

COST-BENEFIT ANALYSIS, DEREGULATED MARKETS, AND CONSUMER BENEFITS: A STUDY OF THE FINANCIAL SERVICES MODERNIZATION EXPERIENCE

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INTRODUCTION

[Citigroup] is facing three types of risk The first is legal risk, related to [Enron] securities that the firm underwrote and sold to investors Then there is the regulatory risk, as Congress could try to restrict Citigroup's activities The final concern is reputational.¹

Cost-benefit analysis and a renewed embrace of deregulated markets are two legacies of the last decades of the twentieth century. This Article examines these two principles through a study of the 1999 financial services deregulation initiative—the last major deregulatory initiative of the twentieth century. It explores whether deregulation produces substantial consumer benefits. Part I of this Article examines cost-benefit analysis as a means to legislative decision-making. It examines whether Congress sought and received adequate explanation and documentation of the stated benefits of financial services deregulation to consumers. I conclude that while Congress has embraced cost-benefit analysis as a means of decision-making by regulatory agencies, it has paid only lip service to the principle in its own deliberations. Benefits frequently went unexplained, unchallenged, and undocumented. In essence, benefits were assumed.

1. Riva D. Atlas, *Sinking Feeling Is Now Settling Over Citigroup*, N.Y. TIMES, July 24, 2002, at C1 (paraphrasing views of Michael Mayo, analyst with Prudential Securities).

Part II explores the most frequently touted benefit of the legislative decision to deregulate particular markets—the benefit to consumers. The deregulated financial services industry—banks, insurance companies and securities firms—serve as the test case. Part II examines the outcome two years after enactment of the legislation. Were the congressional assumptions regarding consumer benefits justified? I find that while consumer benefits were assumed to exist and to be significant, in reality, benefits have been modest or even nonexistent.

Part III of this Article explores possible explanations for the findings that Congress does not choose to employ a rigorous cost-benefit review of legislative proposals, such as the proposal to deregulate the financial services industry, and that experience has revealed little or no consumer benefit to the deregulation initiative. One explanation is political advantage. Endorsing consumer benefits has electoral advantages and therefore such benefits are stated or overstated based on little or no evidence. A second explanation is complexity and resultant unpredictability. A legislative change becomes one factor in a complex and dynamic mix that determines outcomes. Thus, unrelated, post-legislative changes in the business environment may have prevented expected consumer benefits from being realized. Both of these factors may play a role.

But I posit a more fundamental explanation: that the customary, generally accepted model of likely outcomes in deregulated markets must be reexamined. In this model, firms compete by seeking to capture a broad market of customers, products, and geographic areas—primarily on the basis of price. In some industries, however, substantial consumer benefits from deregulation cannot be reasonably expected to accrue, because providing consumer benefits across a wide spectrum of customers and products is not viewed as the best means to maximize profits or stock prices. Yet, legislators continue to assume the contrary.

This Article explores the stated and the realized benefits, if any, of deregulation. Adverse consequences of the 1999 deregulation initiative in the financial services market have recently surfaced. One consequence has been possible anticompetitive practices manifested through attempts to tie loans to investment services.² Another conse-

2. See ASS'N FOR FIN. PROF'LS, CREDIT ACCESS SURVEY: LINKING CORPORATE CREDIT TO THE AWARDED OF OTHER FINANCIAL SERVICES (2003) (reporting results of survey of senior corporate financial professionals, which revealed ties between short-term credit provided by commercial banks and other financial services, such as cash management services, underwriting services, and strategic advisory services), http://www.afponline.org/Information_Center/News/Credit_Access_Survey.pdf.

quence has been possible conflicts of interest and subsequent poor decision-making resulting from deregulated companies' engagement in both corporate lending and investment banking.³

These and other costs of deregulation must be weighed against the realized benefits of deregulation, and not against assumed benefits. This is not to say necessarily that the 1999 deregulation initiative should be reversed. Pushing back the clock is always difficult. Additional safety measures might be required, however, and additional incentives or requirements to provide consumer benefits might be necessary. Moreover, experience now cautions that if an adequate cost-benefit analysis had been done initially, a wiser legislative initiative might have been an alternative to cross-industry competition.

I.

COST-BENEFIT ANALYSIS IN THE LEGISLATIVE ARENA

Mr. TOOMEY: [O]ne of the primary objectives of H.R. 10 is to allow different kinds of financial institutions to offer different financial services with fewer obstacles, fewer impediments imposed by the regulatory structure. To the extent that some version of H.R. 10 succeeds in accomplishing that, would you feel safe in saying that this will almost certainly benefit consumers in the long-run by lowering the cost to these institutions in providing these services?

Mr. GREENSPAN: Oh, most certainly. In fact, at the end of the day, the whole purpose of the capitalist market system is effectively to help consumers.⁴

A. *The Embrace of Cost-Benefit Analysis as a Principle*

Cost-benefit analysis has been increasingly embraced as a tool for decision-making at the federal level. Executive orders dating back

3. See, e.g., Gretchen Morgenson, *Banks Are Havens (And Other Myths)*, N.Y. TIMES, July 28, 2002, § 3 (Money & Business), at 1 (describing investors' concerns with sufficiency of due diligence conducted by banks underwriting or dealing in WorldCom's \$12 billion bond offering, which was managed by Citigroup; analysts believe commercial banks were eager to teach companies how to skirt tax rules and accounting regulations so banks could capture lucrative securities underwriting deals); see also Kurt Eichenwald & Michael Brick, *Enron Investors Say Lenders Took Part in Fraud Scheme*, N.Y. TIMES, Apr. 8, 2002, at A15 (reporting on lawsuit alleging that nine financial institutions participated in deals that disguised Enron's true financial health); Emily Thornton & Wendy Zellner, *Too Close For Comfort*, BUS. WK., Mar. 18, 2002, at 78, 78-79 (reporting that firms that invested in Enron partnerships took part in investment banking business).

4. *H.R. 10—The Financial Services Modernization Act of 1999: Hearings Before the House Comm. on Banking and Fin. Servs.*, 106th Cong. 143 (1999) [hereinafter *House Banking Hearings*] (exchange between Rep. Patrick J. Toomey and Alan Greenspan, Chairman, Federal Reserve System).

to 1981 have directed regulatory agencies to employ cost-benefit analysis.⁵ Some federal regulatory statutes have been interpreted by the courts as requiring cost-benefit analysis.⁶ The 1995 Unfunded Mandate Reform Act explicitly requires a written statement containing a qualitative and quantitative assessment of anticipated costs and benefits of any federal mandate imposed on state and local governments.⁷

Analyzing the benefits and costs of a legislative proposal has a long history as a suggested tool for legislative decisions. Long before the law and economics movement touted the need for cost-benefit analysis, legislative analysts spoke of the need for the legislature to consider the expected positive and negative effects of a legislative proposal before its enactment. This is an aspect of deliberative democracy that seeks collective decision-making by means of open debate among all who will be affected by a decision or by their representatives.⁸ In a deliberative democracy, political debate is organized around concepts of the public good and not around narrow self-interest.⁹ Open discussion is thought to be beneficial since it, among other things, reveals private information, lessens or overcomes the impact of bounded rationality, forces or encourages justification beyond pure self-interest, and legitimizes the ultimate choice.¹⁰

A bit of clarification is necessary here. The term cost-benefit analysis has been used to describe two distinct principles. First, it has been used to describe a standard that determines proper decisions. This standard comes from the law and economics movement and posits that the best outcome is that which leads to the most efficient allocation of resources.¹¹ This aspect of cost-benefit analysis has been

5. See Eric A. Posner, *Controlling Agencies with Cost-Benefit Analysis: A Positive Political Theory Perspective*, 68 U. CHI. L. REV. 1137, 1139 (2001); Edward R. Morrison, Comment, *Judicial Review of Discount Rates Used in Regulatory Cost-Benefit Analysis*, 65 U. CHI. L. REV. 1333, 1333 n.2 (1998).

6. See Posner, *supra* note 5, at 1139 n.17.

7. See 2 U.S.C. § 1532(a) (2000).

8. See, e.g., Jon Elster, *Introduction to DELIBERATIVE DEMOCRACY* 1, 8 (Jon Elster ed., 1998); Joshua Cohen, *Deliberation and Democratic Legitimacy*, in *DELIBERATIVE DEMOCRACY: ESSAYS ON REASON AND POLITICS* 67 (James Bohman & William Rehg eds., 1997).

9. See Cohen, *supra* note 8, at 68.

10. See James D. Fearon, *Deliberation as Discussion*, in *DELIBERATIVE DEMOCRACY*, *supra* note 8, at 45; Thomas Christiano, *The Significance of Public Deliberation*, in *DELIBERATIVE DEMOCRACY: ESSAYS ON REASON AND POLITICS*, *supra* note 8, at 243 (arguing that public deliberation leads to results that are more just and viewed as rationally justified by citizenry).

11. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 13 (4th ed. 1998); see also Matthew D. Adler & Eric A. Posner, *Implementing Cost-Benefit Analysis When Preferences are Distorted*, 29 J. LEGAL STUD. 1105, 1108 (2000) (linking cost-benefit analysis with efficiency).

subject to a great deal of criticism.¹² It is not the aspect of cost-benefit analysis explored in this Article.

A second manner in which the term cost-benefit analysis has been used is to describe a tool in the decision-making process. This tool requires the decision maker to explore in depth the expected or likely benefits and costs of a proposal before making a choice.¹³ As a process of decision-making, cost-benefit analysis does not prescribe a particular outcome. Benefits need not exceed costs for a decision to be proper. Rather, costs and benefits must be made explicit before a choice is made. This process has been widely accepted by academics because, among other things, it serves a democracy principle.¹⁴ Public policy considerations are forced into every legislative debate, and hopefully help to determine decisions. This is because a discussion of public benefits and costs becomes a necessary component of every decision-making process, and that discussion is publicly reported. Such a process may help to avoid decisions based solely on interest group pressure or back-room political trades.

Even as a process for decision-making, some manifestations of the process have been controversial. At times, the cost-benefit process has been described as requiring the monetizing of all costs and benefits.¹⁵ Such monetization has been criticized.¹⁶ The process has also been criticized as requiring frequent comparisons of types of benefits

12. See, e.g., Richard Whisnant & Diane DeWitt Cherry, *Economic Analysis of Rules: Devolution, Evolution, and Realism*, 31 WAKE FOREST L. REV. 693, 725 (1996); see also Robert W. Hahn, *Achieving Real Regulatory Reform*, 1997 U. CHI. LEGAL F. 143, 150 (1997) (listing various criticisms of cost-benefit analysis).

13. See Cass R. Sunstein, *Congress, Constitutional Moments, and the Cost-Benefit State*, 48 STAN. L. REV. 247, 249 (1996) (describing cost-benefit state as one that weighs costs of government actions against benefits of those actions); Whisnant & Cherry, *supra* note 12, at 702 (defining cost-benefit analysis in two ways: narrowly, as whether rule's benefits outweigh its costs, and broadly, as general framework for predicting changes after promulgation of rule).

14. See Sunstein, *supra* note 13, at 252 (arguing that cost-benefit analysis could be part of system of deliberative democracy because it promotes both political accountability and regulatory efficiency); see also Posner, *supra* note 5, at 1141 ("Evaluation of cost-benefit analysis should be based on its usefulness for disciplining agencies and enhancing the control of elected officials, not on its instantiation of ethical principles that elected officials may or may not share.").

15. See Posner, *supra* note 5, at 1146-47.

16. See Jeff Gimpel, Note, *The Risk Assessment and Cost-Benefit Act of 1995: Regulatory Reform and the Legislation of Science*, 23 J. LEGIS. 61, 68, 76 (describing difficulty encountered in quantifying benefits, and discomfort many experience in putting dollar figure on values such as prevention of premature death); Posner, *supra* note 5, at 1147 (stating that cost-benefit analysis "unavoidably involves estimates of hard-to-measure things, like human lives and environmental amenities, so that in practice a cost-benefit analysis may provide support for inefficient regulations").

and costs that are not comparable and cannot be weighed against each other.¹⁷ None of these possible manifestations or critiques of cost-benefit analysis need to be explored in this Article because monetizing costs and benefits is not the only means to employ the process of cost-benefit analysis. In describing cost-benefit analysis as a means to serve the democracy principle, outcomes need not be monetized. Quantitative and qualitative outcomes can all be explored in non-monetary terms. In addition, while comparisons can admittedly be difficult, the democracy principle requires that likely benefits and costs are properly documented and analyzed as part of the decision-making process. It is the process of explication and debate that is important.

While cost-benefit analysis has been accepted as a desirable process for decision-making in a democracy, a question surfaces: Has it been rigorously employed in the legislative process?

B. The Reality of Cost-Benefit Analysis in the Legislative Arena

To explore how cost-benefit analysis is in fact being employed in the legislative process, this Article examines Congress's last major deregulatory action: the 1999 Gramm-Leach-Bliley Act Financial Modernization Act (GLBA),¹⁸ otherwise described as the financial services modernization law. I focus on the claimed benefits of deregulation to consumers. Therefore, the evidence collected in this Article to examine the manner in which cost-benefit analysis is utilized by the Congress is evidence of these benefits. Consumer benefits were, in fact, the primary benefits claimed to have resulted from enactment of the GLBA.¹⁹ An exploration of evidence of costs, including adverse effects, of the enactment was not undertaken in this study but has been explored elsewhere.²⁰

17. See Matthew D. Adler & Eric A. Posner, Introduction, *Cost-Benefit Analysis: Legal Economic, and Philosophical Perspectives*, 29 J. LEGAL STUD. 837, 841 (2000) (“[I]t seems unlikely that the language of economics, or the mere use of the language of trade-offs, or monetization of incommensurables, can explain continuing opposition to cost-benefit analysis among academics and in public policy circles.”); Robert H. Frank, *Why is Cost-Benefit Analysis So Controversial?*, 29 J. LEGAL STUD. 913, 914 (stating that even proponents of cost-benefit analysis admit that comparing disparate categories is very difficult in practice).

18. Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12 U.S.C.).

19. *The Gramm-Leach-Bliley Act: Financial Services Modernization: Hearings Before the Senate Comm. on Banking, Hous., and Urban Affairs*, 106th Cong. 1 (1999) [hereinafter *Senate Hearings*] (statement of Sen. Phil Gramm).

20. Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215 (2002) (discussing risks of achieving “too big to fail” status, engaging in

Deregulation occurs in many forms. GLBA opened the banking, insurance, and securities markets to competitors in the formerly separate banking, insurance, and securities industries.²¹ The Act did not address the issue of deregulation of prices. However, prices in the securities industry—for example, brokerage fees and investment banking fees—were already set by the market. In the banking industry loan prices had always been set by the market and interest rates on deposit prices had been deregulated in the early 1980s.²² In the insurance industry the existence and extent of price regulation varies due to variations in state-by-state regulation. Term life, universal life, and annuity rates are not regulated.²³ A significant number of states, though, require either prior approval or conditional approval of rates for auto, home and commercial general liability insurance.²⁴

What were the expected benefits and costs of this financial services deregulatory initiative?

1. Evidence from the Committee Reports

An examination of the Committee Reports on the GLBA²⁵ reveals the manner in which cost-benefit analysis is being employed in the legislative arena. First, some benefits described in the Committee Reports were uncertain in meaning or likelihood of being realized. Yet no explanation of meaning was given in the Committee Reports, and likelihood of realization was barely discussed. For example, one benefit that was stated repeatedly was that the Act would “enhance competition in the financial services industry.”²⁶ Yet there was no explanation of the manner in which this was expected to occur or the magnitude of the expected effect. Was enhanced competition expected in deposit services, loans for consumers, loans for businesses,

high-risk activities in capital markets, and volatile earnings in capital market activities).

21. §§ 101–03, 113 Stat. at 1341–42 (affiliations and securities activities); §§ 121–22, 113 Stat. at 1373–81 (subsidiaries of national banks); §§ 301–04, 311–13, 113 Stat. at 1407–10, 1417–20 (insurance activities).

22. See Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 204, 94 Stat. 132, 143 (codified as amended at 12 U.S.C. § 3503 (1988)).

23. THE FINANCIAL SERVICES ROUNDTABLE, SPEED TO MARKET: INSURANCE, BANKING, SECURITIES REGULATION, at <https://www.fsround.org/speedtomarketchart.html> (June 18, 2001) (on file with the *New York University Journal of Legislation and Public Policy*).

24. *Id.*

25. H.R. CONF. REP. NO. 106-434 (1999); S. REP. NO. 106-44 (1999); H.R. REP. NO. 106-74, pts. 1–3 (1999).

26. H.R. CONF. REP. NO. 106-434, at 151; see S. REP. NO. 106-44, at 1; H.R. REP. NO. 106-74, pt. 1, at 97; *id.*, pt. 3, at 98.

securities brokerage, investment advice, investment banking services, insurance brokerage, or insurance underwriting? If so, then to what extent? Neither of these questions was answered. A more fundamental question with regard to the stated benefit of “enhanced competition” is: What, exactly, is the *benefit*? Competition is a means, not an end. What is the expected outcome of competition? The Committee Reports did not explain what outcomes were expected to result. Deregulation has been so widely accepted in part because competition has been treated as an end, a benefit per se.

At times, the Committee Reports spoke of a benefit of “improve[d] access to financial services.”²⁷ Perhaps this was the explanation of an expected benefit of increased competition. The Committee Reports did not make this connection clear, and, again, this benefit was not developed. Access to what services? As to such services, what was the expected magnitude of the change? These questions were never even asked.

Questions regarding the meaning and magnitude of “enhanced competition” and “improved access” would not have been idle questions in 1999. National banks had been authorized to serve as securities brokers since the mid-1980s.²⁸ Banks had also been authorized to serve as insurance brokers since the early 1990s.²⁹ Finally, to ensure competitive equality with national banks, forty-four states had authorized state chartered banks to serve as securities brokers, and forty-nine

27. H.R. CONF. REP. NO. 106-434, at 151–52; *see* S. REP. NO. 106-44, at 4 (“[O]verhaul of our financial services regulatory framework is necessary in order to . . . ensure that American consumers enjoy the best and broadest access to financial services.”).

28. *See* *Clarke v. Sec. Indus. Ass’n*, 479 U.S. 388, 409 (1987) (stating that Congress did not intend to subject bank securities business to branching restrictions imposed by 12 U.S.C. § 36(f)); *see also* *Sec. Indus. Ass’n v. Bd. of Governors of the Fed. Reserve Sys.*, 468 U.S. 207, 221 (1984) (holding that Federal Reserve Board’s determination that securities brokerage business limited in scope to buying and selling securities for customers is “closely related” to banking, consistent with Bank Holding Company Act); *Am. Bankers Ass’n v. SEC*, 804 F.2d 739, 741 (D.C. Cir. 1986) (noting that in 1982, Office of Comptroller changed its interpretation of Glass-Steagall Act by allowing national banks to create subsidiaries to offer retail discount brokerage services, to both banking and nonbanking customers, at branch offices of banks).

29. *See* *Indep. Ins. Agents of Am., Inc. v. Ludwig*, 997 F.2d 958, 959–961 (D.C. Cir. 1993) (holding that Comptroller’s determination that § 92 of National Bank Act imposes no geographic limit on insurance market of banks “located” in city with population of less than 5,000, thus freeing banks to solicit insurance customers anywhere, is consistent with congressional intent and prior interpretations by Comptroller); *Indep. Ins. Agents of Am., Inc. v. Bd. of Governors of the Fed. Reserve Sys.*, 890 F.2d 1275, 1284 (2d Cir. 1989) (holding that Federal Reserve Board’s decision that Bank Holding Company Act does not restrict bank subsidiaries from selling insurance, as permitted by state law, was reasonable interpretation of federal law).

states had authorized state chartered banks to serve as insurance brokers.³⁰ Therefore, was significant increased competition reasonably expected in securities brokerage or insurance brokerage? In addition, securities firms and insurance firms have always been able to merge, and in the past, they had not. Therefore, what would change after enactment of the GLBA?

As to competition in underwriting on the part of banks, securities underwriting and insurance underwriting are capital intensive industries. Few banks are large enough to engage in securities underwriting and insurance underwriting. Moreover, banks had already been permitted to acquire or establish securities affiliates to underwrite securities, subject to limits on gross revenues, among other things.³¹ Large banks had done this prior to the enactment of the GLBA.³² Finally, as to competition in the banking market, there were no limitations on offerings of loan products—for example, mortgage loans, consumer loans, credit cards, business loans—by non-bank entities. Insurance companies or securities firms could engage in these activities prior to the GLBA. The limitation was on the offering of deposits. Some insurance and securities companies had avoided even this limitation by owning a thrift institution and using the unitary thrift exception to prohibitions on non-bank activities by depository institutions.³³ Given these pre-GLBA legal structures and market developments, to what extent was increased competition in securities underwriting, insurance

30. *Senate Hearings, supra* note 19, at 103 (testimony of Catherine A. Ghiglieri, Banking Commissioner for the State of Texas); *see also* Lissa L. Broome & Jerry W. Markham, *Banking and Insurance: Before and After the Gramm-Leach-Bliley Act*, 25 J. CORP. L. 723, 749 (2000) (stating that number of states that allowed banks to operate insurance agencies increased from twenty-two to forty between 1995 and 1998).

