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Statement of John D. Hawke Jr.
Comptroller of the Currency
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Committee on Banking and Financial Services
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Mr. Chairman, Ranking Member LaFalce and members of the Committee, I appreciate the opportunity to be with you today. At this hour on a Friday I do not want to burden the Committee with a lengthy statement, and I ask the Chairman's permission to include my entire prepared statement in the record. There are many complex issues in this bill, but the one that has emerged as pivotal is the major issue that divides us from the Federal Reserve. The Federal Reserve would mandate that all new financial activities of banking organizations be conducted only under their jurisdiction in holding company affiliates. 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.

The Anomalies

Let me point out the inexplicable anomalies and inconsistencies in the Fed position:

- First, state banks today are free to conduct through subsidiaries any activities authorized by their states, subject only to a determination by the FDIC that the activity would present no significant risk to the insurance fund. A number of states have already authorized such activities as securities and annuities underwriting and the FDIC has approved these activities.

  No explanation has been offered why national banks should be denied authority already possessed by state banks, and the Fed does not propose to bar state banks from conducting activities different from what are permitted for national banks.

- Second, 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 or "subsidy" policy.

- Third, foreign banks can engage in a broad range of activities in the U.S. through subsidiaries. For example, a significant percentage of the so-called "Section 20" affiliates approved by the Fed are, in fact, 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.

The "Subsidy"

Let me now turn to the subsidy argument. The "subsidy" argument is unclear, to say the least, and there is sharp disagreement as to whether any safety net subsidy exists.

But for the sake of argument, let's assume that banks do enjoy some such subsidy. The question demanding a comprehensible answer is what difference organizational format makes. Before Congress outlaws the use of subsidiaries, and deprives American banking organizations of the ability to use this format, it should require a compelling showing that the affiliate format is materially better in containing the subsidy than the operating subsidiary format. No such showing can be made in light of the constraints that would apply:

- First the same firewalls would apply in the case of each format. The bank could not lend to a subsidiary on any more favorable basis than to an affiliate.

- Second, any equity investment by the bank in a subsidiary could be no more than the bank could pay upstream to its parent holding company by way of dividends.

- Third, any such equity investment would have to be deducted from the bank's regulatory capital in determining whether the bank complied with the well-capitalized standard. Thus, the effect on regulatory capital would be exactly the same as the payment of a dividend.

- In fact, if a subsidy does exist, funds don't 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. To illustrate: if bank earnings reflect the benefit of a subsidy, the holding company can allow its securities underwriting affiliate to use that benefit by simply lowering its prices. The affiliate gets a competitive advantage and it all washes out on the consolidated books of the holding company.

In short, given these constraints, organizational format is wholly irrelevant to the subsidy issue.

Real world experience demonstrates, moreover, that banking organizations have not been acting as if such a subsidy exists. Such activities as mortgage banking, commercial and consumer finance and data processing are presently conducted both through holding company affiliates and bank subsidiaries as evidenced in a table I would like to submit for the record.

Safety and Soundness

Let me turn now to what I think is the most compelling argument against the Fed position -- the importance of the op sub for the safety and soundness of the bank.

Chairman Greenspan was absolutely right two years ago when he testified before this Committee that the op sub was not a safety and soundness problem. If his staff has recently persuaded him to abandon that correct position, he should not have listened to them. He should have been listening to the message that has come from every FDIC chairman in recent history.

The fact is that there is not a penny's worth of difference in the exposure of the bank to the risk in new financial activities when those activities are conducted in op subs as distinct from holding company affiliates. The protections are exactly the same. In fact, if this committee had adopted the Treasury Department's proposal in the last Congress to provide insured banks with safeguards against "piercing the corporate veil," those protections would be even stronger.

The most troubling aspect of the Fed position is that in the name of guarding against the spread of some ethereal "subsidy," it would in fact compromise safety and soundness.

- It would mandate a format that would inevitably weaken banks by forcing them to use their resources to capitalize and fund holding company affiliates, rather than husbanding those resources in the bank.

- It would deprive banks of the opportunity to diversify their revenue flows by capturing the benefits of business opportunities generated by their day-to-day banking activities, and instead would divert those revenue flows to the holding company where they would be unavailable to the bank.

- It would deprive the FDIC of the ability to cushion its losses when a bank gets into trouble by selling off profitable subsidiaries. Anyone who had any involvement in the wave of banking failures 10 years ago knows only too well how difficult it was for the banking regulators -- including the Fed -- to force holding companies to come to the aid of their troubled banks, yet the Fed position today would not merely sanction the diversion of bank resources to affiliates, but would mandate it.

To me it is simply inexplicable that an agency responsible for promoting and preserving the safety and soundness of banks would advocate a position that would have exactly the opposite effect.

"Atrophy" of the Holding Company

Finally, let me address what I think is really at the heart of this debate.

Fed witnesses have objected to the op sub because of concerns about the evolution of a "universal bank" model, which is a clear mischaracterization, and they have spoken of the "atrophy of the holding company" that would result. The notion is that if op subs were permitted, holding companies, which the Fed regulates, would wither and die and the Fed's "window into the banking system" would become less effective.

If that were a realistic threat, I could understand the Fed's concern. But I have yet to find anyone in the marketplace who thinks there is any substance to this concern. Even if op subs are permitted there will still be a myriad of reasons for having a holding company, as any businessman will tell you.

But if anyone has any concern at all in this regard there is a simple answer. Congress can require that any bank over a specified size -- $1 billion, $5 billion, $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.

Mr. Chairman, I respectfully submit that anyone who advances a proposal to impose legislative restrictions on the way our financial services firms organize their businesses -- particularly restrictions that grossly discriminate against national banks -- is under a heavy burden to put forth a clear, consistent and broadly understandable rationale demonstrating that only through such restrictions can well defined governmental interests be protected. Restrictions cannot be justified either to protect competitive advantages of particular segments of the industry or to alleviate fears about a loss of regulatory jurisdiction. I regret to say that I believe that burden has not been carried in this legislation.