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Comptroller Warns that H.R. 10 Would Undermine Safety of National Banking System

WASHINGTON -- Comptroller of the Currency John D. Hawke Jr. told a House panel today that pending banking legislation would undermine the safety and soundness of the national banking system and urged Congress to question closely arguments advanced in favor of that bill by the Federal Reserve.

The provisions advocated by the Fed "would deprive banks of the opportunity to diversify their revenue flows by capturing the benefits of business opportunities generated by the banks' day-to-day banking activities, and instead would divert those revenue flows to the holding company where they would be unavailable to the bank," he said in testimony before the House Committee on Banking and Financial Services.

That format would inevitably weaken banks -- which are backed by the Federal deposit insurance funds and ultimately the taxpayer -- by forcing them to use their resources to capitalize and fund holding company affiliates. In the event of a failure, the Federal Deposit Insurance Corporation would be unable to cushion its losses by selling off profitable subsidiaries.

Mr. Hawke noted that the Federal Reserve would mandate that new activities be conducted only in holding company affiliates regulated by the Fed.

"We support giving institutions the freedom to choose the affiliate or subsidiary format, in either case subject to exactly the same strong safety and soundness protections for the bank," he added.

Mr. Hawke also pointed out a number of "inexplicable anomalies and inconsistencies in the Fed position." For example:

> State banks are free to conduct through subsidiaries any activities authorized by their states with the approval of the FDIC. A number of activities, including the underwriting of securities and annuities, have been approved and the legislation would not roll back that authority for state banks.
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> Any U.S. bank can conduct activities abroad through subsidiaries subject to Fed approval and the Fed has consistently permitted securities underwriting as a permissible activity with no apparent concern for safety and soundness threats.
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> Foreign banks can engage in a broad range of activities in the U.S. through bank subsidiaries. In fact, a significant percentage of the bank securities affiliates approved by the Fed have been direct subsidiaries of foreign banks.

"In light of these precedents, a very heavy burden rests on those who would single out national banks for the kind of discriminatory

treatment that HR 10 proposes --- and I submit that burden has not been carried," Mr. Hawke said.

Mr. Hawke also took issue with the Fed's argument that direct bank subsidiaries would unfairly benefit from a "safety net" subsidy. Even if such a subsidy exists -- which is a matter of great dispute -- it would benefit a holding company affiliate as much as a bank unit, he said.

The Comptroller noted that the same protective firewalls would apply to the bank subsidiary as to the holding company affiliate. A bank would be unable to invest any more in a subsidiary than it would be able to pay in dividends to the holding company and any such equity investments would be deducted from a bank's regulatory capital for the purpose of determining compliance with capital standards. Thus, the effect on regulatory capital would be exactly the same as the payment of a dividend.

Moreover, he said, "if a subsidy does exist, funds do not need to move at all within the company.

"The existence of a subsidy at any place in the structure benefits the consolidated organization and the organization can allocate the benefit of that subsidy in a variety of ways to whatever element of the organization it chooses," he said.

However, real world experience demonstrates that banking organizations do not behave as though a subsidy exists.

Mr. Hawke said the Fed's view that holding companies would "wither and die" if banks were allowed to engage in new activities through subsidiaries is not shared in the marketplace.

"But if anyone has any concern at all in this regard, there is a simple answer," he said. "Congress can require that any bank over a specified size -- $1 billion, $5 billion or $10 billion -- that wants to exercise newly authorized activities through an op sub must continue to maintain a holding company and be regulated as such by the Fed. This will have little or no practical impact on any institution and will assure that the Fed's present role is preserved."

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