Remarks

By

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"Is the Bank Holding Company Act Obsolete?"

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Good morning. It is a pleasure to be here among so many great minds. The mission of the American Enterprise Institute—defend human dignity, expand human potential, and build a freer and safer world—resonates with me on a personal level. I also share the AEI's belief that democracy, free enterprise, and American strength and global leadership are the paths to achieving those ends. That is why I am so committed personally to reducing unnecessary regulatory burden and promoting economic growth.

Before going any further, I want to congratulate Joseph Otting on his confirmation and swearing in as the 31st Comptroller of the Currency. I know he will be a tremendous success. He is joining what I think is a top notch agency, full of dedicated professionals. In fact, I share the sentiment that former Comptroller Charles G. Dawes wrote to incoming Comptroller Lawrence Murray at the turn of the 20th century, "I am glad you are going to be Comptroller of the Currency. It is, with one or two exceptions, the greatest place in Washington." Since Mr. Dawes became Vice President, I will forgive his error in thinking that there are any places in Washington that are better to work than the OCC. So, this speech is a bit of a unicorn in that I am delivering it as First Deputy Comptroller of the Currency, whose resignation from government service is effective at the close of business today. It has been my honor and the highlight of my career *so far* to serve as Acting Comptroller. I think we were able to accomplish a few things during my short tenure and for the many, many people who helped make those things happen, I am deeply grateful.

Serving as Acting Comptroller reinforced my belief that when running well, the federal banking system is an engine capable of powering economic growth and prosperity for consumers, businesses, and communities across the country. Part of the bank supervisors' job is to find that balance where supervision ensures banks operate in a safe and sound manner, provide their customers fair access to financial products and services, and treat those customers fairly. At the same time, regulators strive to eliminate unnecessary regulatory burden and to foster an environment that tolerates prudent risk-taking and encourages banks to focus on meeting the financial and credit needs of their customers.

Regulation is a powerful tool to be used judiciously. We need it, in moderation, to achieve safety and soundness and fair treatment of banks' customers. Anything more places a drag on productivity and economic opportunity. That's a tax we all pay. Policy makers should strive to avoid it.

I also admire the AEI for asking big, difficult questions that force us to reevaluate long-held beliefs. Exploring these questions in a dispassionate manner promotes better policy and ensures that the policies we maintain serve the nation's needs of *today*. Too often laws and regulations outlive their usefulness and original purpose but continue to exist because of a reluctance to change and an unwillingness to examine how things can be done better. The question you have posed—whether bank holding companies have become obsolete—is one of those big questions that is sure to elicit a strong response and inspire a rich debate.

Today's question—"whether bank holding companies are obsolete?"—is a timely one that is being asked in more and more boardrooms each day. It is not a new question. It was being widely discussed prior to the financial crisis as well.[1] Banking companies need ownership structures to be as efficient as possible and serve as sources of strength for their insured depository institutions. Banks of all sizes face pressure to produce returns and compete with more types of companies. Costs, sometimes in the form of increasing regulatory requirements, continue to rise while growth remains modest. There are two levers any business owner can pull to improve performance—reduce costs and gain efficiencies, or increase revenue. If the corporate structure does not produce meaningful benefits for the company in one of these ways, then it is ripe for change.

The answer to the question whether bank holding companies are obsolete is not a simple yes or no. A better question may be whether bank holding companies are a good idea for *all* banking companies. Bank holding companies may continue to serve a useful purpose for large, complex companies, especially those seeking to engage in activities abroad, but they may provide less value to simpler, more traditional banking firms. In the next few minutes, I want to share my perspective by discussing how the recent changes in laws and regulations have decreased the value of, and increased the costs associated with, bank holding companies.

The case of the Bank of the Ozarks is a good example of why smaller banking companies are eliminating their holding companies. Bank of the Ozarks, a state non-member bank, merged its holding company into the bank in June. A month earlier its proxy statement explained why. The reorganization "would lead to managerial, operational, and administrative cost savings and

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[1] Pauline B. Heller and Melanie L. Fein (Updated by Scott Zesch). *Federal Bank Holding Company Law*. Law Journal Press. 2006 (Originally published 1986). See also Carl Felsenfeld, "The Bank Holding Company Act: Has It Lived Its Life," 38 Vill. L. Rev. 1. 1993 (http://digitalcommons.law.villanova.edu/vlr/vol38/iss1/1).

efficiencies." Those savings and efficiencies stem from simplified financial reporting, elimination of Federal Reserve oversight, and decreased SEC registration fees. The company claimed additional gains through consolidated governance and organizational structure, policies and procedures, and risk management, as well as removing the duplication of having boards of directors at the bank and holding company levels.