31. *See* Constance Z. Wagner, *Structuring the Financial Service Conglomerates of the Future: Does the Choice of Corporate Form to House New Financial Activities of National Banks Matter?*, 19 ANN. REV. BANKING L. 329, 355–57 (discussing Federal Reserve Board's orders regarding § 20 of Glass-Steagall Act). Over the years the Board increased the amount of underwriting activity in which banks could participate to no more than twenty-five percent of total revenue. Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities, 61 Fed. Reg. 68,750, 68,752 (Dec. 30, 1996).

32. *Senate Hearings, supra* note 19, at 141 (testimony of Michael E. Patterson, Chairman, Financial Services Council) (stating that over forty-five banks had established so-called § 20 securities affiliates).

33. *See id.* at 74 (appendix to testimony of Ellen S. Seidman, Director, Office of Thrift Supervision) (“Of a total of over 600 unitary holding companies . . . 102 unitary companies were actively engaged in nonbanking activities [F]ewer than half . . . of the 102 companies engage in financial activities such as insurance sales and underwriting, investments, mutual fund management and investor services, and broker-dealer operations.”).

underwriting, or the bank loan market reasonably expected under the Act, and, who would benefit?

A third benefit repeatedly stated in the Committee Reports was “increased efficiency.”³⁴ In deregulatory initiatives, the benefits of enhanced competition and increased efficiency are often stated. Yet, these statements suffer from similar deficiencies. It is not clear what “increased efficiency” means. Does it mean, for example, that the same services are going to be provided to consumers while the provider employs fewer workers? Some constituents may not accept this outcome as a benefit. The one possible effect discussed in the Committee Reports that could be characterized as increased efficiency was eliminating the current administrative steps employed to deliver new financial products and services that produce costs that “are becoming increasingly burdensome.”³⁵ Yet this does not seem to be the only type of “efficiency” the Congress had in mind.

The point is that the term “efficiency” has many possible meanings, but little or no explanation was provided in the Committee Reports. In addition to the issue of meaning, there is the issue of benefit. What are the benefits of increased efficiency—particularly to the consumer? As is the case with the claim of increased competition, increased efficiency has been treated as a benefit per se—an end in itself rather than a means to an end (for example, public benefit). However, as a means to an end, we need to know (a) what will be the benefit (outcome), (b) who will receive the benefit, and (c) what is the expected magnitude of the benefit? For example, will consumers benefit from “efficiencies” through lower costs? Congress saw no need to explore these questions. Efficiency was assumed to be widely understood and widely accepted as a benefit per se.

The questions raised concerning the claim of “increased efficiency” are also not idle questions. The GLBA required a separation of banking, securities, and insurance activities into distinct corporate entities. Given this required separation, what “efficiencies” could be reasonably expected?

At one point in the Committee Reports a more specific benefit was voiced—“more choices and lower costs for consumers.”³⁶ This

34. S. REP. NO. 106-44, at 6 (1999). *See id.* at 4 (explaining that current restrictions “reduce incentives to develop new and more efficient products and services”); *id.* at 6 (quoting Alan Greenspan’s testimony that “without Congressional action . . . the market will force ad hoc administrative responses that lead to inefficiencies”).

35. *Id.* at 5 (quoting testimony of Alan Greenspan).

36. *Id.* at 6. *See also* H.R. REP. NO. 106-74, pt. 3, at 98 (1999) (“The primary objective . . . is to enhance consumer choice.”); S. REP. NO. 106-44, at 4 (1999) (quoting statement of Donna Tanoue, Chairman, Federal Deposit Insurance Corpora-

was one of the few benefits that was easy to comprehend.³⁷ Was it discussed or documented? No. Would it come to pass? That is the question examined in Part II of this Article.

However, before examining the experience under financial services deregulation further discussion of the use of cost-benefit analysis in the legislative area is required. What are possible explanations for such unsatisfactory application of cost-benefit analysis in the Committee Reports? One explanation is that specifics were discussed in congressional offices or committee meetings but never recorded. I don't know if this in fact occurred. But, it does not matter if it did. The reason for use of cost-benefit analysis as a process of legislative decision-making is the democracy principle. This requires public explication and discussion of benefits and costs. Secret discussions do not serve this purpose.

A second explanation is that public explication and discussion of costs and benefits did occur but did not find its way into Committee Reports. Instead, it could be found in Committee Hearings.

2. Evidence from the Committee Hearings

I examined the 1999 Committee Hearings³⁸ preceding the passage of the GLBA for explanation and documentation of the expected benefits mentioned in the Committee Reports, focusing on benefits that might be produced for consumers. Specifically, I searched for the meaning of and expected magnitude of the vague benefits of "enhanced competition in financial services" and "increased efficiency." I also searched for the type and magnitude of the more specific benefits of "improved access to financial services," and "more choices and lower costs for consumers." As part of that search, I was cognizant that whether potential benefits might be realized depends on three factors: ability, willingness, and acceptance. Substantial numbers of members of the industry must have the ability to engage in the activities that are expected to yield benefits. Substantial numbers of mem-

tion, that current system is "unable to provide the full range of financial services required by business and individual consumers").

37. The Committee Reports also spoke of benefits not directed at consumers, such as "enhanc[ing] safety and soundness . . . by requiring that banks may not participate in the new financial affiliations unless the banks are well capitalized and well managed." H.R. CONF. REP. NO. 106-434, at 151-52 (1999). See also S. REP. NO. 106-44, at 4 (explaining that new legislation is necessary "to preserve the safety and soundness of our financial system").

38. *Senate Hearings*, supra note 19; *House Banking Hearings*, supra note 4; *The Financial Services Act of 1999 Before the Subcomm. on Fin. and Hazardous Materials of the House Comm. on Commerce*, 106th Cong. (1999).

bers of the industry must also have the willingness to undertake those activities. Finally, a substantial segment of the public must accept the firms' overtures. Absent one of these factors, the expected benefit will be modest or nonexistent. Did the members of Congress explore these issues when considering specific benefits professed to flow from the proposed legislation?

a. Enhanced Competition

In the Committee Hearings there was some explanation of the types of benefits expected from enhanced competition. There was, however, no examination or documentation of the extent of enhanced competition expected or the likelihood of resultant benefits. Typical is the statement of Michael E. Patterson of J.P. Morgan:

[T]he progress that financial services providers have made in adapting to market forces has been facilitated by regulatory initiatives, but at a painfully slow pace, retarded by lengthy litigation, and encumbered by burdensome restrictions. The loss of the benefits of competition and convenience to consumers, as well as the loss of economic value to U.S. financial services companies, has been enormous.³⁹

This is a very general statement. Perhaps Mr. Patterson was providing one explanation for a type of benefit expected—increased value in and to U.S. financial services companies. Other than that, there is no other explanation, including no documentation of the expected benefit.

A similar explanation of benefit to the industries involved was voiced by others but was focused on the banking industry. For example, Texas Savings and Loan Commissioner James L. Pledger noted:

Banks and other depository institutions over the past decades have continually lost market share to less regulated competition. And these businesses have gained market share at the expense of banks because they face much less regulatory intrusion than their banking competitors, and because of pervasive statutes like Glass-Steagall that limit the ability of banks to compete.⁴⁰

39. *Senate Hearings, supra* note 19, at 141.

40. *Id.* at 30. *See also id.* at 142 (statement of E. Lee Beard, Chair, America's Community Bankers) (discussing how improved competitive opportunities for banks and bank holding companies allow them to meet demand for diverse array of financial services); *id.* at 278–79 (statement of Hjalma E. Johnson, President-Elect, American Bankers Association) (discussing decrease in market share of total assets held by banks and thrifts); *House Banking Hearings, supra* note 4, at 42 (statement of R. Scott Jones, President, American Bankers Association) (“Because we can’t offer customers the products they want, many are taking their business to other providers.”).

A second explanation of the type of benefit resulting from increased competition related it to the benefits of new products and services to be discussed below. Marc E. Lackritz of the Securities Industry Association made this connection:

Our securities industry in the United States is perhaps as competitive as any industry in the world. That competition, which includes the ability to affiliate with entities other than banks, is one reason why the U.S. capital markets are the world's largest and most liquid. In the securities markets, one need only look at the vast choices in products, services, providers, and methods of compensation to see how competition has greatly benefited investors and consumers. Passage of financial services modernization legislation would bring the benefits of this competition to the entire financial marketplace.⁴¹

As noted earlier in this Article, whether increased competition would result was not a certainty. In fact, the refrain regarding the likelihood of enhanced competition as between the insurance and securities industries, was stated by one representative of the insurance industry. James D. Ericson, speaking on behalf of a consortium of insurance groups,⁴² noted, "From the standpoint of affiliation powers, most insurance companies are not in need of modernization legislation at all. We have always been able to affiliate with securities firms and, since the late 1960s, have been able to control a single thrift institution if we wish a banking capability."⁴³

Similarly, the refrain that increased competition in brokerage services may not result because agency type activities in securities and insurance were already authorized and being provided by many banks was voiced by Federal Reserve Chairman Greenspan. When asked about a distinct issue—that of requiring all nonbank activities to be conducted by a bank affiliate rather than a subsidiary—he noted:

Well, remember that most of the smaller banks are doing agency type of activities and they don't have a holding company, they don't need them. They would if they were to engage in merchant banking or insurance underwriting, or securities underwriting. But

41. *Senate Hearings*, *supra* note 19, at 164–65. *See also House Banking Hearings*, *supra* note 4, at 40 (statement of Roy J. Zuckerberg, Chairman, Securities Industry Association) (explaining that increased competition will give customers more choices).

42. These groups included the American Council of Life Insurance, American Insurance Association, Alliance of American Insurers, National Association of Independent Insurers, and the National Association of Mutual Insurance Companies. *Senate Hearings*, *supra* note 19, at 218.

43. *Id.* at 219.

I submit to you that there are very, very few community banks, in my judgment, who have any interest in that whatsoever.⁴⁴

Given these refrains, there was certainly a need for some documentation or explanation of the expected type and magnitude of competition under the proposed legislation. As to documentation of results, this would require documentation of the expected cross-industry activity as well as the expected results. There was no evidence of the increase in cross-industry activity expected, neither the type of activity expected nor the amount of expansion. Instead the Committee Hearings contained only some evidence to the contrary.

Turning away from the issue of whether increased competition would result, we come to the issue of what benefit would be produced. Some benefits were mentioned but almost none documented. The one exception was an expectation of consumer savings. Chairman Leach of the House Committee on Banking and Financial Services tied increased competition to expected consumer savings of \$15 billion annually.⁴⁵ This concrete documentation of benefit is discussed below.

b. Increased Efficiency

Most statements regarding “efficiency” in the Committee Hearings were extremely vague. They provided almost no explanation of the expected outcome. They also did not, of course, try to document or quantify the benefits of increased efficiency. Typical is the testimony of Michael E. Patterson of J.P. Morgan: “As a result of developments in information technology, institutional savings, product innovation, and customer preferences, banking, securities, and insurance products are increasingly similar and competitive with each other. It is inefficient to providers and customers alike to treat them as if they were separate and unrelated.”⁴⁶

The only explanation for the benefit of “efficiency” that was offered was that the proposed bill would avoid the costs of regulatory approvals that are currently required for some activities,⁴⁷ such as lim-

44. *House Banking Hearings*, *supra* note 4, at 124.

45. *Id.* at 1–2. *See also id.* at 40 (statement of Roy J. Zuckerberg, Chairman, Securities Industry Association) (“Increased competition . . . will reduce costs, give customers more choices and help the U.S. financial services industry maintain its preeminent status in the global economy . . .”).

46. *Senate Hearings*, *supra* note 19, at 141 (statement of Michael E. Patterson, Chairman, Financial Services Corporation); *see also id.* at 266 (statement of Robert W. Gillespie, Vice-President, The Bankers Roundtable) (suggesting that changing law to permit firms to offer diverse product lines would eliminate inefficiencies).

47. *House Banking Hearings*, *supra* note 4, at 102 (statement of Alan Greenspan, Chairman, Federal Reserve System) (“[O]ur financial institutions have been required to take elaborate steps to develop and deliver new financial products and services.”);

ited securities underwriting by affiliates of banks. It seems unlikely that this was all that Congress had in mind when it spoke of the efficiency that would likely result from the proposed legislation. Yet, no other explanation was provided.

It is not that explanations of the possible efficiencies expected from cross-industry activities were unavailable. Finance professionals and economists could easily have provided an explanation.⁴⁸ In addition, there were sources of activity that might be used to document increased efficiency. Prior to 1991, some states had permitted state chartered banks to underwrite insurance or securities.⁴⁹ Was there no evidence of the effect of such activity? Abroad, universal banks had existed for many years. Was there evidence of resultant efficiencies in operations? Indeed there was, but it did not prove efficient operations.⁵⁰ However, this evidence was not mentioned in the Congressional Hearings, except in passing.⁵¹ Members of Congress neither sought out nor otherwise provided any explanation.

c. Lower Costs for Consumers

As noted above, the Committee Hearings suggested that lower costs would be the result of increased competition. It is possible that lower costs to consumers might be expected from increased efficiency because it would make the lower costs to consumers possible. Unlike all other benefits explored in the Committee Hearings, the expected benefit of lower costs for consumers was the only one for which docu-

see also Senate Hearings, supra note 19, at 279 (statement of Hjalma E. Johnson, President-Elect, American Bankers Association) (explaining that current framework makes process of offering products customers want more difficult and expensive).

48. *See, e.g.,* James R. Barth et al., *The Repeal of Glass-Steagall and the Advent of Broad Banking*, 14 J. ECON. PERSP. 191, 198 (2000) (suggesting that scope economies would allow banks to increase profitability); ANTHONY M. SANTOMERO & DAVID L. ECKLES, THE DETERMINANTS OF SUCCESS IN THE NEW FINANCIAL SERVICES ENVIRONMENT: NOW THAT FIRMS CAN DO EVERYTHING, WHAT SHOULD THEY DO AND WHY SHOULD REGULATORS CARE? 3–4 (Fin. Insts. Ctr, The Wharton School, Working Paper No. 00-32, 2000) (discussing operating cost advantages of broad financial firms and anticipated revenue from customer consumption of multiple products).

49. *See* Arthur E. Wilmarth, Jr., *The Expansion of State Bank Powers, the Federal Response, and the Case for Preserving the Dual Banking System*, 58 FORDHAM L. REV. 1133, 1177–78 (1990) (citing surveys indicating that twenty-six states allow banks to underwrite some types of “bank-ineligible” securities and six states allow banks to engage in insurance underwriting not permitted to national banks).

50. *See* HELEN A. GARTEN, U.S. FINANCIAL REGULATION AND THE LEVEL PLAYING FIELD 54 (2001) (explaining that many observers of global financial markets concluded that size of financial institutions, as measured by assets, is not key to success).

51. *See House Banking Hearings, supra* note 4, at 142 (statement of Alan Greenspan, Chairman, Federal Reserve System) (arguing that rates of return for European “universal banks” have not been good due to banks’ inferior structures).

mentation was provided. Several industry representatives testified that the proposed legislation would yield a savings of \$15 billion per year for consumers.⁵² This figure was repeated by Representative Leach.⁵³ It was not based on any studies that the witnesses had conducted, perhaps through industry associations. It was based exclusively on the testimony of Treasury Secretary Rubin in 1997. Before we examine that 1997 testimony, it is important to note that Secretary Rubin never reiterated that \$15 billion cost saving figure in his 1999 testimony. More importantly, he was never asked about it by Committee members when he testified in 1999.

Turning to the documentation offered, the \$15 billion figure comes from testimony of Secretary Rubin before the Housing Banking Committee on June 3, 1997.⁵⁴ The testimony was as follows:

The Bureau of Economic Analysis has estimated American consumers spent nearly \$300 billion on brokerage, insurance and banking services in 1995. While it would be hard to judge exactly what would result from financial modernization, if you take 1 percent of that, you've got \$3 billion. If you take a number we consider not to be unreasonable, 5 percent, you have \$15 billion—and that just refers to consumers, it does not refer to business users of financial services. The people who prepared the statistics say that the inclusion of business uses of financial services would very substantially increase that number, perhaps as much as double it.⁵⁵

The testimony reveals no basis for the five percent figure other than an assumption or guess on the part of staff members at the Treasury.

In 1997, when the testimony was given, it was questioned by several members of Congress. Representative Waters discussed the results of a Consumers Union Report that noted that bank fees had increased more than fifty percent since 1990 and that with financial services modernization fees would continue to increase.⁵⁶ Secretary Rubin's response was only that he believed, based on his past experi-

52. *Senate Hearings, supra* note 19, at 204 (statement of Michael E. Patterson, Chairman, Financial Services Council); *House Banking Hearings, supra* note 4, at 8 (statement of David H. Komansky, Chairman, Merrill Lynch); *House Banking Hearings, supra* note 4, at 284 (statement of Michael E. Patterson, Chairman, Financial Services Council); *House Banking Hearings, supra* note 4, at 316 (statement of Roy J. Zuckerman, Chairman, Securities Industry Association).

53. *House Banking Hearings, supra* note 4, at 1–2.

54. *Financial Modernization—Part II: Hearings Before the House Comm. on Banking and Fin. Servs.*, 105th Cong. 128 (1997) (statement of Robert E. Rubin, Secretary, U.S. Department of the Treasury).

55. *Id.* at 129.

56. *Id.* at 149.

ence in the securities industry, that increased competition would lead to lower fees. He noted:

On the question you raised, Congresswoman Waters, with respect to the increased fees, that is precisely the kind of an issue, it seems to me, our proposal does address, because we are advocating increased competition, and I think the best answer to increased fees is increased competition.

With respect—maybe the prime example I would point to is the effort that the securities industry made in the late 1960's [sic] and 1970's [sic]—and I was very much a part of it at the time—to protect fixed commissions because it was in our interest. And soon as you had negotiated commissions, commissions came way down. I think here too, increased competition will tend to militate in that direction.⁵⁷

Similarly, Representative Castle also questioned whether savings would be seen by consumers, and, if so, which consumers were expected to benefit. He noted:

With respect to savings to consumers that [Secretary Rubin] spoke about, you spoke about 1 percent or 3 percent, I worry about who the consumer is, maybe somewhat along the lines of what Ms. Waters has said before. I mean, clearly when brokerage firms started breaking down fees, those who had investments started to save some money. But I do look at such things as automatic tellers, which are now imposing greater fees, and banking fees.

Is there a group of people who are not going to benefit from this at all, but with the increased competition and the desire for the greater dollar or whatever, that they are going to devise ways of—I don't want to say "gouging," but of assessing fees on a small basis? Will we truly have savings?

I can imagine some of the ways we might have savings, but I would like a little more articulated reassurance in that area.⁵⁸

Secretary Rubin acknowledged the issue but then stated categorically, with no explanation, that with new competition no one would be disadvantaged. Specifically, his response was:

It may be something that we haven't thought of, but it seems to me—and maybe we have missed something—that when you introduce new competition into an area, I can see that it may apply unevenly so that some people may benefit more than others. But it is hard for me to see where anybody would be disadvantaged

On the ATM issue, for example, I would think that the more competition and more competitive pressures you have, the more alter-

57. *Id.* at 150.

58. *Id.* at 151.

native ways people are going to be offered to do the same kind of things you do at an ATM, and the more chance you have of getting those fees back down, I would guess.⁵⁹

The full text of Secretary Rubin's testimony reveals that the stated cost savings was merely a guess—an assumption of savings used to arrive at some figure. No experience from the banking or insurance industries was used to support the result. The only experience that was stated as support for some possible cost savings, although not for the five percent figure, was the experience of the securities brokerage industry with fixed commissions.

In the 1999 Committee Hearings there was additional evidence regarding the claimed benefit of cost savings for consumers. Namely, several witnesses offered evidence to disprove cost savings.

As discussed earlier, the new securities underwriting and insurance underwriting powers would be able to be embraced only by large banks. However, John E. Taylor of the National Community Reinvestment Coalition noted that the Federal Reserve's annual survey of fees reported year after year that large banks charged higher fees, not lower ones, than their smaller counterparts.⁶⁰ He questioned, therefore, whether efficiencies translate to cost savings for consumers or whether competition truly leads large institutions to lower costs to consumers. Representative Meeks raised the same point, citing the example of Chase, Citigroup, and Fleet.⁶¹ Edmund Mierzwinski of the U.S. Public Interest Research Group also raised the same point, citing not only the Federal Reserve Board's survey, but also PIRG's own survey.⁶² Interestingly, the benefit was accepted in the final Committee Reports based on Secretary Rubin's guess, with this contrary evidence ignored.

d. Improved Access

The Committee Hearings did offer explanations of the types of improved access expected from the proposed legislation. They did not offer evidence of the magnitude of the expected effects—for example, to what extent are financial markets currently underserved, and how likely is it that new players will target such underserved markets?

