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Statement of the Shadow Financial Regulatory Committee

on

H.R. 10 ("Leach Bill") and the Commerce Subcommittee Draft

September 22, 1997

Although H.R. 10, as adopted by the House Banking Committee, contains some useful reforms, it is ultimately a deficient response to the need for financial modernization. Unfortunately, the recent redraft of H.R. 10 by a House Commerce subcommittee eliminated most of the few good features of the bill, resulting in a proposal with almost no redeeming virtues.

Leach Bill

Chairman Leach and the Banking Committee should be commended for finally breaking away from the idea that banking and commerce should be separated through restrictions on the activities of companies that are permitted to control banks. H.R. 10 would create a limited but real two-way street, in which bank holding companies would be permitted to obtain up to 15 percent of their revenue from nonfinancial (i.e., commercial) activities, and "commercial" companies would be permitted (without becoming regulated bank holding companies) to acquire a bank that does not have more than $500 million in assets or gross revenues that exceed 15 percent of the gross revenues of the consolidated company.

In addition, H.R. 10 would: (I) repeal Sections 20 and 32 of the Glass-Steagall Act, permitting affiliations without revenue limitations between banks and securities firms; (ii) do away with the burdensome and unnecessary firewalls that had been created in earlier drafts of H.R. 10; and (iii) broaden the scope of activities of bank holding companies to include financial activities such as securities and insurance.

In other major respects the bill is disappointing. It provides explicit statutory authority for the Comptroller of the Currency to authorize a range of financial activities for subsidiaries of national banks, but unfortunately this authority is narrower in scope than the authority the Comptroller believes he already has and narrower than the Shadow Committee believes desirable.

However, the most glaring flaw in H.R. 10 is the continued acceptance of the idea that the Federal Reserve Board Board of Governors or any agency should be an "umbrella regulator" of companies that control banks—even those that are substantially engaged in other financial activities such as insurance or securities underwriting. The bill makes modest efforts to control the Fed's use of its authority, by requiring that it consult with insurance and securities regulators and making a cumbersome 10 person National Council on Financial Services (rather than the Fed) the final arbiter on what is a permissible "financial" activity for a bank holding company.

But by endorsing the Fed's "source of strength" doctrine for the first time, the bill gives the Fed the power to force bank holding companies to add capital to their subsidiary banks, and thus enhances the Fed's authority where it should be reduced or eliminated. The prompt corrective action provisions of current law already give legal authority for the primary federal regulatory agency to respond to a bank's weakened capital condition without introduction of another layer of regulation.

The Shadow Committee has previously stated that "[t]here is no reason to have consolidated supervision or an 'umbrella' regulator responsible for regulatory oversight of banks and all their nonbank subsidiaries" (Statement No. 118, May 22, 1995). Even less is there a basis for regulating or supervising the companies that own or control banks. All safety and soundness objectives of bank regulation can be achieved by the regulation and supervision of banks themselves. As the Shadow Committee has noted in the past (Statement No. 115, December 12, 1994), the Bank Holding Company

Act should be repealed, rather than extended even in a limited way to financial or nonfinancial companies that also control one or more banks.

Commerce Draft

But if the Leach Bill accepts the idea that the Fed should be an umbrella regulator of companies that control banks, the Commerce subcommittee's draft magnifies and enshrines it. This draft—which prohibits all nonfinancial activities for bank holding companies, limits the scope of activities permitted to national banks, eliminates the unitary S&L holding company, and gives the Fed the authority to determine whether an activity is a permissible financial activity for a bank holding company—is a throwback to Depression era ideas that should have been discarded long ago.

The Shadow Committee emphasizes again that there is no substantial difference in risk exposure between the affiliation of a bank with a financial activity and the affiliation of the same bank with a nonfinancial or "commercial" activity, and thus no reason to permit bank holding companies to engage only in the former. Moreover, in light of existing statutory restrictions on transactions between banks and their holding company affiliates, there is no justifiable basis for the Fed or any other agency to act as an "umbrella regulator" of the companies that happen to control banks.

With all its deficiencies, the Leach bill at least made a start toward financial modernization. The Commerce draft, however, is a retrograde step, and should be fully reconsidered. Financial modernization, it appears, will continue to be implemented more effectively through the regulatory interpretive process rather than through legislative action.

It is the Committee's policy that members abstain from voting on policy statements in which they have a direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, Robert Litan abstained from voting on this statement.