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Remarks by

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Thank you, and good morning. I'm delighted to participate in this panel on "Rethinking Bank Regulation." This challenge is something we've devoted considerable attention to at the OCC these past three years, because financial modernization has become increasingly important to the country's financial services industry, consumers and the national economy. Forums like these are helpful in furthering the public policy debate about the complex issues raised by rethinking bank regulation, and I'm looking forward to the discussion this morning. Given the caliber of my fellow panelists and the divergent views these issues can generate, I'm sure this will be a thought-provoking discussion.

In the past twenty years, banking policy has come a considerable distance in the direction of greater competition. We've managed to come that distance by holding historic safety and soundness assumptions up to the light of contemporary realities. Banks today have far greater freedom to achieve geographic and product diversification than their predecessors of a generation ago ... diversification that enhances their competitive position and stability.

But in the area of bank structure -- the corporate form of banking organizations -- the trend has been strangely backwards. As the ability of banking organizations to set their own mix of products and services has increased, their ability to decide upon the appropriate corporate structure for offering that mix has declined. I believe we are now overdue for a reexamination of the costs and supposed benefits of government-mandated corporate structures. Because the progress we've realized in our quest to make banks more competitive will be set back if we continue to force banks into structures that serve no clear public policy purpose.

In the absence of government intervention, businesses organize themselves in many different ways. Several different factors tend to drive their decisions regarding their corporate form -- factors such as the diversity and intensity of competition, advances in technology, and the need to achieve operating efficiencies. But relative to their competitors in the

marketplace -- be they foreign, domestic, financial or non-financial -- America's banking organizations are perhaps uniquely hamstrung in their ability to make ordinary business judgments about the corporate structures that work best for them.

#### Forces of Change

Three forces now at work in the marketplace will ultimately require the government to place less emphasis on mandated corporate structures and greater emphasis on effective supervision. These forces are industry consolidation, the evolution of the bank charter, and competition from non-depository businesses.

First, industry consolidation:

Beyond the simple fact that consolidation is occurring lie some very interesting statistics about how it is occurring. Gary Whalen, an economist in the OCC's Bank Research Division, has done a great deal of research in this area. His analysis tells a story of how government imposed structure forces the industry in one direction and -- when allowed to do so -- how the market moves the industry toward a simpler, more competitive structure.

Consider this. In 1980, there were only 16 multistate, multibank holding companies. By the middle of 1995, however, there were approximately 250 multistate, multibank holding companies. This growth was a reflection of the fact that government required the industry to adopt a holding company structure to do business across geographic barriers and on a regional basis.

But today, we are seeing a clear market trend for bank holding companies to consolidate their operations into the minimum number of charters possible when they are empowered to do so. In 1986, the typical interstate holding company had 12 bank affiliates. By the middle of 1995, that number had been reduced by half.

And when you compare the number of bank affiliates to the number of states in which each company operates, you see further evidence of the market's preference for organizational simplification. In 1985, interstate banking companies averaged five bank charters in each state in which they operated, with only a third opting to have just a single charter. During the past decade, however, banks have merged subsidiaries into fewer charters and developed branch networks of these subsidiaries. By 1995, the 250 multistate, multibank holding companies -- on average -- operated two banks in each state in which they conducted business. And over half of these companies chose to have just one charter for each state in which they operated.

We see a similar trend with smaller, single-state holding companies. Rather than operating separately chartered banks, these institutions are also reducing the number of subsidiaries and replacing them with branches. Last year, single-state,

multibank holding companies averaged 2.9 bank charters, down considerably from the 5.6 separate charters they averaged a little over a decade ago.

A second force that will lead government to place less emphasis on mandated corporate structure is the recently established legal framework that allows the bank charter to respond to new circumstances.

The importance of the last year's Supreme Court decision in VALIC went well beyond the sale of annuities. VALIC confirmed that national banks are not limited to the specific powers and activities spelled out in the National Bank Act. And it directed the courts to give "controlling weight to a reasonable construction of the powers of national banks by the Comptroller." The importance of VALIC cannot be overstated, particularly given the system of wild card statutes-- in place in over 30 states-- that automatically grant state chartered banks the same authority held by national banks. Taken together, VALIC and the state wild card statutes establish a legal framework in which the bank charter can continue to evolve to meet the needs of the marketplace.

A third factor creating limits on the government's role in setting organizational structure is competitive pressure from nonbank institutions that do not face the same sorts of costly organizational constraints as banks do today.

Banks are continuing to search for ways to reduce costs, particularly in the face of intensifying competition and technological changes. Certainly, the first place where many in the industry urge us in Washington to begin is to reduce regulatory burden and eliminate costly structural constraints. This need fueled the Riegle-Neal bill's drive through Congress and its enactment into law. But the need hasn't gone away.

A preference for the holding company model rests on certain beliefs that need to be more fully debated:

First, the belief that new financial activities are riskier than traditional activities. That may arguably be true of some new activities, like some exotic derivatives, but it is certainly not true of others, like insurance sales.

Second, the belief that allowing banks to engage directly in these activities increases their risk of failure. But we all know that, as a general proposition, a broader range of assets and activities diversifies risk and reduces the probability of failure and that, in specific cases, one cannot measure the riskiness of an activity in isolation from the systems in place to manage the risks.

Third, the belief that the cost of imposing the holding company model on banking organizations, with all the restrictions associated with that model, is not particularly consequential. But, in fact, the statistics I have already presented regarding the trend toward

simplicity in many banks' corporate form clearly show that, left to its own devices, the market reaches a very different conclusion.

Long-held beliefs must be judged against real world experiences. Banking organizations in virtually all other major industrialized countries enjoy much greater latitude than U.S. banks in selecting their organizational structures. In countries that give bank management the power to choose between the bank model and the holding company model, one rarely sees voluntary adoption of a meaningful holding company structure.

The overseas activities of U.S. banks also provide practical evidence that should give us doubts about whether the American preference for the holding company model rests on a solid footing. Overseas, U.S. banks may engage in securities underwriting and other activities not permitted domestically. In general, they are not permitted to engage in these activities through their foreign branches but must use a bank subsidiary, Edge Act corporation, or a holding company subsidiary. Roughly 85 percent of the assets of all foreign subsidiaries controlled by U.S. banking organizations are either directly bank-owned or controlled through Edge Act bank subsidiaries. To date, there is virtually no evidence that the bank parents have been harmed by these activities.

#### Conclusion

The regulatory regime and structure of financial institutions should not be bound by 20th century conventional wisdom or the legalistic creations of the past. And in our zeal to modernize we must take care not to lock the banking industry into a mindset that could stifle innovation and the efficient -- and safe -- delivery of financial products and services.

We have the ability -- and the responsibility -- to do better. Modern risk assessment and risk management techniques make it possible for supervisors to protect the public policy interests at stake in the banking system, while at the same time, giving banking organizations a great deal more of the freedom most other businesses already have -- the freedom to decide for themselves which corporate form best suits their business needs.

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