59. *Id.*

60. *Senate Hearings, supra* note 19, at 190.

61. *House Banking Hearings, supra* note 4, at 137.

62. *Id.* at 165. *See also id.* at 602 (statement of Deborah Goldberg, Neighborhood Reinvestment Specialist, Center for Community Change) (“Survey after survey has shown that bigger banks charge higher fees for basic banking services.”).

As to the explanations provided, improved access to financial services was a concept with several meanings in the Committee Hearings. One meaning was that the proposed legislation would increase the opportunity for a “small town bank . . . to offer a full range of products that are currently offered by all the different sectors of the business.”⁶³ This was a meaning with relevance in underserved geographical markets such as rural areas.

A second claim (meaning) was the convenience of one-stop shopping. This would not be limited to geographic areas with few current financial service providers. As Marc E. Lackritz of the Securities Industry Association explained:

[A] well-balanced version of financial services modernization legislation would also give customers more choices. Many individual and institutional customers worldwide are demanding to have all their financial needs met by a single firm. The ability of securities firms, insurance companies, and banks to affiliate would allow a single financial services firm to meet those needs Many of the cross-industry acquisitions of securities firms by banks allow one institution to provide a broader range of products and services to its customers.⁶⁴

A final claim was that affiliation would allow offering of products or services that would be otherwise unavailable because they are uneconomical without affiliation. The example provided was Aetna Life Insurance Company’s experience in Mexico. As Richard L. Huber of Aetna explained:

Mexico is one of our most successful markets
We partnered with Bancomer, Mexico’s largest retail bank, to provide the distribution mechanism for our product. Initially, we used the traditional agency distribution network. Then in 1997 as Mexico privatized its social security system, we decided to use the bank’s 1,000-plus branch network to reach the largest possible share of the market.
Seeing the tremendous success of this model, we set up a separately chartered insurance company with the same back office as our existing company to sell inexpensive, plain vanilla auto, homeowners

63. *Senate Hearings*, *supra* note 19, at 23 (statement of Robert E. Rubin, Secretary, U.S. Department of the Treasury).

64. *Id.* at 275. *See also id.* at 206 (statement of Michael E. Patterson, Chairman, Financial Services Council) (explaining that revised financial services laws would give consumers more convenient access to greater number of products and services); *House Banking Hearings*, *supra* note 4, at 337 (statement of ABA Insurance Association) (“Increasingly, our customers demand a mix of financial products and services [C]ross-marketing opportunities that will flow from such affiliations [between banking and insurance firms] would enable us to meet these demands.”).

and life insurance through the same branch network. We expected to draw some of our agency-distributed business, but we felt it was a worthwhile experiment.

The results were very interesting. The bank sales strategy reached an entirely new market segment, lower- and lower/middle-class Mexicans who were never reached by the traditional, higher cost distribution system. Now tens of thousands of Mexicans are participating in the insurance market, protecting their families from devastating catastrophic expenses, generating savings and creating security options.⁶⁵

Ms. Huber further explained the financial barriers that would exist absent affiliation.

The first financial services product that an individual buys when he or she breaks into that lowest level of the lowest part of the middle class, is life insurance.

And, typically, they are relatively small policies, sometimes they are the equivalent of \$2 a week or something like that. And they don't—they are really not serviced today. To the agent, it is just not attractive business. So . . . to have it available and service that population through a branch network to me is a very appealing opportunity.⁶⁶

Other witnesses disputed the claim of increased access to products and services based on experience with large financial institutions. First, evidence was introduced that large banks target wealthy and other more profitable customers for better access and better deals.⁶⁷ This is contrary to the assumption or claim of broad access for rural areas and modest income customers that was discussed earlier. Instead, access would depend on profitability.

Second, evidence was introduced that mergers and acquisitions in the banking industry led to a decline in small business lending by the resultant large banks.⁶⁸ This decline resulted because such lending requires knowledge of community residents and businesses that only local loan officers possess. Thus, the possibility of less access to some products and services was explained and documented.

Similarly, evidence was introduced that large banks had, at times, discontinued support for products, with a resultant anticompetitive ef-

65. *House Banking Hearings*, *supra* note 4, at 15–16.

66. *Id.* at 38.

67. *Id.* at 163, 543–44 (statement of Mary Griffin, Insurance Counsel, Consumers Union).

68. *Senate Hearings*, *supra* note 19, at 329 (statement of John E. Taylor, President, National Community Reinvestment Coalition) (discussing results of number of studies).

fect. William L. McQuillan of the Independent Bankers Association of America presented the example of Citigroup and Visa:

The merger and acquisition wave, which this legislation would accelerate, is already having an anticompetitive effect on ATM networks and credit and debit card markets. As you know, Citigroup Chairman John Reed recently resigned from the Visa board and announced that Citi will no longer support the Visa brand. Literally, the erosion of this brand would undercut the competitive entry of thousands of community banks, thrifts, and credit unions into the credit and debit card markets.⁶⁹

As with other benefits, members of Congress heard but discounted evidence that cast doubt the expected benefit of improved access. They instead accepted the likelihood of the benefit based on evidence of just one example, from just one form of access. The other forms of improved access to financial services were assumed to result and assumed to be substantial. No evidence was presented or demanded.

e. New Products and Services

Congressional Hearings prior to passage of the GLBA could not predict the type of products or services that would result from consolidation of the banking, insurance, and securities industries. They could, however, attempt to explain why this was an expected benefit. The recurring explanation provided in the Committee Hearings was that, in the past, competition in the various distinct sectors of the financial services industry has spurred innovations. Typical is the statement of Marc E. Lackritz of the Securities Industry Association:

In the securities markets, one need only look at the vast choices in products, services, providers, and methods of compensation to see how competition has greatly benefited investors. Consumers can invest in stocks, bonds, and thousands of mutual funds. They can choose a full-service provider or a financial planner to receive advice on managing their assets. More independent and knowledgeable investors can use a discount firm to execute their transactions. Or they can make their trades electronically over the Internet for a fraction of the cost of just a few years ago. Investors can choose to compensate their broker in a traditional commission arrangement, a flat fee basis, or as a percentage of assets under management. These changes greatly benefit investors and they are the direct result of a highly diverse, competitive industry that is willing and able to invest the capital needed to meet the demands of its customers. Passage of financial services modernization legislation would

69. *Id.* at 144.

bring the benefits of competition . . . to the financial services marketplace.⁷⁰

The testimony of David H. Komansky of Merrill Lynch provided examples of new products and services produced due to competition across industry lines:

Consumer needs have prompted the development of financial services that were rare or unknown not long ago—services like mutual funds, money market accounts, credit cards, mortgages, individual retirement accounts, home equity loans, stored value cards, and a variety of products geared to the business owner. Many of these new products are the result of an increasing level of competition by financial services providers across industry lines, providing alternatives to services once available only from a single source.⁷¹

What is interesting about the examples given is that they all resulted either from (a) consumer demands alone, without assistance from cross-industry competition or synergy, or (b) consumer demands, cross-industry competition, and barriers to duplication that required innovation. Variations in terms of mortgages is a good example of the former. The mutual fund and money market accounts are good examples of the latter. The new products and services did not result from new capabilities following consolidations across industry lines. In fact, some of the examples offered might be examples of products that would not have been created or would not have been so widely marketed and accepted unless there existed cross-industry competition resulting from barriers to consolidation.

The only explanation for new products and services made possible due to consolidation is a very vague one. Alan Greenspan explained:

Technologically driven proliferation of new financial products that enable risk unbundling have been increasingly combining the characteristics of banking, insurance, and securities products into single financial instruments. These changes, which are occurring all over the world, have also dramatically altered the way financial services providers operate and the way they deliver their products.⁷²

Members of Congress never questioned Chairman Greenspan about this claim. No one asked for an explanation of the type of products or services he was discussing. No one asked for an example. No one questioned how significant the stated instrument or instruments

70. *Id.* at 275.

71. *House Banking Hearings*, *supra* note 4, at 266–67.

72. *Id.* at 102.

were or were expected to be in the financial services industry. However, these are all questions that cost-benefit analysis demands.

In summary, neither the Committee Reports or Committee Hearings⁷³ demonstrate true cost-benefit analysis on the part of Congress. Benefits were often stated without explanation. Benefits were accepted without documentation. Critical questioning of witnesses discussing benefits was missing. Thus, stated benefits were largely assumed to result and assumed to be significant. A possible explanation for this failure is that no useful evidence existed. This is not the case. Analogous situations had been studied. One analogous situation involves the consequences of industry consolidation and the emergence of larger banking institutions. After all, cross-industry horizontal and vertical integration under the GLBA would produce large financial institutions. Researchers had documented that such large institutions were not more efficient,⁷⁴ did not offer consumers benefits in the deposit product market, such as lower fees or higher deposit interest rates,⁷⁵ and did not increase access to loan products, such as small business loans.⁷⁶ Instead, consumer benefits were lost.

Nonetheless, this evidence was not heard. Rather, benefits were assumed. Whether experience proved these assumptions to be justified is explored in Part II of this Article. The focus in Part II is on the

73. These are the two sources in which data or examples of expected effects are most likely to be found. I also researched the floor debates on the GLBA. It is less likely that evidence would be presented in the floor debates, as opposed to mere enumeration of expected benefits. In fact, the floor debates contained a repetition of only one piece of evidence for expected benefits—the \$15 billion per year expected cost savings to consumers discussed in this article. 145 CONG. REC. S13,889 (daily ed. Nov. 4, 1999) (statement of Sen. Grams); *id.* at H11,514 (statement of Rep. Sessions, incorrectly stating estimated cost savings was \$18 billion); *id.* at H11,520 (statement of Rep. Royce, also mistakenly stating estimated cost savings to be \$18 billion); *id.* at H11,539 (statement of Rep. Vento); *id.* at H11,548 (statement of Rep. Towns); *see also* discussion *supra* Part I.B.1.c.

74. *See* Arthur E. Wilmarth, Jr., *Too Good To Be True? The Unfulfilled Promises Behind Big Bank Mergers*, 2 STAN. J. L. BUS. & FIN. 1, 14–22 (1995) (discussing studies documenting that large bank mergers result in slight decline in overall cost efficiency or no advantage in efficiency).

75. Robin A. Prager & Timothy H. Hannan, *Do Substantial Horizontal Mergers Generate Significant Price Effects? Evidence From the Banking Industry*, 46 J. INDUS. ECON. 433, 450 (1998) (finding that merging banks tend to significantly decrease retail deposit interest rates). Federal Reserve data had also disclosed that larger banks charged significantly higher average fees on retail deposits and related services. *See* Wilmarth, *supra* note 74, at 32. *See also* BIG BANKS, BIGGER FEES: THE 1999 PIRG BANK FEE SURVEY (Oct. 1999), available at <http://www.pirg.org/reports/consumer/bankfees/index.html> (on file with the *New York University Journal of Legislation and Public Policy*).

76. *See* Wilmarth, *supra* note 74, at 36–41 (summarizing existing studies regarding small business lending).

stated benefits of enhanced competition and improved efficiency, and on the consumer benefits of lower costs, new products and services, and improved access.

II.

LEGISLATIVE DEREGULATION AS BENEFIT TO CONSUMERS

“In a substantial majority of cases, the average fees charged by multistate [depository institutions] are significantly higher than those charged by single-state organizations.”⁷⁷

A. *Policy Makers and Assumed Consumer Benefit*

The 1990s have witnessed a surge in legislative proposals to deregulate markets. Policymakers have touted the benefits of deregulation—increased competition leading to benefits for consumers. Consumer benefits, usually in the form of lower cost, was assumed to result from all deregulatory initiatives.

As discussed in Part I of this Article, this was the primary justification for financial services deregulation in 1999. As Senator Gramm, one of the primary sponsors of the legislation, noted:

[M]y goal is to put together a bill that will provide greater diversity and financial services at a lower price to American consumers. If this bill does not meet the test of providing benefit in terms of a greater diversity and availability of product, if it does not meet the test of providing a lower cost for those products, for the people who do the work and pay the taxes and pull the wagon in America, then it would be my view that we have failed in this bill. That, I think, is the test that we need to use in order to judge our success or lack thereof on this bill.⁷⁸

Chairman Greenspan reiterated the belief that deregulation would benefit consumers.⁷⁹

These are not claims that were voiced solely with regard to financial services legislation. The other large-scale deregulatory effort of the 1990s—the deregulation of telephone and cable markets in the Telecommunications Act of 1996—was similarly aimed at providing, and assumed to provide, benefits to consumers. The House Report on the legislation stated:

77. BD. OF GOVERNORS OF THE FED. RESERVE SYS., ANNUAL REPORT TO THE CONGRESS ON RETAIL FEES AND SERVICES OF DEPOSITORY INSTITUTIONS 2 (1999), available at <http://www.federalreserve.gov/boarddocs/RptCongress> (on file with the *New York University Journal of Legislation and Public Policy*).

78. *Senate Hearings*, *supra* note 19, at 1.

79. *See House Banking Hearings*, *supra* note 4, at 143.

Technological advances would be more rapid and services would be more widely available and at lower prices if telecommunications markets were competitive rather than regulated monopolies. Consequently, the Communications Act of 1995 opens all communications services to competition. The result will be lower prices to consumers and businesses, greater choice of services, more innovation, a competitive edge for American businesses, and less regulation. Indeed, the enormous benefits to American businesses and consumers from lifting the shackles of monopoly regulation will almost certainly earn the Communications Act of 1995 the distinction of being the most deregulatory bill in history.⁸⁰

The latest deregulatory initiative at the federal level—deregulation of the electric utility industry—is similarly being presented as a benefit to consumers.⁸¹

In all of these initiatives it has been repeatedly assumed that competition yields consumer benefits, in the form of lower prices and better services. Is this assumption valid? Do deregulatory efforts actually yield substantial consumer benefits? Do they inevitably yield consumer benefits? These questions are examined through the U.S. experience with the financial services modernization legislation.

B. The Evidence—Financial Services Deregulation Two Years Later

The Committee Hearings identified the consumer benefits expected from financial services legislation. Enhanced competition and efficiency were two expected benefits. These, in turn, were expected to produce lower costs for consumers, improved access to financial services (by, for example, reaching underserved areas, providing one-stop shopping, and providing products that are otherwise uneconomical), and new products and services. Whether these benefits have been realized, and, if so, to what extent they have been realized is examined below.

1. Competition

One measure of the effect of the GLBA on competition in financial services is the number of financial holding companies created.

80. H.R. REP. NO. 104-204, at 48 (1995).

81. *Power Politics Lawmakers Fail in Effort to Deregulate Electricity, Spur Competition*, 56 CONG. Q. 2000 ALMANAC 13-3, 13-7 (“In his July 1 radio address, the president said his plan would save consumers \$20 billion a year. In theory, retail restructuring would allow competition that would give homeowners choices among power sellers, driving down prices and making service more reliable.”). The proposed legislation would open the retail market to competition by 2003. *Id.*

The financial holding company is a new entity authorized by the statute that is the vehicle for engaging in cross-industry activities. A significant number of banks have formed financial holding companies, but few insurance companies or securities firms have chosen to do so. Approximately 570 domestic and 24 foreign bank organizations have formed financial holding companies.⁸² Most of these new financial holding companies are small firms.⁸³ However, almost all of the largest banks have chosen to become financial holding companies.⁸⁴ By contrast, only about five of the firms electing financial holding company status are not bank holding companies.⁸⁵ These include Charles Schwab, which acquired U.S. Trust, and MetLife, which acquired a small bank.⁸⁶

Thus, the data from financial holding companies evidences a very modest interest in cross-industry activity on the part of the securities industry and on the part of the insurance industry. Even on the part of the banking industry, the figure of approximately 600 financial holding companies overstates the matter. The Federal Reserve Board reports that only seventy-one of the existing financial holding companies report activities that require the GLBA.⁸⁷

In addition to evidence of increased competition based on data regarding financial holding companies, some evidence is available of cross-industry activity based on government filings and industry news reports. This is not identical in make-up to the data regarding financial holding companies, since some cross-industry activity was author-

82. Governor Mark W. Olson, Remarks before the American Law Institute and American Bar Association (Feb. 8, 2002), at <http://www.federalreserve.gov/board-docs/speeches/2002/20020208/default.htm> [hereinafter Remarks of Governor Olson] (on file at the *New York University Journal of Legislation and Public Policy*). This is out of a total of more than 5,100 bank holding companies in existence. Joe Van Walleghem, *Financial Modernization: A New World or Status Quo?*, FIN. INDUS. PERSP., Dec. 2001, at 49.

83. Of the financial holding companies formed, 460 have \$1 billion or less in assets and a substantial segment have less than \$150 million in assets. See Remarks of Governor Olson, *supra* note 82.

84. *Id.* (stating that twenty-four of twenty-five largest bank holding companies have chosen financial holding company status). See also Van Walleghem, *supra* note 82, at 52 (noting that banking assets held by companies that have converted to financial holding companies represent about two-thirds of total domestic banking assets).

85. *Regulators' Counsel Address GLB Act Effects*, 1941 FEDERAL BANKING LAW REPORTS 6-7 (2001) (quoting Remarks of J. Virgil Mattingly, Jr., Federal Reserve General Counsel, before American Law Institute and American Bar Association).

86. Remarks of Governor Olson, *supra* note 82 (noting also that two securities firms acquired small banks). There had also been the earlier merger of Citicorp, Travelers, and Salomon. *Id.*

87. *Id.*

ized prior to the GLBA⁸⁸ and could continue to be conducted in a non-financial holding company format. One common vehicle was acquisition or formation of a thrift institution and formation of a unitary thrift holding company. The Office of Thrift Supervision reported that of a total of eighty-five applications for new thrift charters by applicants engaged in non-banking activities during the period January 1, 1997 to May 31, 2001, forty-five were filed by insurance companies, and fifteen by securities firms.⁸⁹ In fact, two of the case studies presented below, State Farm and Merrill Lynch, involve firms that have not elected financial holding company status but have entered the banking market. Discussed below are developments in each industry.

a. Bank Entry Into Insurance and Securities

The banking industry has demonstrated significant interest in the securities market, increasing its presence in investment banking and securities brokerage activities. It has demonstrated a more limited form of interest in insurance, limiting itself to insurance brokerage activity and, more specifically, brokerage of annuities and life insurance products.

In the securities arena, banking firms had formed § 20 affiliates prior to passage of the Gramm-Leach-Bliley Act.⁹⁰ Those affiliates have now become part of financial holding companies, and are no longer subject to the earlier restrictions on amount of permissible underwriting each year.⁹¹ In recent years, there have also been several acquisitions of major United States securities firms by banks, especially foreign-based banks.⁹² By the end of 2001, bank-affiliated in-

88. See *supra* notes 28–33 and accompanying text.

89. OFFICE OF THRIFT SUPERVISION, APPLICATIONS FOR NEW THRIFT CHARTERS (2001) (on file with the *New York University Journal of Legislation and Public Policy*).

90. Wagner, *supra* note 31, at 355–58; see also *supra* note 32.

91. See Wagner, *supra* note 31, at 359–60.

92. See, e.g., Niamh Ring, *Europe Casts Acquisition Net on U.S. Firms*, AM. BANKER, Feb. 12, 2001, at 5A (stating that UBS acquired PaineWebber, and Credit Suisse acquired Donaldson, Lufkin & Jenrette).

vestment banking firms topped the list of revenue producers in the industry.⁹³

Apart from securities underwriting, other securities activities might include bank-owned and advised mutual funds and securities brokerage activity. With regard to mutual fund activity, assets under management in bank-owned funds grew from \$125 billion at the end of 1996 to \$217 billion in the second quarter of 2001.⁹⁴ However, bank funds' market share was virtually unchanged.⁹⁵ Involvement in overall sales of mutual funds by banks has increased but peaked in 1998, before passage of the GLBA. It more than doubled from 1995 to 1998, rising from \$19.2 billion to \$46.3 billion, but has retained a healthy level of \$45.5 billion in 1999 and \$40 billion in 2000.⁹⁶

Turning to bank involvement in securities brokerage activities, there have been a substantial number of acquisitions of existing securities firms. Of the mergers and acquisitions involving all United States securities firms (whether investment banking firms, brokerage firms or otherwise) banks were the buyers in twenty-nine percent of the 126 deals announced in 1999, and thirty-six percent of the 120 deals announced in 2000.⁹⁷

Among the largest banking institutions, all commercial banks and almost all thrift institutions offered securities products, including mutual funds, as of July 2001.⁹⁸ For example, First Union's securities

93.

Investment Banking Division 2001 Revenues (in millions)	
Citigroup	\$16,968
J.P. Morgan Chase	\$16,098
Deutsche Bank	\$12,923
Morgan Stanley	\$11,535
Goldman Sachs	\$10,185
Merrill Lynch	\$9,989

Marcus Walker, *Deutsche Bank Finds That It Has to Cut German Roots to Grow*, WALL ST. J., Feb. 14, 2002, at A1. Salomon Smith Barney was the leader as to market share in debt and equity underwriting with 12% and \$486.2 billion of proceeds, followed by Merrill Lynch with 10.7% and \$431.6 billion, Credit Suisse First Boston with \$346.6 billion, Morgan Chase with \$314.9 billion, and Goldman Sachs with \$299.1 billion. Veronica Agosta, *Syndication's Top Tier Grabbed Share*, AM. BANKER, Dec. 31, 2001, at 1.

