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Statement of the Shadow Financial Regulatory Committee on the Leach Bill

May 22, 1995

The Leach bill, approved by the House Banking Committee on May 12 (H.R. 1062), fails to meet the principles the Shadow Financial Regulatory Committee articulated in its statement 118 on May 22, 1995. Indeed, in this and other respects the Leach bill is a step back from the legislation adopted by the House Banking Committee in 1991. The Shadow Committee finds the Leach bill deficient in the following principal respects:

1. By requiring that securities activities be undertaken only through a subsidiary of a bank's holding company, the Leach bill adopts the restrictive notion that nonbanking activities cannot be conducted safely in subsidiaries of an insured bank. As long as an insured bank is otherwise meeting its capital and other prudential requirements, there is no safety and soundness issue associated with establishing nonbanking subsidiaries.

2. By restricting the activities of a financial services holding company (FSHC) so that it may only engage in activities that the Federal Reserve declares to be "financial in nature," the Leach bill adopts the idea that banks should not be affiliated with "commercial" firms. There is no evidence that affiliations between banks and commercial firms pose any special danger to banks or to the financial system, and a good deal of evidence to the contrary. Continued restrictions on the ownership of banks should be recognized for what they are--a means for the Federal

Reserve to assert comprehensive control over the banking system.

By limiting FSHCs to activities the Federal Reserve Board declares are "financial in nature," the Leach bill will prevent FSHCs from substantially expanding their range of activities and restrict their ability to adapt efficiently to changes in the market. The Board's history of timidity in expanding the activities of bank holding companies over the years provides no basis for optimism that it will step up to ameliorate the failures of the Leach bill in this respect. The Leach bill will also prevent nonbanking companies from acquiring banks or FSHCs, and thus restricts entry to and exit from the banking industry.

3. By requiring higher levels of capital for banks that are affiliated through FSHCs with securities firms, the Leach bill perpetuates the false premise that securities activities in particular are riskier than banking and that affiliations between banks and securities firms create special risks for banks. In reality, many securities activities are less risky than banking and provide diversification benefits. Careful scholarship over the years has shown that the policy underpinnings of the Glass-Steagall Act were based on faulty premises. The involvement of banks in the securities business had nothing to do with the failure of banks before the enactment of Glass-Steagall.

4. Insurance services are obviously activities "of a financial nature." By failing to include insurance among the permissible activities for FSHCs, the Leach bill prevents insurance companies from acquiring banks, and prevents financial services holding companies from engaging in insurance activities without regulatory action by the Federal Reserve Board.