Other costs of operating a holding company also add up. While bank holding companies can choose to incorporate in states with relatively progressive corporate laws, they are separate legal entities that become subject to the law of the state in which they are incorporated. As a result, bank holding companies incur separate expenses and state franchise taxes, and in some states may not be eligible to file consolidated state tax returns. I also suspect that the management of banks such as the Bank of the Ozarks are keenly aware of the costs and burdens that would be imposed on their organizations once they cross the $50 billion asset threshold, although that may change if the bipartisan proposal shared by Senator Crapo several weeks ago becomes law. These costs that apply today to holding companies with more than $50 billion in assets serve as artificial deterrents to growth. Without their holding companies, the behavior of banks approaching that level would be guided by market incentives rather than the distortive and artificial forces of government regulations.

For smaller companies, where every dollar counts, the savings and efficiencies of doing away with their holding companies can be material. Meanwhile, any loss in value to the company likely will be negligible for a variety of important reasons. Foremost among those reasons is the fact that for most bank holding companies, the bank is where the action is. It usually makes up the vast majority of the company's assets and activities. That was the case with Bank of the Ozarks. Even with the advent of the financial holding company structure and the wider array of activities they can engage in under the Graham–Leach–Bliley Act (GLBA), most banking organizations continue to conduct business through their bank and bank subsidiaries. In light of this reality, many community and regional banking organizations are realizing that the extra and duplicative costs of maintaining a holding company make little business and economic sense.

With respect to their business activities, banks lose virtually nothing by doing away with their holding company. Over the past several decades, banks have been allowed to do more while bank holding companies have become more restricted.[2] Originally, the Bank Holding Company Act was intended to restrict the geographic expansion of large banking groups and to prevent excessive concentration in commercial banking.[3] The law was created to stop monopolies, and lawmakers had one particular company in mind—TransAmerica.[4] The trend since 1956, when the original statute was enacted, has been toward limiting bank holding company activity to financial activity. Over time, defining the activities permissible for bank holding companies has evolved to incorporate a doctrine of separating banking and commerce. As a consequence, bank holding companies have become limited in their ability to own and operate non-financial and non-banking businesses, even though that could make for a more diverse company. Even the expansion of activities permitted under GLBA in 1999 did not fundamentally alter the direction of limiting non-banking activities, because the additional activities it allowed were financial in nature or incidental to financial activities.

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[2] Heller and Fein. P. 20.

[3] Saule T. Omarova and Margaret E. Tahyar. "That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulations in the United States." Cornell Law Faculty Publications. Paper 1012. 2012 (http://scholarship.law.cornell.edu/facpub/1012).

[4] The Bank Holding Company Act of 1956, Duke Law Journal. Vol. 7, no. 1. Pp. 1-24. 1957 (http://scholarship.law.duke.edu/dlj/vol7/iss1/1).

In addition to these restrictions, the post-crisis framework of the Dodd-Frank Act has added costly prudential requirements. For instance, the law currently subjects holding companies that exceed $10 billion in assets to stress testing requirements that have been used to raise capital levels at banks and manage systemic risk. The Dodd-Frank Act and the Basel capital rules have reduced the flexibility of bank holding companies to issue capital instruments different from those permitted to banks and to downstream capital to their bank and nonbank subsidiaries. While these requirements may make sense for the largest firms and *may* serve a greater societal purpose, they are applied through the use of a $10 or $50 billion threshold that, in my view, appears arbitrary and poorly calibrated to contain systemic risk. The Fed itself seems to share that view.[5]

Given the interconnectivity among the largest firms and the broader financial market, regulation of the holding company might appear to be a convenient way to help manage systemic risk.[6] The holding company structure, however, is not a *necessary* tool for addressing systemic risk. Enhanced prudential supervision and regulation can readily work with a universal banking structure, as it has in countries like Canada, Australia, and Germany. Some research even suggests that the diversification that comes with universal banking played an important role in

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[5] See, e.g., Order approving the application by The PNC Financial Services Group, Inc., Pittsburgh, Pennsylvania, and PNC Bancorp, Inc., Wilmington, Delaware, to acquire RBC Bank (USA), Raleigh, North Carolina (2011); Order approving of the notice by Capital One Financial Corporation, McLean, Virginia ("Capital One"), to acquire ING Bank, FSB, Wilmington, Delaware, and thereby indirectly acquire shares of ShareBuilder Advisors, LLC and ING Direct Investing, Inc., both of Seattle, Washington (2012); and Order approving of the application under section 3 of the Bank Holding Company Act of 1956 by KeyCorp, Cleveland, Ohio, to acquire First Niagara Financial Group, Inc., and thereby indirectly acquire First Niagara Bank, National Association, both of Buffalo, New York (2016).