94. Bill Stoneman, *Bank Mutual Fund Results Mirror Fund World*, AM. BANKER, Feb. 1, 2002, at 12.

95. *Id.*

96. INS. INFO. INST., THE FINANCIAL SERVICES FACT BOOK 105 (2002).

97. *Id.* at 86.

98. *See infra* App. A.

subsidiary has 7,780 registered representatives operating in forty-seven states, including the twelve states in which First Union has bank branches.⁹⁹ A survey of community banks conducted in 2001 found that forty percent offered securities brokerage services and sixty-eight percent planned to offer them within the next three years.¹⁰⁰ In addition, forty percent offered mutual funds and sixty-six percent planned to do so in the future.¹⁰¹

Turning to bank entry into the insurance market, banks have not been willing to become underwriters of insurance products. The Citicorp-Travelers merger is one of the few examples of bank entry into insurance underwriting.¹⁰² Even there, Citi later decided to divest itself of twenty percent of its stake in Travelers' property and casualty insurance business.¹⁰³

As opposed to underwriting, bank involvement in brokerage of insurance products is significant and has been increasing. The largest commercial banks all offer life insurance products, almost all offer other insurance products, and the overwhelming majority also offer annuities.¹⁰⁴ The largest thrift institutions are also overwhelmingly involved in the offering of insurance products and annuities, except for commercial insurance.¹⁰⁵ Some large banks have actually acquired large insurance agencies.¹⁰⁶ In 1999, banks bought sixty-five agencies, and then bought another seventy-four in 2000.¹⁰⁷ Others,

99. Amy L. Anderson, *Bank Broker Combo 2d Only to Citi*, AM. BANKER, Apr. 17, 2001, at 1.

100. Caroline Wilson, *Investment Services: A Weapon in Your Bank's Arsenal*, COMMUNITY BANKER, Aug. 2001, at 23.

101. *Id.*

102. BNP Paribas, the largest bank in France, has also made such forays. BNP expanded its ownership of Honolulu-based BancWest in 2001 to reshape its U.S. banking presence and use it as a platform to sell insurance in the western United States through its insurance subsidiaries. Laura Mandaro, *BNP Pushes for U.S. Insurance*, AM. BANKER, May 8, 2001, at 1; see Laura Mandaro, *Bancassurance Buzz at BNP Paribas' BancWest*, AM. BANKER, Dec. 10, 2001, at 9. In 2002, BNP Paribas acquired United California Bank. See Damien Paletta, *Fed. OKs BNP Bid for United Calif. Bank*, AM. BANKER, Feb. 22, 2002, at 4.

103. Graham Gori, *Citigroup to Buy Mexico Assets of Dutch Insurer for \$1.2 Billion*, N.Y. TIMES, Jan. 19, 2002, at C2.

104. See *infra* App. A.

105. *Id.*

106. See, e.g., Jill Elswick, *Banks and Insurers Slowly Converge*, EMPLOYEE BENEFIT NEWS, May 1, 2001 (specifying First Union, which now ranks as the fourth largest full-service insurance agency, Wachovia, and Wells Fargo, whose acquisition of ACO Brokerage Holdings Corp., parent of the Acordia agency, creates the fifth largest insurance agency in the country), available at <http://global.factiva.com> (on file with the *New York University Journal of Legislation and Public Policy*); Lee Ann Gjertsen, *Wells-Acordia Deal: Wake-Up Call*, AM. BANKER, Mar. 12, 2001, at 1.

107. THE FINANCIAL SERVICES FACT BOOK, *supra* note 96, at 59.

and many small banks, have entered alliances with insurance underwriters or brokerages to sell insurance products. The American Bankers Insurance Association surveyed small banks and found that by the summer of 2001, forty-three percent were selling general lines of insurance, up from thirty-seven percent a year earlier.¹⁰⁸ Among the largest banks (those with more than \$10 billion in assets), ninety-six percent were marketing general lines of insurance.¹⁰⁹

Overall, the total amount of life/health insurance premiums sold through banks more than doubled from 1997 (\$165 million in premiums) to 2000 (\$422 million in premiums).¹¹⁰ Bank sales of annuities have been much greater. Annuity sales by banks totaled \$37.8 billion in 2001, up from \$29.8 billion in 2000.¹¹¹ These sales have been through alliances with insurance firms.¹¹²

b. Insurance Company Entry into Banking and Securities

A number of the large insurance firms have entered the banking market. However, entry is not prevalent. Among the ten largest life/health insurance firms, four have entered the personal banking market, and two of the four are the only firms that have entered the commercial banking market.¹¹³ Three of the ten (which are also three of the four engaged in personal banking) have entered the more limited market of lending—in the form of mortgage, credit card, or other loan offerings. Among the ten largest property/casualty insurance companies, three have entered the personal banking business, none have entered the commercial banking business, and five (including the three engaged in personal banking) have entered the more limited business of offering only mortgage loans, credit cards, or other loans.¹¹⁴

Among the new competitors, most that have entered the market have acquired or formed a thrift, and become unitary thrift holding companies. In fact, during the period January 1, 1997 to May 31,

108. Bill Stoneman, *GLB: Banks Embrace Insurance, Not Much Else*, AM. BANKER, Mar. 8, 2002, at 12A (including survey of banks with less than \$1 billion of assets). Sale of general lines of insurance differs from sales of annuities only or sales of credit life insurance.

109. THE FINANCIAL SERVICES FACT BOOK, *supra* note 96, at 106.

110. *Id.* at 104. It is estimated, however, that banks hold only a 1.8 percent market share of U.S. life insurance sales. Kenneth Kehrer & Brad Powell, *Bank Sales of Life Insurance Gained Momentum in First Half*, NAT'L UNDERWRITER, Oct. 22, 2001, at 6 (showing figures as of first half of 2001).

111. Trevor Thomas, *Banks' Annuity Sales Up 27% Last Year on Surge of Fixed Annuities*, NAT'L UNDERWRITER, Apr. 1, 2002, at 12.

112. *See id.* (listing insurers selling annuities through banks).

113. *See infra* App. A.

114. *Id.*

2001, forty-five of the eighty-five total applications for new thrift charters submitted by applicants engaged in non-banking activity came from insurance companies.¹¹⁵ State Farm, Metropolitan Life, Prudential, Allstate, and ING Barings have all either formed a banking institution (typically a thrift) or acquired a small, existing banking institution.¹¹⁶ In addition, two trade groups, the Independent Insurance Agents of America and the National Association of Mutual Insurance Companies, have formed banks that offer bank products through their members.¹¹⁷

The products offered are primarily directed toward consumers—for example, home mortgage loans, home equity loans, consumer loans, credit cards, and various deposit offerings. The target for such offerings varies. State Farm, for example, offers its products both to policyholders and the general public.¹¹⁸ Prudential targets its policyholders.¹¹⁹ The vehicle for offering bank products embraces the GLBA's goal of "efficient" product offerings. All companies are operating a branchless bank—marketing bank products through their existing insurance agents and providing customers access to their accounts through the Internet, telephone, and ATMs.¹²⁰

This entry of large insurance companies and trade groups into banking potentially could substantially increase competition in the

115. APPLICATIONS FOR NEW THRIFT CHARTERS, *supra* note 89.

116. *Dutch ING Is Granted Thrift Charter*, AM. BANKER, July 6, 2000, at 4 (stating that ING received approval to start federal thrift and has application pending to acquire federal savings bank ReliaStar Bank); Lee Ann Gjertsen, *Captive Agents Gave Edge to Insurers Vying in Banking*, AM. BANKER, Jan. 3, 2002, at 1 (noting State Farm's operation of thrift institution); Jeremy Quittner, *Insurers Look to Policyholders as Bank Customers*, AM. BANKER, Oct. 16, 2001, at 10A (stating that Prudential Bank is thrift subsidiary of Prudential Financial); David Reich-Hale, *Allstate Betting on Full-Service Web Banking*, AM. BANKER, July 26, 2001, at 11 (noting that Allstate acquired thrift charter in 1998 only to provide e-commerce services and was granted full thrift charter in 2001); Trevor Thomas, *Fed OKs MetLife's Acquisition of Bank*, NAT'L UNDERWRITER, Feb. 26, 2001, at 18 (finding that MetLife's acquisition of Grand Bank, N.A. is first time insurance company has acquired bank since passage of GLBA).

117. Sally Roberts, *Some Insurance Entities Banking on Diverse Offerings*, BUS. INS., Jan. 7, 2002, at 12D (noting that Assurance Partners Bank, thrift affiliated with National Association of Mutual Insurance Companies, opened its doors in June 2000, and InsurBanc, thrift co-owned by Industrial Insurance Agents of America and W.R. Berkley Corp., began operations in April 2001).

118. *See infra* notes 209–11 and accompanying text; Gjertsen, *supra* note 116, at 1 (stating that MetLife aims to sell banking products to its employees and beneficiaries of its life insurance policies).

119. Quittner, *supra* note 116, at 10A (stating that Prudential focuses on affluent policyholders).

120. *See, e.g.*, Reich-Hale, *supra* note 116, at 11 (describing banks operated by Allstate, State Farm, and MetLife).

bank product market. This is because of the large number of agents available to market the bank products.¹²¹ For example, by the end of 2001, State Farm had trained approximately ninety percent of its agents to market its bank products in forty-eight states and the District of Columbia.¹²² Even when the target customer base is limited to policyholders, the potential market is large.

The reality, however, is that almost all of the insurance company affiliated banks are quite small. The largest are State Farm Bank, with \$3 billion in assets and approximately \$2.4 billion in deposits, and ING Bank, with \$9.3 billion in assets and \$6.7 billion in deposits, as of June 30, 2002.¹²³ Prudential Savings Bank, which has been operating since 1989, had \$521 million in assets and only \$88.6 million in deposits.¹²⁴ MetLife Bank had assets of \$334 million and deposits of \$206.8 million.¹²⁵ Allstate Bank had assets of \$368 million and \$254.7 million in deposits.¹²⁶

There are several reasons for the variance between the potential of insurance company competitors and the reality. One reason is that most insurance companies do not aim to create large banking operations. Rather, they merely wish to supplement the financial options

121. Lee Ann Gjertsen & David Reich-Hale, *While Spreading Out, Allstate Thrift Keeps Narrow Focus*, AM. BANKER, Mar. 6, 2002, at 1 (stating that Allstate has 12,500 agents nationwide, and that 5,000 agents are currently trained to market bank products); Quittner, *supra* note 116, at 10A (noting that Prudential has 11,500 agents in U.S. including 6,500 trained as financial advisers); David Reich-Hale, *State Farm Bank-Product Sales Force Growing Fast*, AM. BANKER, Sept. 7, 2000, at 6 (State Farm expects to have 16,000 agents trained by 2002).

122. Gjertsen, *supra* note 116, at 1 (explaining that 14,000 agents—approximately ninety percent of State Farm agents across country—have been trained in selling bank products).

123. FED. DEPOSIT INS. CORP., STATISTICS ON DEPOSITORY INSTITUTIONS, at <http://www3.fdic.gov/sdi/main.asp> (June 30, 2002) (on file at the *New York University Journal of Legislation and Public Policy*). This is an increase from Dec. 31, 2001, when State Farm Financial Services had \$1.3 billion in assets and \$875 million in deposits. FED. DEPOSIT INS. CORP., STATISTICS ON DEPOSITORY INSTITUTIONS, at <http://www3.fdic.gov/sdi/main.asp> (Dec. 31, 2001) (on file at the *New York University Journal of Legislation and Public Policy*).

124. STATISTICS ON DEPOSITORY INSTITUTIONS (June 30, 2002), *supra* note 123. This is little changed from Dec. 31, 2001, when the bank had \$466 million in assets and \$87 million in deposits. STATISTICS ON DEPOSITORY INSTITUTIONS (Dec. 31, 2001), *supra* note 123. At that time, the Prudential Bank and Trust Co., operating since 1945, had assets of \$676 million and deposits of \$518 million. *See id.*

125. STATISTICS ON DEPOSITORY INSTITUTIONS (June 30, 2002), *supra* note 123. This compares with \$268 million in assets and \$145.7 million in deposits as of Dec. 31, 2001. STATISTICS ON DEPOSITORY INSTITUTIONS (Dec. 31, 2001), *supra* note 123.

126. STATISTICS ON DEPOSITORY INSTITUTIONS (June 30, 2002), *supra* note 123. This compares with \$133.6 million in assets and \$31 million in deposits as of Dec. 31, 2001. STATISTICS ON DEPOSITORY INSTITUTIONS (Dec. 31, 2001), *supra* note 123.

available to their insurance customers.¹²⁷ A second reason is that the marketing arms of the firms—insurance agents—are primarily interested in selling insurance, and not bank products.¹²⁸ A third reason is the decision to use a branchless network. Consumers are reluctant to entrust their deposit accounts, and perhaps their loan business, to a distant entity that provides access through technology.¹²⁹

The discussion above has focused on insurance company entry into the banking business. Entry into the securities business, as a principal, has been more modest. As was true of insurance company entry into banking, most insurance companies have not acquired a large securities firm. Three exceptions are the Citicorp–Travelers merger, Axa Financial’s interests in Donaldson, Lufkin & Jenrette and Alliance Capital,¹³⁰ and ING’s acquisition of the Pilgrim and Aetna mutual funds.¹³¹ While insurance companies have not typically become underwriters of securities or managers of mutual funds, they have entered the business of brokering securities generally or brokering mutual funds. Eight of the ten largest life/health insurance companies are engaged in distribution of securities or mutual funds,¹³² and seven of the ten largest property/casualty insurance companies are engaged in this business.¹³³ Most insurance companies sell the securities and mutual funds of unrelated entities.¹³⁴ Occasionally insurance compa-

127. Quittner, *supra* note 116, at 10A (reporting that insurers’ purpose in opening banking divisions is not to grow by seeking new customers but to offer banking products as add-ons to insurance policies they already sell). Holly Melcher, a State Farm marketing specialist, noted State Farm wanted to meet their customers’ needs, not to compete directly with banks. Jim Bohman, *Insurance Industry Dabbles in Banking: State Farm, Allstate Most Aggressive Players*, DAYTON DAILY NEWS, Jan. 20, 2002, at 1F.

128. Roberts, *supra* note 117 (noting that mindset issue is big challenge); Lee Ann Gjertsen, *Tough First Year for NAMIC-Chartered Thrift*, AM. BANKER, June 27, 2001, at 9.

129. See David Reich-Hale, *Allstate Says E-Bank Isn’t Meant as Profit Center*, AM. BANKER, Oct. 10, 2001, at 6 (stating that e-banking forays by insurance companies not expected to do much damage to more established players); Orla O’Sullivan, *Net Banks: More Dream than Reality*, U.S. BANKER, Feb. 2000, at 30; David Reich-Hale, *State Farm Hopes Banking Clients Are There*, AM. BANKER, Oct. 20, 2000, at 1.

130. James R. Kraus, *Axa Says Its Expansion Plans Do Not Include Bank Deals*, AM. BANKER, Apr. 25, 2000, at 1 (stating that Axa owns seventy percent stake in Donaldson, Lufkin & Jenrette, Inc. and fifty-seven percent stake in Alliance Capital Corp., the mutual fund company).

131. Matthew Hunter, *ING Hopes Fund Rebranding Raises Profile*, AM. BANKER, Mar. 5, 2002, at 9.

132. See *infra* App. A.

133. *Id.*

134. See, e.g., David Reich-Hale, *Fund Sales 101 for Allstate Agents*, AM. BANKER, Aug. 3, 2000, at 7 (stating that Allstate representatives are trained to sell variety of mutual funds, including Fidelity and Oppenheimer).

nies—for example, State Farm and ING—have affiliates who manage their own mutual fund offerings.¹³⁵ They have rarely entered the investment banking business.

c. Securities Company Entry into Banking and Insurance

The securities industry has demonstrated a modest interest in competing in the banking market and almost no interest in competing in the insurance market. Apart from Citigroup, the only major securities firm that has elected to become a financial holding company is Charles Schwab.¹³⁶ Schwab's election was due to its purchase of U.S. Trust and their trust banking operations. However, some securities firms have acquired small thrifts and become unitary thrift holding companies.¹³⁷ Among the applications to the Office of Thrift Supervision for new thrift charters, during the period January 1, 1997 to May 31, 2001, fifteen of the eighty-five total applications filed by applicants engaged in non-banking activity came from insurance securities companies.¹³⁸

The aim of expansion into banking has not been to establish a full-scale retail operation that competes with regional or national banks. Instead, the aim is either to (a) offer existing customers—typically limited to high net-worth individuals—more financial options, or (b) compete only in a narrow product and/or customer niche. Merrill Lynch and Schwab offer examples of the former approach. Schwab announced in March 2002 that it plans to apply for a national bank charter to offer FDIC-insured products in addition to investment products. According to Schwab's chief strategy officer, it plans to offer the products not to consumers generally but to “our best clients, who we know are important affluent clients but may just be treated as run-of-the-mill clients at a bank.”¹³⁹ Similarly, Merrill Lynch offers its sweep account to brokerage customers,¹⁴⁰ and its bank deposit ac-

135. See *infra* text accompanying notes 181–184.

136. BD. OF GOVERNORS OF FED. RESERVE SYS., 87 FEDERAL RESERVE BULLETIN 233 (2001); see also FED. RESERVE BD., FINANCIAL HOLDING COMPANIES, available at <http://www.federalreserve.gov/generalinfo/fhc/> (Jan. 24, 2003) (listing Charles Schwab as financial holding company) (on file at the *New York University Journal of Legislation and Public Policy*).

137. E.g., Jessica Toonkel, *Lehman Set to Sell Bank Services to Nonbanks*, AM. BANKER, May 16, 2000, at 1 (stating that Lehman Brothers acquired Delaware Savings Bank of Wilmington).

138. APPLICATIONS FOR NEW THRIFT CHARTERS, *supra* note 89.

139. Niamh Ring, *Why Schwab Wants Another Charter to Add Bank Services*, AM. BANKER, Mar. 1, 2002, at 1.

140. Cheryl Winokur, *Merrill, Late to the Party, Offers Premium FDIC-Insured Account*, AM. BANKER., Feb. 2, 2000, at 1.

counts to customers depositing at least \$250,000 for certificates of deposits of one month or longer.¹⁴¹

The sweep account is a good example of a product or service that has received a great deal of attention as evidence of securities company entry into banking. Sweep accounts originally transferred excess cash in brokerage accounts to money funds. In recent years, several securities firms offered the option of transferring the funds to FDIC-insured accounts at one of the securities firms' bank affiliates. This has been introduced as a customer option by Salomon Smith Barney, Morgan Stanley Dean Witter, and Merrill Lynch, as well as Prudential Securities and TD Waterhouse, among others.¹⁴² However, it is made available only to existing brokerage customers as an additional financial option. Moreover, the evidence regarding sweep accounts similarly suggests that securities firms are not seeking a broad consumer presence. For example, in April 2001, Merrill Lynch announced that customers holding bank money market deposit accounts with less than \$100,000 in their accounts would receive an interest rate as much as a full percentage point lower than customers with \$100,000 or more in such accounts.¹⁴³

There are several product and/or customer niches that have become the second form of competition in banking products and services. Targeting wealthy clients by offering trust services (sometimes called wealth-management services) is the most frequently embraced niche for securities firms. Schwab's acquisition of U.S. Trust,¹⁴⁴ Merrill Lynch's earlier entry into trust banking,¹⁴⁵ and, more recently, the entry of Lehman Brothers and Goldman Sachs¹⁴⁶ are all examples.

A second niche is targeting small business owners for a range of product offerings, including small business loans. Merrill Lynch and Morgan Stanley are examples of securities firms that have entered this

141. MERRILL LYNCH, TAILORED BANK DEPOSITS, available at http://www.askmerrill.ml.com/product_details/1,2270,20295,00.html (last visited April 8, 2003) (for terms of one week to one month, minimum deposit of \$500,000 is required) (on file at the *New York University Journal of Legislation and Public Policy*).

142. Winokur, *supra* note 140, at 1 (stating that FDIC-insured sweep accounts have been available for years, and will continue to grow due to passage of financial modernization law).

143. See Charles Gasparino, *Merrill Lynch's Small Investors Face Rate Cut*, WALL ST. J., Apr. 30, 2001, at C1.

144. Niamh Ring, *Discount Brokerage King Steps Up in Class with U.S. Trust Purchase*, AM. BANKER, Jan. 14, 2000, at 1.

145. See Matt Ackermann, *Lehman Hires Exec for Start of Trust Banking*, AM. BANKER, Dec. 3, 2001, at 1 (stating that Merrill Lynch's trust operation got its start in 1987).

