBA permits a financial institution to share private information about a customer with its affiliated institutions without getting the customer's permission.[22] Second, the GLBA permits a financial institution to share customer information with a non-affiliated third party as long as the customer has not "opted-out" of allowing such disclosure.[23] Finally, the GLBA requires a financial institution to disclose its policies relating to the sharing of private information to its customers when the relationship begins and annually thereafter.[24]

With these basics in mind, the Symposium turns to analyzing the GLBA's effect on access to capital and control over private information.

---

[17] *Id.* at 6.
[18] *Id.* at 14.
[19] *Id.* at 18 .
[20] *See* Glass, *supra* note 3, at 18.
[21] *Id.* at 3–4.
[22] *Id.* at 20.
[23] *Id.* at 19–20.
[24] *Id.* at 19.

ACCESS TO CAPITAL

Michael Bylsma, the director of the Community and Consumer Law Division of the Comptroller of the Currency and Deborah Goldberg, the of the Center for Community Change, have different perspectives about the GLBA's effect on access to capital.[25] Bylsma states that in his view, "GLBA will not significantly alter the CRA or the positive role it plays in increasing access to credit among low- and moderate-income persons in this country."[26] Goldberg, on the other hand, in asking what low-income communities will get from the GLBA, answers, "Not much, or at least, not much that's good."[27]

Bylsma and Goldberg analyze the three key CRA-related provisions of GLBA. Bylsma states that the provisions prohibiting banks from expanding into the securities and insurance businesses unless they have a satisfactory CRA rating will ensure that banks continue to fulfill their CRA obligations.[28] Even though this provision does not require banks to apply to engage in these new businesses or permit members of the public to comment on the applications, Bylsma points out that things could have been worse for communities: the Senate's version of the financial modernization bill did not include any provisions tying a bank's right to engage in new businesses to its CRA record.[29] Deborah Goldberg is less sanguine about this provision, describing it as "a modest provision designed to insure that bank holding companies . . . cannot completely abandon service to low-income people and communities in their quest for new financial services horizons."[30] Goldberg calls the provision a "useful statement of public policy" that "will surely have some impact," but warns that the impact should not be overstated since 98 percent of banks and thrifts currently receive satisfactory or better CRA

[25] *See* Michael S. Bylsma, *Financial Modernization: What's in it for Local Communities?*, 17 N.Y.L. SCH. J. HUM. RTS. 37 (2001); Deborah Goldberg, *Remarks of Deborah Goldberg*, 17 N.Y.L. SCH. J. HUM. RTS 65 (2001).

[26] *See* Bylsma, *supra* note 25, at 39.

[27] *See* Goldberg, *supra* note 25, at 65.

[28] *See* Bylsma, *supra* note 25, at 47.

[29] *Id.*

[30] *See* Goldberg, *supra* note 25, at 65.

ratings.[31]

Second, Michael Bylsma expresses optimism about the extended examination cycle for small banks with satisfactory or better CRA ratings. He believes that this will be an incentive for small banks to get and maintain at least a satisfactory CRA record.[32] Bylsma also notes that this provision is better for CRA enforcement than earlier versions of the GLBA, which would have exempted 76 percent of all rural banks from the CRA.[33] Deborah Goldberg, on the other hand, states that extending small banks' CRA examination cycles is unlikely to reduce regulatory burden for them, because their safety and soundness and consumer compliance examinations will not be on shorter cycles, and their CRA exams, although less frequent, will cover more time.[34] In contrast to the lack of benefit to banks, Goldberg argues that the extended examination cycle may hurt the public, especially in rural areas where small banks play a very important role.[35]

Finally, Bylsma addresses the "sunshine" provision. He asserts that while the provision places new burdens on financial institutions and community groups that enter into CRA lending agreements, the provision should provide members of the public with more information about CRA activities in their communities, deter agreements that are made for vague or ill-defined motives, and help ensure that funds committed in the agreements are accounted for.[36] Bylsma points out once again that things could have been worse for the CRA, as earlier versions of the financial modernization law would have created a "safe harbor" from public scrutiny for expansion applications from banks with satisfactory CRA ratings.[37] Deborah Goldberg, on the other hand, saves her strongest criticism for the "sunshine" provision. She states that the "sunshine" provision is likely to have a "chilling effect" on CRA activity, discouraging

---

[31] *Id.* at 66.

[32] *See* Bylsma, *supra* note 25, at 42.

[33] *Id.*

[34] *See* Goldberg, *supra* note 25, at 67.

[35] *Id.*

[36] *See* Bylsma, *supra* note 25, at 50.

