Banking at Merrill Lynch: A Function of Client-Driven Innovation

Remarks by

John Qua
Senior Vice President and Head of the Global Banking Group
Merrill Lynch & Co., Inc.

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I want to congratulate the FDIC for organizing this symposium – an opportunity to focus on current issues in financial regulation.

I'm proud to call myself a banker. I know some see negative connotations. I hear lots of jokes about bankers not having a sense of humor. Fortunately I don't get any of them.

But as head of global banking for Merrill Lynch, I'm proud to be part of a profession that brings together capital with ideas. That is a marriage that produces long-term financial security for our clients, and fuels constant progress for society.

Much of the innovation we have seen in the financial marketplace over the past few years has been spurred by Gramm-Leach-Bliley's recognition that customers are entitled to the widest range of products in the most convenient and efficient manner. Congress recognized that rigidly segregating different kinds of financial services only frustrated the customer. The new law broke down outdated barriers. Banks, securities firms and insurance companies were permitted to compete to serve savers and investors. Financial service firms were unchained from an antiquated law and given new freedom to design innovative products and services that satisfy people's needs.

Gramm-Leach-Bliley once and for all set the ground rules for banks, securities firms and insurance companies to compete. No longer do we rely on regulatory actions, court rulings, or the discovery of some legal loophole. Our nation's financial institutions can plan for the future, spurring innovation and new competition.

The logic of the new law has come to life. It is the logic of the marketplace, and we see it in practice every day. We now see it in new financial products and services that were not dreamed of just a few years ago. We see it in products and services that transcend old barriers, so clients can get what they actually want and need. The customers are in charge now. Any financial services firm that wishes to succeed must start by recognizing that simple fact.

That's something Merrill Lynch has recognized for a long time. The products and services we offer have traditionally sprung from our determination to meet our clients' needs – in fact, to anticipate them. In today's highly competitive marketplace, no financial services firm can do otherwise and hope to succeed.

From Merrill Lynch's point of view, I can tell you that paying attention to the client has spurred a lot of innovation.

Focusing on the client led us to create the Cash Management Account over 25 years ago. Our research told us customers had a deep desire to aggregate several financial management activities within a single account. So in 1977 Merrill Lynch launched the CMA. It was the first time customers were offered an account that combined a traditional brokerage margin account with cash sweeps into a money market fund, check-writing privileges, and a debit card. At the time, some in the banking industry opposed the CMA.

Now it is the industry standard. Just last December, it was named by *Forbes* magazine as one of the top business innovations of the last 85 years.

Focusing on the client led us to pioneer the concept of an interest-only mortgage. In its basic form, our PrimeFirst Mortgage is a 25-year adjustable rate mortgage which features interest-only payments for the first 10 years. It provides clients with the benefits of liquidity and diversification, as lower initial down payments make more cash available for investments or other purposes. At the same time, it offers the tax advantages of interest deduction and the ability to pre-pay principle without penalty. So far, our clients have been attracted to $35 billion in PrimeFirst Mortgages.

In other words, focusing on the client leads to innovative combinations of financial services – because clients don't want to be restricted. Focusing on the client leads to thinking outside the box – because today's clients will not be hemmed in. It leads to change – because the only way to succeed is by anticipating what your clients will want next.

Focusing on the client led Merrill Lynch to banking more than 30 years ago. It's a natural outgrowth of being a financial service provider, essential to providing a full menu of client services.

We have always been a financial firm. Financial services is our business – our only business.

Merrill Lynch conducts banking in the United States through two depository institutions– Merrill Lynch Bank USA, a Utah industrial loan corporation; and Merrill Lynch Bank and Trust, a New Jersey state non-member bank. We also own a federal savings bank that offers personal trust services to our clients. And we conduct significant banking activities outside the United States through banks in London, Dublin, Switzerland, and elsewhere. The combined balance sheet of our global banks is approximately $100 billion.

Deposits in our domestic banks – Merrill Lynch Bank USA and Merrill Lynch Bank and Trust – approach $70 billion. Both U.S. banks are subject to the same banking laws and are regulated in the same manner as any bank in this country. They are subject to the same deposit insurance, the same safety and soundness requirements, the same consumer protection regulations, and the same Community Reinvestment Act. We are subject to every requirement that applies to FDIC-insured depository institutions. And the sections of the Federal Reserve Act, 23A and 23B, that prevent any abuse of a bank charter by diversified financial companies, apply to industrial loan corporations, their subsidiaries, and their parents.

Certainly Merrill Lynch is no stranger to regulation. Our non-bank divisions are regulated by more than 20 different bodies, including the SEC, the Financial Services Authority in the United Kingdom, the Singapore Monetary Authority, the Central Bank of Ireland, and the Japanese Ministry of Finance.

Effective financial regulation assures the safety and stability of financial institutions for the protection of the public. It preserves fair competition, also in the interest of the public. And it encourages innovation. It connects the largest institution to the needs of the smallest client. At Merrill Lynch, we have found that maintaining several different kinds of banks around the globe helps us to develop innovative products.

That brings me right back to the point I started at a few minutes ago – the value of our current regulatory structure. At Merrill Lynch, we were among many in the industry who worked for reform for almost 20 years. It finally came through the new law, which established new overall ground rules, including options for how firms would be regulated.

Firms were given the choice of being a financial services holding company, or retaining their current structures and engaging in functionally regulated securities, banking, and insurance activities. Either route leads to where Congress wanted the industry to go. Either choice leads to safe and stable financial institutions, fair competition, and innovation and value for the customers.

Merrill Lynch – like other companies – chose to maintain a structure closer to its tradition, rather than adopt a totally new status as a bank holding company. Our structure is based on a limited purpose bank, including an industrial loan company, consistent with Congress's ground rules.

The FDIC's authority over industrial loan bank owners allows it to address concerns about conflict of interest, dealings with affiliates, concentration of power, or expansion of the federal safety net. Chairman Powell has made it clear that the FDIC has the regulatory authority it needs to prevent abuse. As he put it: "Congress has given us good tools to manage the relationship between parents and insured subsidiaries … indeed the FDIC manages these relationships every day in the industrial loan company model with little or no risk to the deposit insurance funds, and no subsidy transferred to the non-bank parent."

In other words, the goal of safety and security is being satisfied. The goal of competition is certainly being satisfied; just look at all the new kinds of companies that are springing up in the financial services field.

And the goal of innovation is being pursued as it has never been pursued before.

Just a few years ago, financial services were presented to customers in rigid, unconnected, and inconvenient silos. Today, new financial services are being shaped by cobbling together elements of banking and securities, or securities and insurance, or parts of all three.

Not too long ago, free cash balances in a brokerage account just languished there. Today, they can be swept electronically into a banking account, to earn a competitive interest rate.

For that matter, it wasn't that long ago that banking was something you had to do in bank, or at a banking machine. Now it is something you can do wherever or however it is convenient to you – over the Internet or the phone. And you can check out your investment and retirement portfolios at the same time.

Financial companies have been making it their business to invent a better mousetrap. If they fail to, someone else will – and push them aside. The winner is the customer. Firms like Merrill Lynch are competing to make that happen.

Thank you.