146. *Id.*

market.¹⁴⁷ In fact, in the Consumer Bankers Association's 2000 Small Business Banking survey, Merrill Lynch, as well as American Express, were named by almost one-third of banks surveyed as likely top competitors within five years.¹⁴⁸ One final product niche is private label banking products. This is a niche embraced by Lehman Brothers.¹⁴⁹

A common characteristic of securities company entry into banking is that for many of the products offered, consumers generally are not the target of their interest, and therefore would not enjoy the benefits of their products and services.

As to the extent of competition offered by securities firms, the size of the banking institutions formed or acquired by major securities firms vary widely. Merrill Lynch, for example, owns Merrill Lynch Bank, Merrill Lynch Trust Company, and Merrill Lynch Bank and Trust Company. The largest is Merrill Lynch Bank, with assets of \$62.8 billion and deposits of almost \$56 billion.¹⁵⁰ Others are smaller institutions. Lehman Brothers Bank had assets of \$8.3 billion and deposits of \$2.8 billion.¹⁵¹ Morgan Stanley Bank had assets of \$2.8 billion and deposits of \$624.6 million.¹⁵² However, for Merrill Lynch, and for others, the overwhelming majority of its deposits came from its decision to sweep excess cash in brokerage accounts to FDIC-in-

147. See Jessica Toonkel, *Morgan Stanley Pushes Into Small-Biz Lending*, AM. BANKER, July 17, 2000, at 1 (stating also that Morgan Stanley is not first financial services company to enter this market; Merrill Lynch began courting small business customers in 1986 with cash management accounts and added loans in 1993).

148. CONSUMER BANKERS ASS'N, 2000 SMALL BUSINESS BANKING STUDY EXECUTIVE SUMMARY, available at <http://www.cbanet.org/Surveys/hilites.html> (last visited April 8, 2003) (on file at the *New York University Journal of Legislation and Public Policy*).

149. See Toonkel, *supra* note 137, at 1.

150. STATISTICS ON DEPOSITORY INSTITUTIONS (June 30, 2002), *supra* note 123. This is down from December 31, 2001, when the bank had \$65.7 billion in assets and almost \$60 billion in deposits. STATISTICS ON DEPOSITORY INSTITUTIONS (Dec. 31, 2001), *supra* note 123. Merrill Lynch Bank and Trust Company had assets of \$15.3 billion and deposits of \$14.3 billion at year end 2001. *Id.* Merrill Lynch Trust Company, F.S.B. had assets of almost \$268 million and deposits of \$28 million. *Id.*

151. STATISTICS ON DEPOSITORY INSTITUTIONS (June 30, 2002), *supra* note 123. This compares with \$8.5 billion in assets and \$2.5 billion in deposits as of December 31, 2001. STATISTICS ON DEPOSITORY INSTITUTIONS (Dec. 31, 2001), *supra* note 123.

152. STATISTICS ON DEPOSITORY INSTITUTIONS (June 30, 2002), *supra* note 123. This is down sharply from December 31, 2001, when the bank had \$4.2 billion in assets and \$2 billion in deposits. STATISTICS ON DEPOSITORY INSTITUTIONS (Dec. 31, 2001), *supra* note 123. Morgan Stanley Trust had assets of \$69 million and deposits of \$500,000 at year end 2001. *Id.*

sured accounts.¹⁵³ Thus it is not clear that they are competing directly with traditional banks for deposit dollars.

Turning to securities company interest in insurance, there has been very little of the convergence that the GLBA was intended to foster. Apart from the formation of Citigroup, there have been no major insurance underwriters that have been acquired by or formed by securities firms. Securities industry activity has largely been limited to offering some insurance products, such as annuities, to existing securities customers. This has typically occurred through distribution arrangements, such as securities firms selling products created by others.

d. Overall Effect—Competitive Pressures

Bank affiliates of insurance companies are small institutions. Bank affiliates of securities firms are larger, but they are not siphoning funds from existing bank deposits. Rather, the funds come from short-term shifts from securities accounts to bank accounts. Are banks feeling competitive pressure from these activities? The periodic survey of commercial banks in the Tenth Federal Reserve District¹⁵⁴ conducted by the Federal Reserve Bank of Kansas City helps answer this question. In that survey, less than twenty percent of banks opined that the ability of insurance, securities, and other financial firms to enter the banking business has had a significant change in the competitive situation in their market.¹⁵⁵ As to those banks reporting increased competition from insurance, securities, and other financial firms, competition for loan products was seen to originate primarily from insurance companies.¹⁵⁶ As to deposit products, competition was seen as coming from both insurance companies and securities firms.¹⁵⁷

The survey also asked banks about expected competition in deposit and loan products over the next five years. Both insurance companies and securities firms are cited as competitors. However, in competition for deposits, both securities firms and insurance compa-

153. See, e.g., David A. Bochnowski, *Time to End Big Brokerage Firms' Free Ride in Deposit Insurance*, AM. BANKER, Apr. 20, 2001, at 16 (stating that Merrill Lynch has transferred more than \$50 billion into its banks since last year); Niamh Ring, *CEO Downplays Merrill's Role as Bank*, AM. BANKER, Sept. 11, 2001, at 20 (quoting Merrill Lynch Chairman as saying that achieving \$70 billion in deposits was easily accomplished by transferring money from money market funds into deposit accounts).

154. See generally Van Wallegghem, *supra* note 82, at 49. The district covers Colorado, Kansas, Missouri, Nebraska, New Mexico, and Wyoming.

155. *Id.* at 53. In addition, between forty and fifty percent of banks reported "some change" in the competitive situation in their market areas. *Id.*

156. See *id.* at 54.

157. See *id.*

nies dropped in importance among the list of all competitors between the 1994 survey and the 2001 survey.¹⁵⁸ Insurance companies also dropped in importance among the list of competitors for loans from tenth to eleventh in importance as a source of competition.¹⁵⁹ Securities firms did not appear in 1994 on such list of competitors for loans. They did appear in the 2001 survey but were ranked 12th out of a list of 13 competitors.¹⁶⁰

The Ninth Annual Survey of Community Bank Executives¹⁶¹ revealed a similar outcome. This survey asked about sources of competition generally, and not competition due to entry into the banking business. Executives were asked about sources of competition that were a major concern. The percentage that identified brokerage firms, mutual fund companies, and insurance companies was significant, but also declined significantly between the years 2000 and 2002.¹⁶²

In summary, industry-wide data points to no increased competition in insurance underwriting, substantially increased competition in securities underwriting via the efforts of a few large bank affiliates, and modestly increased competition in banking. It also reveals modest increases in competition in insurance brokerage and securities brokerage.

Two policy questions result. First, can we always assume that deregulation will yield a significant increase in competition? The financial services modernization experience reveals that the answer is

158. See Forest Myers & Richard J. Sullivan, *The 2001 Survey of Commercial Banks in the Tenth Federal Reserve District: Changes and Challenges*, FIN. INDUS. PERSP., Dec. 2001, at 6. Securities firms dropped from second to fourth in importance as sources of competition. Insurance companies dropped from fifth to eighth in importance.

159. See *id.* at 7.

160. *Id.*

161. GRANT THORNTON, NINTH ANNUAL SURVEY OF COMMUNITY BANK EXECUTIVES (2002).

162. *Id.* at 3. The survey results were as follows:

Percentage of community banks that say the following sources of competition are a major concern			
	2000	2001	2002
Brokerage Firms	65%	66%	56%
Mutual Fund Companies	51%	49%	37%
Insurance Companies	*	31%	21%

* question not asked in 2000.

Of course, such "competition" may be in the form of offerings of investment or insurance products by securities and insurance firms rather than bank products.

“no.” In some segments of the industry there may be no change, and in other segments of the industry the change might be modest.

A second policy question is whether increased competition is a benefit per se. Experience has demonstrated that free competition can, at times, produce more costs than benefits. For example, one of the causes of the large number of savings and loan failures during the 1980s, leading to the savings and loan bailout, was free competition brought about by deregulation of interest rates and deregulation of investment powers.¹⁶³ That experience cautions that unbridled competition and excessive deregulation can be disadvantageous rather than beneficial.¹⁶⁴ As a result, competition cannot be touted as a benefit per se.

2. *Efficiency*

The evidence of securities firm and insurance firm entry into the banking market reveals a decision to market these products through an existing distribution system and through the Internet. Thus, insurance firms have utilized existing insurance agents to market bank products. Securities firms have utilized existing brokers (financial consultants) to market bank products. No bank branches were created. This is a low-cost distribution system relying on cross-selling. Similarly, banks have used bank personnel to market securities and insurance products. They have also, at times, allowed insurance or securities company employees to offer their products at bank branches. These are also low cost distribution mechanisms made available due to cross-selling. The direct benefit is generating additional fee income from the new product offerings and doing so at low cost to the firm. This is a benefit to the members of the industry. The public policy question is whether there are also benefits to consumers, such as public benefits. This question is explored in the analysis of the stated benefits of lower costs for consumers, new products for consumers, and increased access for consumers.

163. See JAMES R. BARTH, *THE GREAT SAVINGS AND LOAN DEBACLE* 40–44 (1991) (arguing that deregulation came after industry was in serious trouble and contributed to difficulties facing savings and loans); MARTIN LOWY, *HIGH ROLLERS: INSIDE THE SAVINGS AND LOAN DEBACLE* 246–48 (1991) (positing that while interest rate deregulation might have been needed, fast growth was encouraged without capital; additionally, asset side deregulation led many savings and loan institutions to rush into real estate development).

164. See LOWY, *supra* note 163, at 248 (discussing possible limits on deregulatory initiatives such as asset side deregulation); LAWRENCE J. WHITE, *THE S&L DEBACLE* 74–76 (1991) (arguing that deregulation needed to be accompanied by substantially stepped-up safety and soundness regulation and/or expanded use of economic incentives to reduce risks).

3. *Lower Costs for Consumers*

No industry-wide data has been reported regarding possible cost savings to consumers resulting from financial services deregulation. Therefore, I examined the issue by exploring the actions of the large firms that had decided to take advantage of some or all of the opportunities presented by the GLBA. I explored their actions in sample product lines in the banking, securities, and insurance industries. Were these firms, motivated by competition and enabled by efficiency, acting as cost leaders—offering prices to consumers that were lower than the industry average?

In the banking market, I examined interest rates on home mortgage loans, interest rates on bank deposits, and interest rates and fees on credit cards.

a. Home Mortgage Rates

I examined the rates charged by five firms that had decided to take advantage of the new powers granted under the GLBA—State Farm, Allstate, Merrill Lynch, Citigroup, and J.P. Morgan Chase. The sample used was interest rates in conventional thirty-year and fifteen-year fixed rate home mortgages for typical consumers.¹⁶⁵ Where more than one rate was available, depending on fees charged, then the lowest available annual percentage rate (APR) was used in the comparison.

The results were as follows:

165. Rates were obtained from the firms' Web sites on April 30, 2002. At some firms, rates varied depending on the points paid by the borrower—for example, fees paid as a percentage of the principal amount of the loan. The points charged for the rate in question are indicated in the accompanying chart. Research regarding interest rates for conventional thirty-year and fifteen-year fixed rate home mortgages at the end of May 2002 and the end of June 2002 revealed similar results to those discussed in this Article and enumerated in Chart 1 and the comparisons provided by the Bankrate Web site.

CHART 1
HOME MORTGAGE INTEREST RATES

Financial Institution	30 Year Fixed-Rate Mortgage-APR	15 Year Fixed-Rate Mortgage-APR
State Farm Bank*	7.075	6.625
Allstate Bank**	6.94	6.448
Merrill Lynch Credit Corp.***	7.01	6.84
Citimortgage****	6.489	6.285
Chase*****	6.671	6.131

*Rates based on points of 0.25 percent.

**Rates based on points of 0.625 percent (30 year) and 0.75 percent (15 year).

***Rates based on points of 1 percent.

****Rates based on points of 5.5 percent (30 year) and 4.125 percent (15 year). For loans assessed points of 2.25 percent (30 year) the APR was 6.676, and points of 2.125 percent (15 year) 6.345 APR.

*****Rates based on points of 1.75 percent (30 year) and 1.625 percent (15 year).

For purpose of comparison, I researched available home mortgage rates in the New York area (Long Island) on the Bankrate Web site.¹⁶⁶ The search for rates on thirty-year fixed-rate mortgages yielded ninety-five returns, ranging from an APR of 6.16 to an APR of 7.25. State Farm, Allstate and Merrill Lynch were not on this rate list compiled by Bankrate. Chase and Citibank were, and they ranked ninety-second and ninety-third on the list—charging just about the highest rates available. Chart 1 indicates that State Farm, Allstate, and Merrill Lynch, all with rates near or above seven percent, would also be charging among the highest rates.

The search for rates on fifteen-year fixed-rate mortgages yielded ninety-four returns, ranging from an APR of 5.78 to an APR of 6.80. State Farm, Allstate and Merrill Lynch were not on this list compiled by Bankrate. Chase and Citibank were, and they ranked ninety-second and eighty-eighth, respectively. Again, the ranking represented an interest rate that was one of the highest in the returns. While State Farm, Allstate Bank, and Merrill Lynch were not included in the list of financial institutions reported by Bankrate, a comparison with the rates found in Chart 1 reveals that all three are similarly charging among the highest rates on fifteen-year home mortgage loans.

166. See Bankrate.com, <http://www.bankrate.com> (search conducted May 1, 2002) (on file at the *New York University Journal of Legislation and Public Policy*). The Chase and Citibank rates reported were based on a loan with no points charged, as were almost all the other loans reported. *Id.*

b. Bank Deposit Interest Rates

I examined rates and yields on bank deposit accounts consisting of savings/money market accounts, three-month certificate of deposit (CDs), six-month CDs, one-year CDs, two-year CDs, and five-year CDs. Rates were examined during a three-month period—consisting of reported rates the last week of February, March, and April 2002. The information comprising the sample was from New York City area banks as reported each Thursday in *Newsday*. This report includes between fifty-six and fifty-nine financial institutions for each period. Allstate and State Farm surfaced on the list in March 2002. Citibank and Chase were on the list throughout. Merrill Lynch was not included. Charts 2, 3, and 4 contain key comparisons based on annual percentage yield (APY).

This data reveals that State Farm and Allstate are competing for deposit accounts based on price. In all categories, they provided yields above the average, and in most cases yields close to the highest yields reported. By contrast, Chase consistently provided yields below the average. For Citibank, the data supplies a mixed message. Citibank provided yields below the average for accounts with maturities of less than one year, but somewhat above the average for accounts with longer maturities. Yet even this mixed message of cost leadership in some deposit products on the part of Citibank was not consistently found. Subsequent reports disclosed Citibank providing below average yields on all deposit accounts.¹⁶⁷

c. Credit Card Rates and Fees

Rates and fees on credit cards issued by financial institutions were examined. The available sample were the largest institutions in the New York City area.¹⁶⁸ This was supplemented by a search of the State Farm Bank Web site.¹⁶⁹ The results are as follows:

167. *See Rates: Banks and Thrifts*, *NEWSDAY*, June 27, 2002, at A57.

168. *See Best Credit-Card Deals*, *NEWSDAY*, Apr. 28, 2002, at F8. The reports published at the end of February 2002 and the end of March 2002 contained similar results. In both reports, Chase offered the lowest rate. Curiously, in these earlier reports Citibank was not listed. *See Best Credit-Card Deals*, *NEWSDAY*, Mar. 31, 2002, at F4; *Best Credit-Card Deals*, *NEWSDAY*, Feb. 24, 2002, at F4.

169. *See* State Farm Insurance, <http://www.statefarm.com/bank/rates.htm> (search conducted Apr. 30, 2002).

CHART 2
 RATES: BANKS AND THRIFTS AS OF APRIL 24, 2002

	Savings or Money Market	3-month CD	6-month CD	1-year CD	2-year CD	5-year CD
Highest APY	3.05 State Farm 2.46	2.44 State Farm 2.44 Allstate 1.90	2.64 State Farm 2.59 Allstate 2.15	3.20 Allstate 3.20 State Farm 3.05 Citibank 2.30	4.15 State Farm 4.03 Allstate 3.65 Citibank 3.60	5.50 State Farm 5.25 Allstate 4.85 Citibank 4.80 Chase 4.45 Chase 4.0
Average APY	1.48 Allstate 1.40 Chase 0.75 Citibank 0.75	1.63 Chase 1.50 Citibank 1.50	1.83 Citibank 1.70 Chase 1.55	2.24 Chase 2.00	3.22 Chase 2.9	
Lowest APY	0.60	1.00	0.10	0.43	1.32	2.45

Source: *Rates, Banks and Thrifts*, NEWSDAY, April 25, 2002, at A53

CHART 3
 RATES: BANKS AND THRIFTS AS OF MARCH 27, 2002

	Savings or Money Market	3-month CD	6-month CD	1-year CD	2-year CD	5-year CD
Highest APY	3.05	2.70	2.85	3.55	4.29	5.50
	State Farm 2.46	State Farm 2.70 Allstate 2.00	State Farm 2.85 Allstate 2.20	Allstate 3.55 State Farm 3.30 Citibank 2.25	State Farm 4.29 Allstate 3.75 Citibank 3.50	State Farm 5.50 Allstate 4.90 Citibank 4.75
Average APY	1.49	1.63	1.80	2.20	3.10	4.32
	Allstate 1.40	1.63	1.80	2.20	3.10	4.32
	Chase 0.75	Chase 1.50	Citibank 1.65	Chase 1.80	Chase 1.90	Chase 3.65
	Citibank 0.75	Citibank 1.50	Chase 1.55			
Lowest APY	0.60	1.00	0.10	0.43	1.32	2.45

Source: *Rates, Banks and Thrifts*, NEWSDAY, March 28, 2002, at A53.

CHART 4
 RATES: BANKS AND THRIFTS AS OF FEBRUARY 27, 2002

	Savings or Money Market	3-month CD	6-month CD	1-year CD	2-year CD	5-year CD
Highest APY	3.05	2.45	2.60	3.00	3.90	5.30
Average APY	1.50	1.58	1.74	2.04	Citibank 3.00	Citibank 4.50
	Chase 0.75	Chase 1.50	Citibank 1.55	Citibank 2.00	Chase 1.75	Chase 3.10
Lowest APY	0.75	Citibank 1.25	Chase 1.35	Chase 1.40	1.32	
	0.60	1.00	0.10	0.43		2.45

Source: *Rates, Banks and Thrifts*, NEWSDAY, February 28, 2002, at A49.

CHART 5
CREDIT CARD RATES AND FEES

Financial Institution	Annual Percentage Rate	Annual Fee
Greenpoint Bank	14.40	0
Bank of New York	14.24V*	0
Emigrant Savings Bank	13.99V	0
HSBC Bank USA	13.65V	0
Astoria Federal Savings	12.99	0
Dime Savings Bank	11.74V	0
State Farm Bank	11.65V	0
Citibank	10.74V	0
Chase	4.75**	\$85

* V means variable rate

** This low rate is an introductory rate

This sample reveals that State Farm, Chase, and Citibank are competing based on price—i.e., a cost leadership strategy—in the credit card market. The credit card market appears to be a national market—for example, consumers obtain credit cards from distant providers. If so, additional research is needed to determine if State Farm, Chase, and Citibank are also cost leaders in this larger national market.

d. Life Insurance

In the life insurance market, I examined rates for term life insurance through online quotes.¹⁷⁰ Rates were not available online for Citigroup (Travelers) or Allstate. Therefore, the available comparison was for State Farm and other comparable life insurance firms, those rated A+ +. The results are as follows:

170. The quotes were obtained for a male, age forty-nine, non-smoker, not engaged in hazardous occupation or activity, no medical conditions (if requested for a quote), resident in New York City. The quotes sought were for \$100,000 term life insurance, with a ten year guarantee (if question was asked). First, State Farm's rates were obtained through online insurance brokers. See Life Insurance Rate Quote, at <http://cust.insure.statefarm.com/cgi-bin/fortecgi/3988618> (search conducted Apr. 19, 2002). Second, other rates were obtained from the first three Web sites delivered through a Google search for term life insurance—<http://secure1.insweb.com> (search conducted Apr. 19, 2002), <http://www.instantquote.com> (search conducted Apr. 19, 2002), and <http://www.quotesmith.com> (search conducted Apr. 19, 2002). Third, a search was made of the Web sites of the ten largest life health insurance companies ranked by net premiums in 2000, as reported by the Insurance Information Institute. THE FINANCIAL SERVICES FACT BOOK, *supra* note 96, at 51. Of these firms, only Prudential Life Insurance offered an online quote, for term life insurance for a \$100,000 policy. See <http://www3.prudential.com> (search conducted April 19, 2002).

