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Statement of the Shadow Financial Regulatory Committee

on

Repeal of the Bank Holding Company Act and Restrictions on Product Diversification for Banking Organizations

December 12, 1994

The Office of the Comptroller of the Currency (OCC) recently proposed steps to lighten the regulatory burden on subsidiaries of national banks. Specifically, the OCC suggested that an expedited application review process be put in place and that consideration be given to expanding permissible activities for subsidiaries of national banks. The Shadow Financial Regulatory Committee applauds this initiative and sees it as bringing us closer to eliminating the need for regulating the activities of banking organizations under the Bank Holding Company Act.

Historically, the restrictions in the Bank Holding Company Act were rooted in populist fears about concentrating power in the hands of a few large conglomerate firms, as typified by the proposed combination of Transamerica Corp. and Bank of America. In 1956, legislation addressed concerns about interstate combinations of banking organizations and combinations of industrial enterprises and multibank holding companies. The 1970 amendments to the Act brought one-bank holding companies under regulation and extended the Federal Reserve Board's responsibility for deciding what activities were appropriate for corporate owners of commercial banks to undertake. In these decisions, the Fed is required both to determine that proposed activities are so closely related to banking

as to be a proper incident thereto, and to consider how these activities affect bank risk exposure.

In recent decades, bank holding companies have been induced to try to expand into an increasingly wide array of previously precluded activities, including issuance of securities and insurance products. At the same time, nonfinancial and nonbank financial firms have developed subsidiaries and affiliates whose products closely substitute for bank loans and deposits. Industrial companies have been permitted to operate federally insured thrift institutions. Additionally, as a result of state actions and Congressional actions, restrictions on interstate banking have been eliminated.

Fears of inappropriate risk-taking by insured depository institutions are now addressed squarely and more appropriately by the FDIC Improvement Act (FDICIA) of 1991. FDICIA mandates risk-adjusted deposit insurance premiums and prompt corrective supervisory discipline, keyed to the adequacy of a bank's capital. These mandates have supported significant improvement in the capital positions of banking organizations and help to insulate the taxpayer from risks that either new product lines or affiliations between banking and commercial firms may entail.

Requiring supervisory intervention into the affairs of undercapitalized institutions makes risks to capital from new activities a principal focus of banking supervisors. As long as supervisors strive to force recapitalization before net worth can go to zero, the risks to taxpayers from banks affiliating with firms engaged in nontraditional banking or commercial activities are not qualitatively different from traditional activities provided they can be adequately monitored.

The Bank Holding Company Act has outlived its usefulness. Banking organizations now operate nationwide and have diverse product lines. Market power associated with this expansion is constrained by nonbank competitors. Banks now compete with securities firms, financial subsidiaries of industrial firms, communications companies, and data processors. There is no longer any substantial reason to regulate the corporate ownership of banks or the activities in which these owners can engage.