[37] *Id.* at 48–50.

community groups from participating in the CRA regulatory process and discouraging the partnerships that have emerged between banks and community groups, both of which have been fundamental to CRA's success.[38] Goldberg asserts that this chilling effect is exactly what "sunshine's" sponsors intended, and that it will further Senator Gramm's "anti-CRA crusade."[39]

In two contrasting views of the future role of the CRA in a financially modernized world, Deborah Goldberg and Lawrence J. White, the Arthur E. Imperatore Professor of Economics at New York University's Stern School of Business, initially agree that financial modernization has passed the CRA by.[40] Their remedies, however, differ. Professor White calls the CRA a "localist anachronism in the wider and more competitive financial world of the twenty-first century."[41] He argues that the CRA pressures banks to subsidize projects with a public purpose, and should be replaced with a system of public subsidies.[42] Deborah Goldberg, on the other hand, lists several trends that threaten the CRA, including bank consolidation, increasingly complex corporate structures, technology, and affiliations with other financial services institutions.[43] In contrast to Professor White, however, she calls for a "modernized" CRA to ensure its continued effectiveness.[44]

CONTROL OVER PRIVATE INFORMATION

Depending on your perspective, the GLBA is either the "'greatest expansion of personal privacy in the history of American finance,'" or "'Consumers, investors and the American public will have no protection [of] their privacy whatsoever under this bill.'"[45]

---

[38] *See* Goldberg, *supra* note 25, at 67.

[39] *Id.*

[40] *Id.*; *see also* White, *supra* note 6.

[41] *See* White, *supra* note 6, at 125.

[42] *Id.* at 126.

[43] *See* Goldberg, *supra* note 25, at 68–76.

[44] *Id.* at 73.

[45] *See* Gregory T. Nojeim, *Financial Privacy* 17 N.Y.L. SCH. J. HUM. RTS. 79, 80 (2001), quoting Rep. Sue Kelly (R-NY) and Rep. John Dingell (D-MI),

One of our Symposium contributors represents the first perspective, one represents the second perspective, and two mediate between them.

Dolores S. Smith, Director of the Division of Consumer and Community Affairs of the Board of Governors of the Federal Reserve System, and John H. Mann, a senior attorney in the Division, mediate these perspectives. They describe the regulations several federal agencies recently issued to implement the privacy provisions of the GLBA.[46] Smith and Mann assert that the regulations seek to strike a balance between the interests of consumers in controlling personal information and the interests of the financial services industry in minimizing the costs of affording consumers this control.[47] They cite, among others, four examples of this balancing effort. First, the regulations define personal information broadly to include virtually all the information a financial institution obtains about a customer.[48] They assert that this provision benefits consumers by bringing a large volume of information under control, and benefits banks by creating a clear definition, thus reducing compliance burdens.[49] Second, the regulations require the privacy notices to cover a broad range of topics, but promote concise notices, which are easier for consumers to absorb.[50] In addition, if an institution wants to reserve the right to disclose all personal information, it simply needs to say so, it need not provide examples of the sorts of information it will reveal.[51] Third, the regulations contain exceptions to the statutory ban on sharing customer account numbers that Smith and Mann assert will benefit financial institutions and consumers by allowing institutions to disclose account numbers to certain entities such as mail houses that send out promotional statements about the institution's products with

---

respectively.

[46] *See* Dolores S. Smith and James H. Mann, *The New Consumer Financial Privacy Regulations: Balancing the Interests of Consumers and Industry*, 17 N.Y.L. SCH. J. HUM. RTS 91 (2001).

[47] *Id.* at 91–92.

[48] *Id.* at 99.

[49] *Id.* at 100.

[50] *Id.* at 101.

[51] *See* Smith and Mann, *supra* note 46, at 100–101.

the institution's bills or to the institution's clients in affinity credit card programs.[52] Fourth, the regulations delay the statutory implementation date of the privacy provisions by approximately seven months, enough time for financial institutions to develop compliance programs but not too much time to excessively delay implementation of the law.[53] Smith and Mann conclude that this mediation between consumer and financial industry interests will continue not only in agency rulemaking but by Congress and State legislatures as they consider additional privacy legislation.[54]

David Glass returns to the Symposium to present his perspective on GLBA's effect on consumer privacy.[55] Glass argues that GLBA's provision permitting for cross-marketing of products among a bank's affiliates is a pro-consumer provision, because "vigorous competition is the best way to ensure that consumers can have the greatest possible choice among the products and services they want and need."[56]

Gregory Nojeim, legislative counsel for the American Civil Liberties Union, has a different perspective.[57] He argues that the pre-GLBA walls between insurance companies, banks, and securities firms operated as a *de facto* privacy protection, but once the GLBA removed these walls, it also eliminated the privacy protection without providing a sufficient replacement.[58] Nojeim argues that the GLBA violates the "golden rule" of informational privacy: "sensitive personal information given for one purpose ought not to be used for other purposes without the express consent of the person to whom the information relates."[59] In place of GLBA's "illusory" privacy protections, Nojeim favors "true consent," which would require consumers to expressly consent to the disclosure of personal

---

[52] *Id.* at 102.

[53] *Id.*

[54] *Id.*

[55] *See* David L. Glass, *Remarks of David L. Glass*, 17 N.Y. L. SCH. J. HUM. RTS. 51 (2001).

[56] *Id.* at 54–55.

[57] *See* Nojeim, *supra* note 45, at 79.

[58] *Id.*

[59] *Id.* at 81.

information.[60]

In conclusion, as will become evident in reading the articles in this Symposium, perhaps the only thing all our Symposium authors agree on is that the debate over access to capital and control over personal information started by the GLBA promises to continue for many years.

---

[60] Id. at 84–85.