CHART 6
TERM LIFE INSURANCE

Company	Annual Premium (\$100,000)	
State Farm	\$244	(most stringent underwriting requirements)
	\$373	(non-tobacco rate, standard underwriting requirements)
John Hancock	\$271.56	
Northwestern Mutual	\$291	
William Penn Life	\$186	Preferred 1
	\$217	Preferred 2
	\$258	Preferred 3
	\$317	Standard
Prudential Life	\$203	Term Essential
	\$236	Term Elite

This sample suggests that State Farm's policies are comparable in price to the offerings of comparable insurance companies. It does not appear to be a cost leader.

e. Securities Trading

In the securities market, prices were examined for stock brokerage services and fees charged by mutual fund companies. Various sources conduct annual reviews of either securities brokerage firms generally or online securities brokers. The surveys include assessment of price in relation to services rendered. Most of the major cross-industry participants—Merrill Lynch, Citigroup, J.P. Morgan Chase—have securities brokerage facilities, including online services, that would be prime candidates for cost leadership in the securities brokerage market. The reviews examined were the *SmartMoney* 2002 Broker Survey,¹⁷¹ the *Barron's* 2002 Online Broker Ranking,¹⁷² the *Money* 2001 Best Online Brokers Report,¹⁷³ and the *Kiplinger* 2001 Best Online Broker Rankings.¹⁷⁴

SmartMoney's rankings are of securities brokerage firms generally, and are not limited to online brokers. The rankings are broken down into two broad categories—best brokers for the “do it yourselfer” (discount brokers) and best brokers for the “delegator” (full

171. See Anne Kadet & Eleanor Laise, *Brokers Wild*, SMARTMONEY, Aug. 2002, at 76.

172. See Theresa W. Carey, *Wild Ride on the Web: The Online Brokers That Have Survived Seem Better for the Experience*, BARRON'S, Mar. 18, 2002, at 23.

173. See Adrienne Carter & Leslie Haggin Geary, *The Best Online Brokers of 2001*, MONEY, June 2001, at 93.

174. See Brian P. Knestout, *Best Online Broker*, KIPLINGER PERS. FIN., Oct. 2001, at 48.

service brokers). Rankings are made of commissions and fees, as well as quality of service, offerings of top performing mutual funds, research tools, and breadth of products and amenities.

A total of twenty-seven brokers were included in the do it yourself rankings. For commissions and fees, the top five rankings in 2001 went to Brown & Co. (a subsidiary of J.P. Morgan Chase), Datek, Dreyfus, Mydiscountbroker, and Ameritrade. Among affiliates of diversified financial companies, CSFB direct (Credit Suisse) ranked eighth in commissions and fees, TD Waterhouse (Toronto Dominion) ranked fourteenth, Morgan Stanley ranked eighteenth, ML Direct (Merrill Lynch) ranked twenty-fifth, Cititrade ranked twenty-third, and Charles Schwab ranked twenty-seventh. For 2002, the top five rankings for commissions and fees went to Scottrade, Brown & Co., Mydiscountbroker, EmpireNow, and Bidwell & Co. Affiliates of diversified financial companies were again toward the bottom of the rankings, with TD Waterhouse ranking the highest at ninth, Harris-direct ranking twelfth, Charles Schwab ranking eighteenth, ML Direct ranking twentieth, and Cititrade receiving the lowest ranking at twenty-first.

In the second ranking, best brokers for the delegator, nine brokers were ranked in 2001. Brokerages in this ranking were full-service firms. As to commission and fees, the order of the rankings were:

- A.G. Edwards
- Merrill Lynch (tied for second)
- Charles Schwab (tied for second)
- Edward Jones
- Morgan Stanley
- Salomon Smith Barney
- American Express
- Prudential
- UBS Paine Webber

The *SmartMoney* rankings disclose that the diversified financial companies are sometimes among the cost leaders. However, among discount brokers, they are grouped at the bottom of the rankings. Among full-service brokers they are dispersed throughout the rankings along with non-diversified companies.¹⁷⁵ Diversification does not always or typically lead to cost leadership.

175. This was equally true in the 2002 rankings. In 2002 the order of the rankings on commission and fees was: (1) Fidelity, (2) Charles Schwab, (3) A.G. Edwards, (4) American Express, (5) Morgan Stanley, (6) Merrill Lynch, (7) Salomon Smith Barney, (8) Edward Jones, (9) UBS Paine Webber, and (10) Prudential.

Barron's ranked online brokers. Rankings were made in six areas, including costs. Twenty-two firms were ranked. The highest ranking on costs (for those brokers charging the lowest costs) was a five. Three brokers earned the highest ranking—Brokerage America, Brown & Co., and Interactive Brokers. Four brokers earned rankings of 4.5 or 4, namely: Datek, Terra Nova, Mr. Stock, and Ameritrade Pro. Among diversified financial firms, TD Waterhouse earned a ranking of 3.5; Harris Direct earned a ranking of 2; Charles Schwab earned a ranking of 1.5; and Merrill Lynch earned a ranking of 1.5. Thus, only one affiliate of a diversified financial firm could be characterized as a cost leader, while all others were at the bottom half of the *Barron's* ranking on costs.

The *Money* magazine ranking is of the best online brokers. It ranked twenty-four brokerages based on cost, as well as customer service, products and tools, ease of use of the online system, and system responsiveness. The top three brokers in the category of cost were Datek, Scottrade, and A.B. Watley (earning a rating of five stars). The cost rating for diversified financial firms were as follows:

TD Waterhouse (four stars)

CSFB Direct (three stars)

Merrill Lynch Direct (one star)

Charles Schwab (one star)

Morgan Stanley Online (one star)

Once again, the cost survey places most diversified firms at the bottom of the rankings.

Finally, the *Kiplinger* survey of online brokerages ranked fifteen brokerages based on price and service. The top ranking based on cost went to Brown & Co., followed by Scottrade and Datek. The most costly were Merrill Lynch, Morgan Stanley, and Schwab. The survey separately ranked the brokerage firms for mutual fund low-cost competitiveness—funds offered without sale charges, no-load funds without special brokerage transaction fees, and transaction fees when they are charged. Top ranking went to Scottrade, followed by Datek and Ameritrade.

In the *Kiplinger* rankings on cost, only one firm, Brown & Co., was affiliated with a diversified financial company (J.P. Morgan Chase). All the other top rankings went to firms that were not affiliates of diversified financial firms.

f. Mutual Funds

As discussed above, the *Kiplinger* survey of brokerages includes a ranking of cost competitiveness in the area of mutual fund offerings.

The 2002 *Forbes* Mutual Fund Guide contains a similar ranking. The *Forbes* survey contains a listing of “best buys.”¹⁷⁶ Rankings are based on cost efficiency and five-year risk adjusted return. Funds are ranked according to the type of fund offered, broken down into fifteen categories including index funds, U.S. stock funds, and taxable U.S. Treasury funds. Five funds are described as “best buys” in each category. Out of these seventy-five possible rankings, funds of diversified financial companies received only two mentions—Credit Suisse Global Tech-Com Fund and Harris Insight-Tax-Exempt Bond-N Fund. The most frequently cited funds in the *Forbes*’ “best buys” rankings were Vanguard funds.

In summary, deregulation and cross-industry expansion has not typically led diversified firms to offer cost savings for consumers. This is certainly true in the securities market. It appears to be true in the insurance market, based on the limited data collected. Finally, it is also true in most banking product markets and for most diversified competitors in such markets. In addition, the cost savings offered in the banking market do not necessarily translate into actual cost savings by consumers. Ability and willingness to offer cost savings are two determinants of actual cost savings. However, acceptance on the part of the public is a third, necessary determinant. As discussed in this Article,¹⁷⁷ efficient marketing of bank products by insurance firms and securities firms—for example, through branchless banks—has not been accepted by many customers for such products.

4. *Increased Access*

The Committee Hearings defined “increased access” to mean providing access to underserved geographical areas, providing products and services that are uneconomical absent cross-industry activity, and providing consumers with one-stop shopping convenience.

It is possible that certain geographical areas are not adequately served by bank branches but are now being reached by insurance agents or securities brokers marketing bank products. Conversely, it is also possible that some geographical areas are not adequately served by securities brokers and, perhaps, by insurance brokers, and they are now being served by bank branches offering both insurance and securities products. This is a possibility, but it has not been studied and documented to date.

176. See 2002 *Mutual Funds Guide: Best Buys*, FORBES, Feb. 4, 2002, at 94.

177. See *supra* notes 127–129 and accompanying text.

One type of benefit that is a form of increased access on the part of underserved geographic areas or markets has been some new commitment to lending to low-income communities. For example, in May 2000, Merrill Lynch announced a \$159 million, three-year initiative in Asian-Pacific, Latino, and African-American communities in Southern California and the San Francisco Bay area.¹⁷⁸ The initiative appears to be a move to meet obligations under the Community Reinvestment Act.¹⁷⁹ In other words, legislative obligations, rather than the free market of deregulation, seem to have motivated this consumer benefit.

As to the claimed benefit of introduction of formerly uneconomical products, none have been reported. The Aetna experience in Mexico, presented in Committee Hearings,¹⁸⁰ has not been duplicated in the United States.

Finally, as to one-stop shopping, at first glance the benefit has been realized. However, for all “sales” except sales of bank deposits—for example, for sales of loan products, insurance products, and securities products—this benefit did not require the GLBA. It results from cross-selling, which can be done in a brokerage capacity. In addition, many firms opting for a true universal bank structure, such that firms engaged in underwriting and distribution across industry lines provide access to fewer products in their one-stop financial supermarket. The one-stop financial supermarket may offer convenience to consumers, but it also, in many cases, offers access to fewer products in a product line.

Firms taking full advantage of the GLBA’s opportunity for convergence become vertically integrated. As a result, many have decided to offer their own products in their supermarkets, or have been shunned by competitors who fear sales staff will favor the integrated

178. Press Release, Merrill Lynch, Merrill Lynch, Greenlining Institute Announce New \$159 Million Economic Partnership for Southern California, San Francisco Bay Area (May 11, 2000), available at http://www.ml.com/about/press_release/20000510.htm (on file at the *New York University Journal of Legislation and Public Policy*).

179. *Gearing Up for CRA*, U.S. BANKER, June 2000, at 14; see *State Farm Secures Federal Thrift Charter from OTS*, BANKING POL’Y REP., Nov. 30, 1998, at 2 (describing that when State Farm received approval for federal thrift charter, it committed to make \$195 million in loans to low- and moderate-income borrowers during its first three years of operation, and in long-term loans equal to greater of five percent of thrift’s assets or amount of deposits generated from low- and moderate-income persons).

180. See *supra* note 65 and accompanying text.

firm's own products.¹⁸¹ Thus, State Farm's entry into the securities market has been through the offering of ten mutual funds managed by State Farm VP Management Corp.¹⁸² However, these are the only funds offered to State Farm customers—competitors' products are not available. State Farm made the same decision regarding referrals for auto insurance customers seeking auto loans. State Farm previously had relationships with nine bank partners to which it made referrals. However, after State Farm Bank decided to build a loan portfolio, all such relationships were terminated and all referrals made to State Farm Bank.¹⁸³ Similarly, when ING decided to offer mutual funds through its bank unit, it offered customers only the funds of other ING subsidiaries.¹⁸⁴ When Citigroup decided to sell Travelers' property and casualty business, it decided to continue to market the Travelers property and casualty insurance products after the disposition, but to also begin to sell insurance from other companies. Until the disposition, other auto insurers feared Citibank would push Travelers insurance products and therefore would not let Citibank sell their products.¹⁸⁵

This consequence of fewer product offerings by financial supermarkets that are the product of convergence contrasts with the greater availability of product offerings by financial institutions that merely broker products. For example, a study of bank offerings of mutual funds found that banks sell, on average, 617 mutual funds from twenty-one different fund families.¹⁸⁶ The sentiment of one industry official reflects the adverse consequence of convergence. Axa Finan-

181. This is not true of all vertically integrated firms. Merrill Lynch, for example, allows online investors to buy, sell, or exchange more than 2,400 mutual funds from more than ninety fund families including Merrill Lynch's three fund families. See Press Release, Merrill Lynch, Merrill Lynch Launches Merrill Lynch Direct (Dec. 1, 1999), available at <http://www.ir.ml.com/news/1991201-24857.cfm>.

182. Press Release, State Farm, Leading U.S. Insurer Adds Mutual Funds to Its Product Line (Mar. 15, 2001), available at <http://www.statefarm.com/media/release/mutfund.htm> (on file at the *New York University Journal of Legislation and Public Policy*).

183. See Veronica Agosta, *State Farm to Cut Loan Tie to N.J.'s Valley National*, AM. BANKER, Dec. 6, 2000, at 6 (stating all relationships would be terminated by end of 2001).

184. David Reich-Hale, *ING Selling 6 Funds Online Through Del. Bank Unit*, AM. BANKER, Jan. 2, 2002, at 8.

185. See Floyd Norris, *Citigroup Goes to the Well Again on Travelers Unit*, N.Y. TIMES, Dec. 20, 2001, at C1; Paul Beckett, *Weill's Way: Citigroup Keeps Refining Focus*, WALL ST. J., Dec. 20, 2001, at C1 (reporting that Citigroup offers other companies' property-casualty insurance internationally, but has only offered Travelers' in U.S.).

186. See Matthew Hunter, *For Banks, A Funny Thing Happened on the Way to the 'Supermarket'*, AM. BANKER, Aug. 8, 2000, at 1.

cial, formerly Equitable Companies, owns Equitable Life and a majority stake in Alliance Capital, a mutual fund company. Banks are the main channel for distributing Axa's products. Vice Chairman Michael Hegarty noted the company is leery of combining with a bank, or a large securities company, because, "We want the freedom to distribute through as many desktops as possible."¹⁸⁷

5. *New Products*

New products have emerged in the financial services industry in recent years. However, they seem to have emerged due to factors unrelated to the GLBA. For example, the case studies below reveal that product innovations have surfaced, and all involve the Internet—for example, cardless credit card accounts, online business procurement, online person-to-person funds transfers, and account aggregation services. These were surely stimulated primarily by the existence of and increasing use of the Internet. It is not clear that cross-industry activity, authorized by the GLBA, was also a factor that led to these innovations. For example, several securities firms have introduced the account aggregation service in late 2000 and 2001.¹⁸⁸ Account aggregation is an online service in which various online accounts of customers are brought together for display and transactions by the customer. Securities firms have added investment advice to the service. Similarly, insurance products that compete with traditional bank products have emerged, such as the "total return" fixed annuities.¹⁸⁹ These surfaced prior to the GLBA and therefore cannot be said to be a byproduct of the Act.

III.

ASSUMPTIONS CONFRONT CURRENT BUSINESS PRACTICES

A. *Possible Explanations for Actual Outcomes*

The industry-wide evidence and case studies in Part II of this Article reveal that the expected benefit of increased competition was realized to some degree. In addition, the expected benefit of efficiency was realized. The assumption in the Committee Hearings was that these, in turn, would yield consumer benefits. However, the evi-

187. Kraus, *supra* note 130, at 1 (concluding that deal between Axa Financial and major bank would close more doors than it would open).

188. See Megan J. Ptacek, *Winning Duo: Aggregation Plus Advice*, AM. BANKER, Oct. 4, 2000, at 1 (citing Morgan Stanley Dean Witter and Merrill Lynch).

189. See Jack L. Martin & Kathran J. Martin, *Total Return Annuities Can Be CD Alternative*, NAT'L UNDERWRITER, Jan. 24, 2000, at 7 (stating concept began taking root six years ago).

dence has largely been to the contrary. Little or no cost savings for consumers has resulted. No product innovations have been generated. No formerly uneconomical products or services have surfaced. The only significant consumer benefits that may have resulted are increased geographical access and the convenience of one-stop shopping. However, evidence is needed of the former, and the latter has produced the curious outcome of fewer product offerings in some one-stop financial supermarkets. Why have our assumptions been proven to be largely unjustified?

1. Time

One explanation for the failure of the GLBA to generate substantial consumer benefits is that too little time has passed. The claim would be that firms are slowly embracing the cross-industry concept and, in time, greater benefits will be realized. One example of projected future cross-industry activity is provided by the Ninth Annual Survey of Community Bank Executives.¹⁹⁰ It revealed a projected doubling in the number of community banks offering insurance products in the next three years, and a more than fifty percent increase in the number of community banks offering brokerage services and mutual funds.¹⁹¹ However, these changes do not necessarily involve vertical, cross-industry entry—for example, as an underwriter of insurance or securities products as well as a broker. Banks and securities firms have been unwilling to engage in insurance underwriting due to the low rates of return in the insurance industry.¹⁹² This is not

190. See Grant Thornton, *supra* note 161.

191. *Id.* at 4. The survey revealed the number of community banks offering various products and services today and those likely to offer in three years. The results, in part, were as follows:

Percentage of community banks that offer these products and services today and are likely to offer in three years		
	Today	In Three Years
Brokerage Services	45%	69%
Mutual Funds	43%	66%
Insurance Products	33%	65%

192. The norm for return on equity in the life insurance industry, for example, is fifteen percent. See Lee Ann Gjertsen, *Does Bob Benmosche's New MetLife Have What It Takes to Break Out?*, AM. BANKER, Jan. 8, 2001, at 1 (reporting that MetLife's return on equity was 9.5 percent). In the property-casualty industry, returns on equity have been even lower. See Susanne Sclafane, *Insurers Report Sickly Results*, NAT'L UNDERWRITER, Feb. 21, 2000, at 1 (reporting industry rate of return was 9.3 percent in 1998 and 7.3 percent through nine months of 1999); see also detailed data on returns in the insurance, banking, and securities industries contained in App. B.

a short-term phenomenon—not one that changes over time. Insurance firms have been unwilling to engage in investment banking due to the highly cyclical nature of the business, the great difference in business cultures between insurance and investment banking executives, and the highly competitive nature of the investment banking business that denies most new entrants substantial market share.¹⁹³ These characteristics and differences are endemic. They will not change over time.

In addition, if increased cross-industry involvement occurs, even if it occurs only in a brokerage capacity, this does not necessarily mean that lower costs and increased access to products will result. This is a business planning decision. As discussed below, past experience reflects a focus and differentiation strategy on the part of many new cross-industry competitors, and such a strategy does not yield substantial consumer benefits, especially in the form of lower costs.

In addition, the business plans of all existing securities and insurance company entrants into the banking market undermine substantial realization of substantial consumer benefits for another reason. Namely, the efficient distribution system of insurance agents and brokers serving a branchless bank undermines substantial customer acceptance, particularly acceptance of deposit products.¹⁹⁴ This is not likely to change over time. A branch network is costly, leading to reliance on branchless bank offerings.

In summary, more entrants and offerings are possible in time. However, time is not likely to change the conclusion of lack of substantial consumer benefit.

2. *Political Claims*

A second explanation for the variance between the stated consumer benefits of the GLBA and the realized benefits is that industry leaders and legislators were exaggerating consumer benefits. Benefits as diverse and substantial as enumerated in the Committee Hearings were never actually expected. They were reported to provide an illusion of congressional action for the public good, rather than action for the good of a small number of large corporations that had the ability to seize the powers granted by the statute—to engage in banking, insurance underwriting, and investment banking. This is a possibility. Certainly unfounded claims and exaggerations of public benefits have

193. *E.g.*, John Tagliabue, *Swiss Banks Calling Wall St. Home*, N.Y. TIMES, Aug. 31, 2000, at C20 (noting that French insurance and financial services giant Axa is shedding Donaldson because Axa is not prepared to spend capital to be player in global investment banking).

194. *See supra* text accompanying notes 127–129.

occurred before. For example, the calls for repeal of the estate tax in 2001 relied on the justification that repeal would save the family farm.¹⁹⁵ However, the American Farm Bureau Federation, one of the leading advocates for repeal, said it could not cite a single example of a farm lost because of estate taxes.¹⁹⁶ Political claims as an explanation probably has some truth to it. It seems, however, not to be the only explanation.

3. Complexity

Another possible explanation is based on the concept of complexity.¹⁹⁷ This explanation may come in one of two forms. In one form the argument is that the GLBA is one factor influencing business decisions when introduced into a business environment. However, that environment is one in which decisions are shaped by many factors. Thus, if all things remained the same, the Act would have yielded some or all of the consumer benefits claimed. However, there have been shocks to the business environment that have made some or all of the expected benefits infeasible at this time. There was the severe downturn in the securities industry—both investment banking and securities brokerage—due to a recession followed by the September 11th attacks and then the Enron scandal.¹⁹⁸ There were the loan losses incurred by some large banks involved in cross-industry activity due to unexpected shocks, such as the Enron bankruptcy.¹⁹⁹ There was also the drain on earnings in the property and casualty insurance in-

195. David Cay Johnston, *Talk of Lost Farms Reflects Muddle of Estate Tax Debate*, N.Y. TIMES, Apr. 8, 2001, at 1. For example, President Bush and others stated “To keep farms in the family, we are going to get rid of the death tax.” *Id.* Senator Charles E. Grassley, chair of the Senate Finance Committee and an Iowa hog farmer, stated that due to the estate tax “The product of a life’s work leaches away like seeds in poor soil.” *Id.*

196. *Id.*

197. Vincent DiLorenzo, *Complexity and Legislative Signatures: Lending Discrimination as a Test Case*, 12 J.L. & POL. 637, 640–41 (1996).