[6] Ralph Chami, Thomas F. Cosimano, Jun Ma, and Céline Rochon. "What's Different about Bank Holding Companies?" IMF Working Paper. February 10, 2017. (http://www.imf.org/~/media/Files/Publications/WP/wp1726.ashx).

helping the banking systems in countries like Canada and Australia better withstand the most recent financial crisis.[7]

If the holding company structure is not necessary as a tool to manage systemic risk of the largest of firms, then it has even less of a place with respect to small and midsize firms that do not present systemic issues. In fact, as I discussed in my testimony before Congress in June, the imposition of increasingly onerous regulations on holding companies based on arbitrary asset thresholds following the financial crisis has erected competitive barriers that benefit the largest firms to the detriment of smaller ones.[8]

My testimony before the Senate Banking Committee discussed the inefficiencies presented by bank holding companies and offered several suggestions that would reduce the disadvantages of maintaining a holding company and make it easier to operate without one. Congress could reduce regulatory redundancy in this situation by amending the Bank Holding Company Act to provide that when a depository institution constitutes a substantial portion of its holding company's assets—say, 90 percent—the regulator of the depository institution would have sole examination and enforcement authority for both the holding company and the depository institution. This change would eliminate supervisory duplication and its inherent inefficiencies, freeing resources to meet the needs of banks' customers and communities. It could be limited to holding companies of a certain asset size. At the same time, banking law would continue to recognize that it is appropriate to have a separate regulator for large companies that conduct complex activities, including securities and derivatives businesses, as well as consumer and commercial banking.

[7] Michael D. Bordo, Angela Redish, and Hugh Rockoff. "Why didn't Canada have a banking crisis in 2008 (or in 1930, or 1907, or ...)?" NBER Working Paper No. 17312 (2011) (http://www.nber.org/papers/w17312.pdf).
[8] Keith A. Noreika. Testimony Before the Committee on Banking, Housing, and Urban Affairs. U.S. Senate. June 22, 2017 (https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-71b.pdf).

The proposed change simply would extend to smaller banking organizations the benefits of having a single federal regulator at both the bank and holding company levels, a benefit that state banks that are members of the Federal Reserve System and their holding companies already enjoy.

Another approach to the problem of multiple regulators would be to eliminate statutory impediments for firms that want to operate without a holding company. Congress could modernize the corporate governance requirements for national banks by allowing them to adopt fully the governance procedures of, for example, the state in which their main office is located, the Delaware General Corporation Law, or the Model Business Corporation Act. This change would put these banks on the same footing as bank holding companies and benefit banks that wish to operate and access the capital markets without a holding company.

Of course, even without Congressional action, companies like the Bank of the Ozarks are fixing the problem on their own by merging the holding company into the bank and dispensing with the additional costs, complexity, legal liabilities, and corporate inefficiencies. In doing so, companies should carefully consider all of the business implications of operating without a bank holding company. Ultimately, companies like Bank of the Ozarks will have the final word on whether bank holding companies are obsolete.

I want to allow ample time to answer some of your questions. But, before closing I want to make one more point about bank holding companies in our country. Nothing in law requires their existence, and they serve no inherent banking purpose. Our country is unusual among modern nations to invoke the concept of bank holding companies. Canada, Germany, France, Switzerland—all have robust, competitive banks without holding companies.[9] The reasons for

[9] Heller and Fein. P. 21.

enacting the Bank Holding Company Act, which included preventing monopolies, limiting the mixing of banking and commerce,[10] and facilitating geographic expansion in the face of state law restrictions, have largely passed from the scene as federal and state laws have evolved over the past 60-plus years. The more recent use of bank holding companies to manage systemic risk is neither necessary nor entirely effective. What remains is the cost of duplicative regulation and burden that restrict economic potential. For those reasons, bank holding companies may have outlived their practical business value in our financial system and may, in fact, be obsolete.

Again, I congratulate AEI on holding this event and having this important conversation, and I'd be happy to answer any questions as time allows.

[10] Keith A. Noreika. Remarks Before The Clearing House Annual Conference. November 8, 2017 (https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-134.html).