198. See Tania Padgett, *Shying Away: Skittish Investors Looking to Maximize Cash Seek Options that Don’t Include Stock*, NEWSDAY, Feb. 24, 2002, at F8; Matthias Rieker, *Glum Outlook for Investment Banks*, AM. BANKER, Aug. 10, 2001, at 20; Amanda Fung, *Glum 2nd Half Forecast for 5 Major Brokerages*, AM. BANKER, July 3, 2001, at 20.

199. Heather Timmons & Christopher Palmeri, *The Perils of J.P. Morgan*, BUS. WK., Jan. 21, 2002, at 62; Tania Padgett, *Enron’s Collapse Takes Toll on Banking Industry*, NEWSDAY, Jan. 17, 2002, at A47 (reporting that J.P. Morgan Chase, Citigroup, and FleetBoston face exposure due to Enron bankruptcy and loan exposure in Argentina). However, commercial banks generally registered their best fourth quarter earnings ever during 2001. Press Release, FDIC, Quarterly Banking Profile: The FDIC Preliminary Bank Earnings Report, Fourth Quarter 2001 (Feb. 10, 2002), available at <http://www.fdic.gov/news/news/press/2002/pr2302a.html>.

dustry due to the weak economy, claims from tropical storms, the Enron collapse, and the claims arising from the September 11th attacks.²⁰⁰

In this first form of the complexity argument, benefits are said to have been reasonably expected but temporarily short-circuited by external events. In a second form of the complexity argument, benefits are said to exist, but are difficult to trace. The argument begins with the notion of aperiodic outcomes²⁰¹—different firms will react differently to the GLBA. Some firms will reduce prices in credit card rates only, some will raise rates on long-term deposits only, some will only offer consumers rebates on credit card purchases, and others will lower fees for bank services or securities brokerage services. As to any one of these possible responses, many factors lead a firm's decision to grant consumers some benefits and the amount of benefit to provide. Thus, tracing the outcome to the GLBA, as one of many contributing factors, is impossible. However, this does not mean the Act has had no effect. We do not know for sure, one way or the other.

The explanations discussed above—time, and especially political claims and complexity—may be part of the reason that the stated consumer benefits of the GLBA have not been realized to a substantial degree. However, I want to suggest an additional explanation that seems to overshadow these three in importance. That explanation involves assumptions regarding business plans, and is discussed below. This explanation provides a degree of certainty to expected outcomes, despite the concept of complexity. This is because short-term external events, such as economic downturns, cannot be reasonably claimed to have short-circuited expected consumer benefits if the firms in question never planned to provide such benefits. Similarly, difficulty in tracing causes and effects cannot lead to the assumption that consumer benefits must have been forthcoming as a result of the GLBA, if the firms in question never planned to provide such benefits.

B. Another Explanation—Business Plans in the Modern Economy

Management theory notes that every business has a choice among various options to achieve the goal of competitive advantage. One

200. INS. INFO. INST., 2001 YEAR END RESULTS, available at <http://www.iii.org/media/industry/financials/2001yearend/content.print> (recounting report of negative 2.7 percent return in property/casualty industry in 2001, down from 6.5 percent in 2000).

201. See Vincent DiLorenzo, *Equal Economic Opportunity: Corporate Social Responsibility in the New Millennium*, 71 U. COLO. L. REV. 51, 82 (2000) (discussing chaotic turbulence and outcomes in systems subject to strange attractor—systems allowing an infinite number of variations in outcomes).

strategy is cost leadership, which involves lowering costs of production and charging customers a lower price than competitors charge.²⁰² A second option is a differentiation strategy—creating a good or service that customers perceive as unique.²⁰³ Differentiation can be via physical characteristics, such as quality or reliability, or by appeal to psychological needs such as prestige or status.²⁰⁴ This allows the firm to charge a premium price, provided customers believe the product's differentiated qualities are worth a price above the industry average and certainly above the cost leader's price. A differentiation strategy may be employed in many product market niches or few.

A third option is a focus strategy. This strategy concentrates on serving a particular market niche, which can be a geographical niche, a product line niche, or a type of customer niche.²⁰⁵ Once a focus strategy is chosen, then within a niche, the firm can pursue either a cost leadership or a differentiation strategy.

As to any of the three strategies discussed above, there is also a choice as to market segmentation.²⁰⁶ A firm may choose to compete in a particular geographic market, in a particular product line, and/or for a particular type of customer.

The legislative history of the GLBA reflects an assumption that large corporations follow a business strategy of cost leadership in a broad geographic, product, and customer market. This might be called the traditional, supermarket retailer business plan. This business plan is one in which large firms (1) target a mass market, (2) seek a broad geographical presence, and (3) offer a large range of products.

This is thought to increase revenues by maximizing a firm's number of customers and the number of products customers purchase. Volume is key. Price is used as the primary inducement to convince the largest number of consumers to become and remain customers. This model is reflected in the actions of "supermarkets" in various sectors—food supermarkets, home repair supermarkets, household goods supermarkets, and toy supermarkets. An illuminating example is provided by recent activities in the retail grocery business. Kroger Company has been the leader in annual grocery sales for many years. Recently, Wal-Mart Supercenters have sold groceries thirty percent cheaper, on average. Wal-Mart is on a trajectory to vault from their

202. See CHARLES W.L. HILL & GARETH R. JONES, *STRATEGIC MANAGEMENT: AN INTEGRATED APPROACH* 205 (5th ed. 2001).

203. See *id.* at 208.

204. See *id.* at 204.

205. See *id.* at 214.

206. See *id.* at 204.

current number nine position in grocery sales to number one in 2005. To lure back customers, Kroger decided to respond by cutting prices.²⁰⁷

Small firms have also existed that did not compete based on price, but on service and quality by, for example, pursuing a focus and differentiation strategy. These smaller firms did not seek a broad geographical presence, did not offer a broad range of products, and often did not target a mass market. It was assumed, however, that this was a model for a small firm. Large firms were expected to, and typically did behave differently.

If one accepts this traditional retailer model, then congressional assumptions regarding consumer benefits seem reasonable. Almost all of the benefits recited reflect the traditional retail business model. Broad product and geographic competition are the means of operation. Lower costs for consumers are the very method of ongoing competition between various market participants. Efficiency gains are common, in part due to market power in dealing with suppliers. They allow for lower costs and trigger decisions to reduce prices. Access follows from geographic and product expansion.

Unfortunately, the financial services modernization experience reveals that in today's market, this traditional, supermarket retailer model is not followed by many large corporations, including corporations that are both retailers and producers of financial products. This modern business plan accepts the goal of maximizing net profits in order to maximize return on equity. However, it believes that this goal is best achieved by a differentiation strategy, perhaps combined with embrace of a focus strategy, such as market segmentation. This might be called the specialized retailer model. It is characterized by decisions to (1) target only segments of customers (who may be corporations and not consumers) who generate the greatest net revenue; (2) embrace primarily or exclusively the products and services that generate the greatest net revenues (for example, requiring the least capital or labor commitment); (3) minimize the costs of geographic reach by relying more and more on virtual presence through, for example, telephone access to brokers and Internet access to products and services; (4) attract and retain customers primarily based on expertise, experience, reputation, and, at times, convenience; and (5) relegate price, as a means of competition, to a small role—an enticement for "relationship financial services." One product or service is offered at

207. See Leah Beth Ward, *Kroger Sees a Shadow Lurking Over Aisle 3*, N.Y. TIMES, Apr. 7, 2002, at C4.

a lower price as an enticement for acceptance of a broad range of products or services that are not offered based on price and that yield high returns.

If firms follow the specialized retailer model, the stated consumer benefits of the GLBA could not be assumed. Lower costs for consumers do not follow from decisions to compete or from gains in efficiency. Increased access does not necessarily arise if a focus strategy is pursued in a particular geographic, product, and/or customer market.

In order to understand better the response of industry members to the GLBA, I decided to undertake a study of the actions of the industry members most active in introducing cross-industry products and services. I studied the actions of State Farm, Merrill Lynch, and Citigroup during the years 2000 and 2001—the two years following the enactment of the GLBA. The study was of (1) all press releases issued by each firm, and (2) news reports in leading competing industry publications.²⁰⁸ All articles discussing the activities of each firm involving cross-industry activities, such as acquisitions or divestitures and product and service offerings, were studied. The aim of these case studies was to uncover the motivations of these firms based on their actions and the business environment. More fundamentally, the aim was to examine their business plan for participation in the new environment created by the GLBA. Were these firms interested in competing in the banking market, insurance market, *and* securities market? If so, in what sectors of that market? Did they experience cost savings from efficiency in cross-industry activities? If the answer to either of these questions was yes, then what was the result? Did competitive motivations and gains due to efficiency translate into decisions to cut costs for consumers, or otherwise to provide benefits to consumers? In other words, were these firms acting as cost leaders and doing so in a broad product, customer, and geographic market?

1. Case Study: State Farm

In the period after January 2000, State Farm decided to actively enter the banking market as a principal. It “created” a distribution network for a wide range of deposit and loan products on the part of its subsidiary bank. In March 2000, State Farm Bank, which has one office in Bloomington, Illinois became accessible by Internet and tele-

208. This consisted of news reports regarding State Farm and Merrill Lynch in *American Banker*, news reports regarding Merrill Lynch and Citibank in *National Underwriter*, and news reports regarding State Farm and Citibank in *Securities Industry News*.

phone to customers nationwide.²⁰⁹ This made available the bank's deposit products—checking accounts, savings accounts, certificates of deposit and money market accounts—and the bank's home mortgage products. It then began training its 16,000 insurance agents to market the bank's products. In October 2000, it announced that all of the bank's products would be available throughout the U.S. by the end of 2001, upon completion of its training program.²¹⁰ This distribution vehicle would make available to customers not only the bank's deposit products and home mortgage products but also consumer loans such as auto loans and leases, and home equity loans and lines of credit. In addition, in April 2001 State Farm Bank began offering a Visa Credit Card with no annual fee and a rewards program.²¹¹ State Farm Bank has not chosen to offer commercial and business loans. State Farm's decision was to enter the consumer banking market with a broad product line made available to consumers across the United States.

While it chose to enter the deposit and loan market as a principal, it did not choose to enter the trust or wealth management market as a principal. Instead, State Farm Life Insurance Company formed an alliance with Phoenix Home Life Insurance Company to make Phoenix the provider of wealth-management services for State Farm customers.²¹² The services provided involve estate planning, retirement planning, business planning, charitable giving, and executive benefits. These are also services frequently provided by banks. They will be made available through State Farm's insurance agents.

State Farm's competitive efforts in the securities area have not been as substantial as their efforts in the banking area. The only reported entry into the securities market was entry into the mutual funds market in March 2001.²¹³ State Farm began to offer ten State Farm Mutual Funds nationwide. The funds would be managed by State

209. Press Release, State Farm, State Farm Bank Extends Internet and Telephone Access Across United States (Mar. 29, 2000), available at <http://www.statefarm.com/media/release/bankext.htm>.

210. Press Release, State Farm, State Farm Bank to be Fully Operational Country-wide by End of 2001 (Oct. 9, 2000), available at <http://www.statefarm.com/media/release/bkoperat.htm>.

211. Press Release, State Farm, State Farm Bank Now Offering Visa Credit Cards (Apr. 9, 2001), available at <http://www.statefarm.com/media/release/bankcard.htm>. The rewards program was one percent of net purchases awarded in State Farm Dollars that could be redeemed to pay State Farm insurance premiums, to make payments due on a State Farm mortgage or consumer loan, to purchase State Farm Mutual Funds, or as a deposit in a new or existing State Farm Bank deposit account.

212. Press Release, State Farm, State Farm, Phoenix Form Alliance to Serve Affluent Customers (Mar. 30, 2001), available at <http://www.statefarm.com/media/release/phoenix.htm>.

213. Leading Insurer Adds Mutual Funds to Its Product Line, *supra* note 182.

Farm VP Management Corp. and sold through that entity. The funds would be available through State Farm insurance agents, the Internet, and by telephone. In other words, in the securities area, State Farm is pursuing a focus strategy regarding product offerings.

In summary, State Farm made a decision to actively compete in the banking market, except for the market for commercial and business loans. It also made a decision to actively compete only in the securities submarket of mutual funds. Consumer benefits flow not merely from a willingness to compete, but also from an ability to compete. Ability depends on presence and efficiency. Potentially, State Farm's competitive presence could be substantial. As noted above, bank products and securities products would be made available through the Internet, by telephone, and through 16,000 insurance agents located throughout the United States. The last could market the products to the more than 40 million State Farm policyholders in the United States.²¹⁴

Turning to the expected efficiency that would result from cross-industry activity, there are obvious cost-savings that State Farm will enjoy through its decision regarding marketing strategy. State Farm decided to market its bank products and mutual funds through its existing insurance agents. It created a bank with only one office. There would be no bank branch network and no network of securities brokerage offices. In addition, sales (as well as management) of its mutual funds will occur through its existing broker-dealer, through which State Farm also sells its variable insurance products. Thus, the decision was to realize efficient operations in the form of cost savings from cross-selling by an existing distribution network. In other words, State Farm positioned itself to be a cost leader if it chose to adopt this business strategy.

Given this decision to compete, especially in the bank market, and given the decision to market efficiently, what were the reported benefits to consumers? Almost no cost savings to State Farm bank customers have been reported in press releases or news reports—e.g., lower fees, lower loan rates, higher rates payable on deposits. The one small benefit reported is that the State Farm Visa card has a rewards program.²¹⁵ My own study of bank deposit, home mortgage and credit card rates discloses no interest rate cost savings in home mort-

214. *Id.*

215. *See* State Farm Bank to Be Fully Operational Countrywide by End of 2001, *supra* note 210. Of course, the benefit is mutual in that it is used to market State Farm products.

gage loan products.²¹⁶ The only potential consumer cost savings (i.e., greater returns) would be in deposit products and, to some extent, in credit card products.²¹⁷ Similarly, State Farm's mutual funds did not appear among rankings of best buys.²¹⁸ Consumer benefits depend upon willingness, ability, and acceptance. Willingness translates into the benefit of cost savings only if cost leadership is also adopted as a competitive strategy. Although additional research is necessary, it appears that State Farm made a decision to embrace cost leadership as a strategy only in the bank deposit market. Naturally, this would limit potential cost savings to customers to this market. Moreover, even this benefit is only a potential one. For benefits to be realized, ability, willingness and acceptance must all be present. Consumer acceptance of State Farm's efficient marketing strategy is discussed below.

Turning to the other stated benefits of the GLBA, no new products have been introduced. Rather, State Farm is marketing traditional bank and securities products. Finally, no increased access in the form of affordable product offerings has been reported. One benefit that might be in evidence is the benefit of increased access by currently underserved communities through the reach of 16,000 insurance agents nationwide. Yet, this is only a possibility. No one has examined whether such agents are located in areas not adequately served by bank branches or securities brokers. Research is needed on this question. Another access benefit that might be in evidence is one-stop shopping. Insurance agents are now offering insurance products, bank products, and some securities products. As discussed earlier,²¹⁹ this benefit is not as significant as one might expect. This is because vertically integrated firms are offering consumers only their own products, thereby, in a sense reducing access rather than expanding it. In addition, one-stop shopping is only a potential benefit until it is demonstrated that consumers accept the firm's marketing strategy—the means of access the firm makes available for consumers.

Increased access and cost savings are only potential benefits unless the marketing decision transforms the potential into reality. The marketing strategy of State Farm was one based on efficiency—use of existing insurance agents, no new branch offices. However, that decision limited realization of actual benefits to consumers. First, insurance agents have been reluctant to actively market bank and securities products. Second, customers are reluctant to embrace bank products,

216. *See supra* Part II.B.3.a.

217. *See supra* Charts 2–5.

218. *See* discussion *supra* note 175 and accompanying text.

219. *See supra* text accompanying notes 181–187.

especially deposit products, of an institution that has no local bank presence.²²⁰ In other words, willingness has existed at the management decision-making level, but has been weaker at the implementation level. In addition, acceptance on the part of the public has also been weak. As a result, as of September 2001, State Farm Bank had 125,000 customers and \$1 billion of deposits.²²¹ On the asset side, insurance agents have been most successful in marketing auto loans, due to State Farm's significant presence in sales of auto insurance and the fact that insurance agents have been making auto loan referrals for years.²²² In large part, therefore, the touted benefits of competition and efficiency have proven to be mutually exclusive, with efficient operations undermining substantial competitive outcomes for consumers.

Overall, in the banking market, State Farm's actions manifest only a modified traditional, supermarket retailer plan. It has marketed a broad range of bank products, in a broad geographic area, to a broad customer base. However, it has not decided to be a cost leader in all product markets. It has decided to be a cost leader in the deposit markets, but not in the loan market. By contrast, in the securities market, State Farm has pursued a focus strategy. It has not chosen to compete in a broad array of securities products. Rather it has focused on mutual funds. Moreover, in that focused market it has not decided to be a cost leader.

2. Case Study—Merrill Lynch

Bank products offered in the United States through Merrill Lynch have been products underwritten by the firm itself.²²³ In other words, the expected result of vertical integration across industry lines has been witnessed. However, those products have not been offered to a

220. See Reich-Hale, *State Farm Hopes Banking Clients Are There*, *supra* note 129, at 1 (discussing obstacles faced by branchless institutions and importance of insurance sales to insurance agents).

221. Quittner, *supra* note 116, at 10A. Deposits have grown to \$2.4 billion as of June 30, 2002. See *supra* note 123.

222. Lee Ann Gjertsen, *Core Hurting, State Farm's Banking*, AM. BANKER, Mar. 14, 2002, at 1 (noting that State Farm Bank had \$851 million in assets on June 30, 2001, and had \$1.8 billion of assets as of March 2002).

223. By contrast, in the global market it had created an alliance with HSBC. See Press Release, Merrill Lynch, Merrill Lynch, HSBC to Create New Company Forming the First Global Online Banking & Investment Service (Apr. 18, 2000), available at http://www.ml.com/about/press_release/041800.htm. However, in May 2002, that alliance was ended due to insufficient returns. See Press Release, Merrill Lynch, Merrill Lynch, MLHSBC to Be Integrated Into HSBC (May 17, 2002), available at http://www.ml.com/about/press_release/05172002-1_mlhsbc_integrated_pr.htm.

broad customer market, and competition has not been through cost leadership. In other words, a focus and differentiation strategy has been employed.

One product offering has been trust services. In December 2001, Merrill Lynch announced the creation of five regional high-net-worth trust centers in the United States, as well as the roll-out of a direct-access platform for trust accounts with less than \$1 million in assets or with less complex service needs.²²⁴ Merrill Lynch Trust Company was founded in 1987, and by 2001 administered more than \$85 billion in assets in more than 20,000 institutional and personal trust accounts.²²⁵ In addition, Merrill Lynch's International Private Client Group announced in March 2001 that the value of assets held in Merrill Lynch trusts for overseas clients had increased from \$10 billion to \$17 billion over the previous 15 months.²²⁶

Small business loan and financial products have been a second, directly underwritten offering. In January 2002, Merrill Lynch announced plans to launch a diversified commercial finance unit through a subsidiary of Merrill Lynch Bank USA.²²⁷ The unit will offer asset and cash-flow based loans, equipment leases and loans, and interim financing for income-producing properties, among other products and services. Earlier, Merrill Lynch had launched an enhanced online cash management service for small and midsize businesses that included access to an online business procurement management system that offered, among other things, real-time shipping and tracking capa-

224. See Press Release, Merrill Lynch, Merrill Lynch Creates Regional Trust Centers (Dec. 6, 2001), available at http://www.ml.com/about/press_release/12062001-01_trust_centers_pr.htm; see MLHSBC to Be Integrated Into HSBC, *supra* note 223.

225. See Press Release, Merrill Lynch, Merrill Lynch Creates Regional Trust Centers (Dec. 6, 2001), available at http://www.ml.com/about/press_release/12062001-01_trust_centers_pr.htm; see MLHSBC to Be Integrated Into HSBC, *supra* note 223.

226. Press Release, Merrill Lynch, Increased Demand for Trust Services (Mar. 20, 2001), available at http://www.ml.com/about/press_release/03202001-01_trust_services_pr.htm; see also Niamh Ring, *Merrill Trust Business Bullish Outside America*, AM. BANKER, Mar. 21, 2001, at 1.

227. Press Release, Merrill Lynch, Merrill Lynch to Launch Middle-Market Commercial Finance Initiative (Jan. 14, 2002), available at http://www.ml.com/about/press_release/01142002-1_middle_market_pr.htm; see also Heike Wipperfurth, *Merrill Bullish on Banking: Hungry for Lenders Amid Huge Layoffs in Brokerage Unit*, CRAIN'S N.Y. BUS., Mar. 25, 2002, at 1 (explaining that Merrill Lynch started its Business Financial Services Unit Group seventeen years ago and had portfolio of \$7 billion in small business loans in 2001). Professor Sam Hayes of Howard Business School noted: "They are doing a very smart thing. The middle market is a traditionally higher-margin market than the big corporations that shop for funds all over the world." *Id.*

bilities.²²⁸ These product offerings complement two sweep accounts for small businesses, the Working Capital Management Accounts, that have been marketed for over ten years and have amassed \$100 billion of assets.²²⁹

Sweep accounts for securities customers have been a third directly underwritten offering. In February, 2000 Merrill Lynch initiated a new cash management account in which excess cash in its brokerage accounts would be swept into an FDIC-insured account at one of two banks it owns.²³⁰

A final directly underwritten offering is an online banking presence. In February 2001, Merrill Lynch announced plans to offer banking products online.²³¹ This announcement came three months after it launched its online brokerage services, and plans were to integrate the two.²³²

The offerings of bank products suggests a broad product, customer, and geographic presence. However, this is only a potential presence. As discussed earlier,²³³ Merrill Lynch has made a decision to make the deposit products available to brokerage customers and to high net worth individuals. They are not marketed to consumers generally. Nor are the consumer loan products marketed to consumers generally. There has been no roll-out of a mass marketing campaign—for example, to broadly market home mortgages to all consumers via advertising or via outreach by Merrill Lynch's 16,000 financial consultants. A distinct issue is whether even a focus strategy will utilize cost leadership as a competitive tool. However, the earlier discussion of competition in the home mortgage market, securities brokerage market, and mutual funds market indicates that Merrill Lynch has not adopted cost leadership as a business plan.

An interesting insight into Merrill Lynch's business plan comes with an announcement in April 2001 relating to brokerage customers. The company launched the Merrill Lynch Financial Advisory Center

228. Press Release, Merrill Lynch, Merrill Lynch Launches Enhanced Online Banking Services for Small and Midsize Businesses (June 12, 2000), available at http://www.ml.com/about/press_release/06122000-1_enhancedonlinebanking_pr.htm.

229. Byles Dinkin, *Commentary: Revamped Offerings Can Counter Erosion of Small Business Deposits*, AM. BANKER, June 29, 2000, at 14A.

230. Winokur, *supra* note 140, at 1.

231. Jessica Toonkel, *Merrill Lynch Adds Internet Bank to Growing On-Line Plan*, AM. BANKER, Feb. 25, 2000, at 1.

232. *Id.* See also Liz Moyer, *Morgan Aims to Expand Base of Wealthy Clients with New On-Line Bank*, AM. BANKER., Mar. 14, 2000, at 4 (discussing Merrill Lynch and Morgan Stanley Dean Witter's launch of online brokerage services designed to capture attention of emerging affluent).

233. See *supra* notes 139–141 and accompanying text.

which focuses on customers with less than \$100,000 in their accounts. These customers must access their accounts online or by telephone.²³⁴ This is further confirmation of a decision not to completely embrace a broad customer market.

Merrill Lynch's overall decisions over the first two years after enactment of the GLBA challenges another assumption regarding expected competition. The assumption was that large firms would enter the new markets as principals—for example, Merrill Lynch would underwrite insurance and underwrite bank loans. However, for many product offerings, vertical integration is not a strategy upon which Merrill Lynch has always chosen to embrace. Its decision has often been to form alliances instead. This is especially true in the insurance arena.

In the insurance market, Merrill Lynch's activities have been more limited than in the banking market, and its reliance on alliances have been even more common. Merrill Lynch has formed alliances to distribute insurance products. In March 2002, the firm announced an alliance with MetLife to distribute variable annuities through the Merrill Lynch Insurance Group.²³⁵ Thirteen companies have arrangements with Merrill Lynch to provide annuities to Merrill Lynch customers.²³⁶ In 2001, Merrill Lynch negotiated with German insurer Allianz A.G. to possibly distribute its insurance and annuity products in the United States.²³⁷ As to the business plan to rely on alliances, one financial analyst reported, "They know they don't have to manufacture everything."²³⁸

Overall, in the new banking and insurance markets open to Merrill Lynch, it has pursued a focus strategy and a differentiation strategy. It has not adopted cost leadership as its competitive strategy, and it has not chosen to be an active competitor for a broad range of banking products or insurance products.

As a result, the GLBA's stated benefit of cost savings to customers has not been realized. Similarly, the benefit of introduction of new

234. Niamh Ring, *Nudge Out of Branches at Merrill*, AM. BANKER, Apr. 24, 2001, at 1 (explaining that not everyone with less than \$100,000 is automatically enrolled; those with more complex needs may still be dealt with by financial consultant).

235. Lee Ann Gjertsen, *MetLife Unit Gets Merrill Lynch Distribution Deal for Variables*, AM. BANKER, Mar. 15, 2002, at 10.

236. *Id.* Merrill Lynch sold \$3.3 billion of annuities in 2001. *Id.* MetLife has also partnered with A.G. Edwards, PNC Financial, and Dime Bancorp, but the banking companies mainly sell its fixed annuities.

237. Amy S. Friedman, *Cross-Selling Offers? Europe, U.S. Listening*, AM. BANKER, Mar. 29, 2001, at 1. It does not appear that the talks led to an agreement.

238. *Id.* (quoting Diana R. Yates, financial services analyst at A.G. Edwards).

products has not been witnessed, except if one accepts account aggregation as a new product.²³⁹ However, this seems to be a by product of the Internet and not of the GLBA. Access in the form of affordable products offerings have also not been witnessed, unless one accepts online brokerage as an affordable product offering.²⁴⁰ Since this is a product offering for Merrill Lynch in the securities market, this does not appear to result from the GLBA, i.e., cross-industry entry by new competitors. In any event, online and discount brokers' surveys²⁴¹ reveal that Merrill Lynch's product is not a cost leader. It emerged as a cost leader only in a survey of full-service brokerage firms.

3. Case Study—Citigroup (Citi)

Citigroup's decision to merge with Travelers has thrust it into both the securities and insurance market. As to competition in the securities market, Citi has decided to actively compete in the investment banking market both in the United States and abroad. Thus, its Salomon Smith Barney subsidiary acquired Schroders' PLC in January 2000.²⁴² Schroders is one of the U.K.'s leading investment banking and asset management firms. By the end of 2001, Citigroup's investment banking division topped the industry's list of revenue producers.²⁴³ How has it achieved this outcome? One vehicle is acceding to issuer's demands that Citi make big, barely profitable loans to corporate clients if they want to manage highly profitable stock or bond offerings or advise on mergers.²⁴⁴ This would translate into cost savings for some large corporations. It would not translate into cost savings for Citigroup's consumer customers.

Another set of decisions involving the securities market may impact consumers. In November, 2000 Citi introduced its first family of no-load index funds.²⁴⁵ Such funds, of course, are available to inves-

239. *Merrill Lynch Begins Aggregation Service*, AM. BANKER, Feb. 21, 2001, at 12.

240. Merrill Lynch began offering online securities brokerage services in December 1999. Merrill Lynch Launches Merrill Lynch Direct, *supra* note 181.

241. *See supra* Part II.B.3.e.

242. Press Release, Citigroup, Citigroup's Salomon Smith Barney Unit to Acquire Investment Banking Business of Schroders PLC, One of Europe's Leading Financial Advisory Firms (Jan. 18, 2000), available at <http://www.citigroup.com/citigroup/press/000118b.htm> (stating that acquisition of Schroders' investment banking business doubled Salomon Smith Barney's investment banking platform in Europe).

243. *See supra* note 93.

244. *See* Patrick McGeehan, *Showdown on Wall Street*, N.Y. TIMES, June 15, 2001, at C1. *See also supra* notes 2–3 and accompanying text.

245. Press Release, Citigroup, SSB Citi Launches No-Load Index Fund Family; "Citi" Funds Available on New Cititrade Online Brokerage Platform (Nov. 13, 2000), available at <http://www.citigroup.com/citigroup/press/001113a.htm>.

tors with no sales charge. The same day, it announced a new discount trading service which would be available online.²⁴⁶ These two services that could yield consumer savings were made available online. This is a decision regarding geographic presence. Namely, Citi decided to offer these services that provide the potential for consumer savings solely through the efficient mechanism of online presence. A broad geographic presence was rejected.

These new services offer a potential for cost savings. However, in surveys of brokerage firms generally and online brokers specifically,²⁴⁷ Citigroup has not emerged as a cost leader. Similarly, in rankings of mutual funds based on cost,²⁴⁸ Citigroup was not mentioned as a cost leader. Thus, its entry into the securities market has not yielded cost savings for consumers relative to existing competitors. This is even true in the submarket of online trading. Cost leadership was not adopted as a competitive strategy.

In the insurance market, Citi has announced expansions abroad during the 2000–2001 period in question. Thus, in May 2000, it announced a partnership with the Fubon Group that included a commitment to pursue expansion in the property and casualty and the life insurance markets across Southeast Asia and China.²⁴⁹ In 2002, Citigroup decided to purchase the assets of the Mexican life insurance company and pension fund of Aegon, the Dutch insurer.²⁵⁰ These acquisitions do not evidence Citi's competitive activities in the United States. Yet, they are useful for assessing Citigroup's overall business plans. Namely, for a global, diversified company, the desire to maximize profits may lead to a decision to use assets, including cost savings generated from the Travelers' merger, to expand abroad rather than attempting to capture insurance customers in the United States.

The only other major decision of Citigroup regarding insurance activities in the 2000–2001 period was the decision to divest the property and casualty insurance operations that it acquired in its merger with Travelers.²⁵¹ This was done because Travelers' property and

246. Press Release, Citigroup, Citigroup Announces New Generation of Online Trading and Banking with Cititrade and Citibank Online (Nov. 13, 2000), available at <http://www.citigroup.com/citigroup/press/001113c.htm>.

247. See *supra* Part II.B.3.e.

248. See *supra* Part II.B.3.f.

249. Press Release, Citigroup, Citigroup and Taiwan's Fubon Group Announce a Powerful Strategic Partnership (May 6, 2000), available at <http://www.citigroup.com/citigroup/press/000506a.htm>.

250. Gori, *supra* note 103, at C2.

251. Joseph B. Treaster & Riva D. Atlas, *Citigroup to Shed Part of Travelers Unit in Stock Sale*, N.Y. TIMES, Dec. 20, 2001, at C9.

casualty business was generating a 10.9% return on equity, while Citigroup was looking for a 20% plus return.²⁵²

The discussion above has concentrated on Citi's decisions regarding competition. Its realization of the benefits of efficiency have come from cross-marketing of products. In January 2002, it reported that revenues for investment banking products sold to commercial banking customers increased 15% from the prior year, and sale of Travelers life and annuity products sold through Citibank branches also increased 17%.²⁵³ Such increase in successful cross-marketing has been accomplished not merely in Citi's branch network. It has also resulted from increasing use of the Internet to provide products and services, for example, Citi's no-load mutual fund and discount brokerage service that are available online.

Yet, competition and efficiency are means to an end. What benefits to consumers have resulted? Lack of cost savings from a cost leadership position has already been discussed. The only reported cost savings in the post-GLBA era has been on the part of large corporations demanding low cost corporate loans from Citi in exchange for the award investment banking business.

In addition to the benefit of lower costs for consumers, another consumer benefit discussed in the Committee Reports and Hearings on the GLBA was the expected introduction of new products. No new products or services have been announced by Citi in the insurance market or in the securities market. In the banking market, and financial services market generally, there have been several innovations announced. In February 2000, Citigroup and Commerce One announced plans to launch a business-to-business portal providing e-commerce services to Citibank's worldwide corporate customers.²⁵⁴ The portal includes the ability to take advantage of Citibank's broad array of financial services. In November 2000, Citigroup announced a similar alliance with Oracle Corp. to market Oracle's exchange services to its

252. Christian Murray, *Largest IPO Ever for a U.S. Insurer*, *NEWSDAY*, Mar. 21, 2002, at A55.

253. Press Release, Citigroup, Citigroup Reports Fourth Quarter and Full-Year Earnings (Jan. 17, 2002), available at <http://www.citigroup.com/citigroup/press/020117a.htm>. But see Bill Stoneman, *Cross-Selling Proves to Be a Hard Sell at Citigroup*, *AM. BANKER*, Oct. 16, 2001, at 8A (questioning success of efforts to market insurance products to bank customers).

254. Press Release, Citigroup, Citigroup and Commerce One Announce Plan to Build Internet Marketplace (Feb. 17, 2000), available at <http://www.citigroup.com/citigroup/press/000217a.htm>.

corporate customers.²⁵⁵ These two decisions are benefits for corporate customers, not consumers. Moreover, they appear to be the result of the emergence of the Internet and not the result of cross-industry opportunities opened up by the GLBA. After all, the Act opened only the insurance and securities markets to banks and not the full range of commercial activities.

In July 2000, Citigroup announced an alliance with AOL that relates to the expected benefits of new products and increased access for consumers. The AOL alliance offers a full range of Citigroup financial services—banking, insurance products, and securities products and services—to AOL users.²⁵⁶ It also creates a new payment and money transfer system providing consumers the ability to access payments capabilities and to complete person-to-person money transfers. In October 2000, Citigroup's bank subsidiary, Citibank, also launched an online person-to-person payments service through its Internet service.²⁵⁷ Finally, in July 2000, Citigroup announced an account aggregation service for consumers,²⁵⁸ and, in November 2000, a similar one for small businesses.²⁵⁹

Thus, there have been some product innovations by Citi that are for the benefit of consumers. A common feature of these new product offerings is that they are available for online transactions to online customers. Again, the decision was made not to compete in the form of geographic presence but in the form of efficient, online presence.

A final benefit discussed in the Committee Reports and Hearings is increased access. One aspect of access is providing services in an unserved or underserved geographic area. Perhaps Internet offerings of financial products provide such a benefit for communities with an

255. Press Release, Citigroup, Oracle and Citigroup Announce Global Alliance for B2B Commerce (Nov. 14, 2000), *available at* <http://www.citigroup.com/citigroup/press/001114a.htm>.

256. Press Release, Citigroup, Citigroup and America Online Announce Major Strategic Online Financial Alliance (July 18, 2000), *available at* <http://www.citigroup.com/citigroup/press/000718a.htm>.

257. Press Release, Citigroup, Citibank Launches Consumer Payments Engine on the Internet with c2it (Oct. 31, 2000), *available at* <http://www.citigroup.com/citigroup/press/001031a.htm>.

258. Press Release, Citigroup, Citigroup Launches MyCiti.com, New Consumer Account Aggregation Site with Yodlee Technology (July 18, 2000), *available at* <http://www.citigroup.com/citigroup/press/000718b.htm>. Account aggregation pulls together banking, investment, and other information from customers' online accounts, displays it in one statement, and allows customers to manage and act upon their online financial portfolio.

259. Press Release, Citigroup, Citigroup Expands Big-Business Advantages for Small Business at Bizzed.com (Nov. 15, 2000), *available at* <http://www.citigroup.com/citigroup/press/001115b.htm>.

insufficient number of financial services providers with a geographical presence. This is a possible benefit only. It requires research that has not been undertaken to date. Namely, research is needed on the geographic location of consumers' subscribing to Internet services and their willingness to use the Internet for financial services such as banking.

A second aspect of access is providing one-stop shopping. Certainly, Citi has made this available through cross-selling of products. However, as discussed earlier, Citi has chosen or been forced to offer only its own products. Thus, vertical integration has created one-stop shopping in a shop offering fewer products and not more products. A third aspect of the expected benefit of increased access is making available low-cost products not otherwise economically viable. No evidence of this possible benefit has been uncovered in Citi's activities.

Overall, Citi has decided upon market competition in a broad cross-industry market, as advocates of the GLBA expected. Its entry has been broader than State Farm, that has a very limited securities market presence, or Merrill Lynch, that markets some insurance products but only as a broker and not as an underwriter. However, similar to Merrill Lynch's decisions across product markets and State Farm's decisions in all but the bank deposit market, Citibank's entry into the securities and insurance market does not appear to be as a cost leader. Lack of cost leadership in securities brokerage and mutual fund offerings has been discussed. No evidence of cost leadership in insurance has been reported to date. The only evidence of cost savings provided by Citi that has been uncovered in the new competitive world unleashed by the GLBA has been in the market for corporate loans, as a lure for securing underwriting business. This, of course, is not a benefit provided to consumers.

CONCLUSION

Deregulation does not inevitably yield consumer benefits. Congress assumed that financial services deregulation would inevitably produce substantial consumer benefits, including consumer cost savings of \$15 billion per year. Experience has demonstrated, however, that some consumer benefits have not materialized while others have been very modest. A primary reason for this finding is that many large corporations do not embrace a competitive business strategy of cost leadership in a broad product, geographic, and customer market. This is another congressional assumption that has been proven to be unjustified. For firms pursuing a focus strategy and one based on

product differentiation, consumer benefits in the form of cost savings or broad geographic or customer access will not be forthcoming. The adopted business strategy prevents their existence.

APPENDIX A
SURVEY OF FINANCIAL SERVICES ACTIVITIES

An interesting insight into cross-industry activity is provided by the Insurance Information Institute's July 2001 Survey of activity on the part of the top ten companies, ranked by revenues, in each of the major financial services sectors that make up the Fortune 500. The survey does not differentiate between "manufacturers" (i.e., underwriters) of the product and "distributors" of it.

Sector (1)	Personal auto/homeowners insurance	Life/health insurance	Commercial insurance	Annuities	Asset management/retirement funds/money market accounts (2)	Personal banking	Securities/investment banking/mutual funds	Commercial banking	Mortgages/credit cards/personal/business loans (3)
Securities									
Morgan Stanley Dean Witter		X		X	X		X		X
Merrill Lynch		X		X	X	X	X	X	X
Goldman Sachs Group					X		X		X
Lehman Brothers Holdings					X	X	X	X	X
Bear Stearns					X		X		
Charles Schwab		X		X	X		X		X
A.G. Edwards		X		X	X		X		X
Franklin Resources					X	X	X	X	X
E*Trade Group	X	X		X	X	X	X		X
Raymond James Financial		X		X	X	X	X	X	X

Mass. Mutual Life Insurance		X		X	X	X	X	X	X	X	X	X	X
American General		X		X	X	X	X	X	X	X	X	X	X
AFLAC		X											
UnumProvident		X											
Guardian Life Ins. Co. of America		X		X	X	X	X	X	X	X	X	X	X

- (1) Sectors defined by Fortune.
- (2) Includes annuities, mutual funds and IRAs.
- (3) Includes home equity and auto loans.

Source: INSURANCE INFORMATION INSTITUTE, FINANCIAL SERVICES FACT BOOK 2002 at 9-12. The survey results are also available at <http://www.financialservicesfacts.org/financial/today/convergence/crossselling/content/print/>.

APPENDIX B

RETURNS ON EQUITY IN THE FINANCIAL SERVICES INDUSTRY

The Insurance Information Institute has collected and calculated returns for the property/casualty insurance industry (*i.e.*, return on average net worth) and for the life/health insurance industry (*i.e.*, return on equity) based on statutory accounting principles and GAAP accounting principles. It found the following:

ANNUAL RATE OF RETURN, PROPERTY/CASUALTY AND LIFE/HEALTH INSURANCE, 1994-2000				
Property/casualty insurance			Life/health insurance	
Year	Statutory accounting	GAAP accounting	Statutory accounting	GAAP accounting
1994	5.6%	5.6%	NA	NA
1995	9.0	8.7	NA	11.0%
1996	9.5	9.3	12.6%	10.0
1997	11.9	11.6	13.4	12.0
1998	9.2	8.5	9.7	11.0
1999	6.6	6.0	11.3	13.0
2000	6.5	5.8	12.8	10.0

Source: INS. INFORMATION INST., FINANCIAL SERVICES FACT BOOK 2002, at 31 (footnotes omitted).

Commercial banks, by contrast, have substantially higher returns than property/casualty insurance companies and even higher returns than life insurance companies. The Insurance Information Institute reported the following:

PROFITABILITY OF COMMERCIAL BANKS, 1996-2000	
	Return on equity
Year	Commercial banks
1996	14.45%
1997	14.68
1998	13.93
1999	16.31
2000	14.07

Source: INS. INFORMATION INST., FINANCIAL SERVICES FACT BOOK 2002, at 58.

Moreover, securities firms have suffered lower profits in recent years but have enjoyed substantially higher returns than both insurance companies and commercial banks over the long term. The Insurance Information Institute reported the following:

SECURITIES INDUSTRY PRETAX RETURN ON EQUITY BY FIRM CATEGORY				
Year	National Full Line	Large investment bank	Regional	Discounter
1990	-8.3%	5.4%	1.0%	15.4%
1991	19.9	25.2	34.9	35.5
1992	21.4	23.7	40.0	33.7
1993	28.4	23.8	43.7	39.1
1994	4.8	-7.2	21.7	26.4
1995	20.3	11.5	33.8	38.5
1996	28.2	26.2	40.0	42.6
1997	32.8	23.4	32.8	37.4
1998	26.1	16.4	13.7	29.7
1999	32.5	28.0	21.2	46.3
2000	32.9	24.6	24.9	48.6

Source: INS. INFORMATION INST., FINANCIAL SERVICES FACT BOOK 2002, at 91.