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Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

July 8, 2014

Robert deV. Frierson
Secretary,
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551.

Dear Mr. deV. Frierson,

Americans for Financial Reform ("AFR"), and Public Citizen on behalf of 350,000 Public Citizen members and supporters, appreciate the opportunity to respond to the Federal Reserve Board (Board) request for comments on "Concentration Limits on Large Financial Companies" (the 'Proposed Rule'). AFR is a coalition of more than 200 civil society organizations that have come together to advocate for reform of the financial industry. Members of AFR include major labor, consumer, civil rights, investor, retiree, community, and faith based groups. A list of AFR members is attached.

Section 622 of the Dodd-Frank Wall Street Reform and Consumer Protection Act establishes a financial sector concentration limit that prohibits a financial company from merging, consolidating with, or acquiring, another company if the resulting company's consolidated liabilities would exceed 10 percent of the aggregate consolidated liabilities of all financial companies in the United States. This concentration limit is intended, along with a number of other provisions in the Dodd-Frank Act, to promote financial stability and address the perception that large financial institutions are "too big to fail".

The fact that some financial institutions have grown too large is a central problem in banking policy today. The crash of 2008 demonstrated moral hazard. Bankers took excessive risk with the implicit understanding that they would receive government bailouts. Since the financial crisis, prominent regulators have admitted that 'too big to fail' is a continuing problem in the financial sector.[1] Continuing scandals have also illustrated the problems that excessive size can create for bank management. [2]

[1] See, for example, Carney, Mark, "Inclusive Capitalism: Creating a Sense of the Systemic", May 27, 2014, available at http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech731.pdf; Hoenig, Thomas, Speech to the National Association of Business Economists, February 24, 2014, available at http://www.fdic.gov/news/news/speeches/spfeb2414.html ; Yellen, Janet, Speech at the Independent

Before approval of Dodd-Frank, Congress considered strict limits on bank size. The Brown-Kaufman amendment would have restricted bank deposits and liabilities to 10% of the GDP, and non-deposit liabilities of banks to 2% of the GDP. Though there was rigorous debate on these principles, the final provision approved by Congress was Section 622, a more modest concentration limit.

Section 622 strengthens the Riegle-Neal Act. This law established a deposit liability cap that prohibits a depository institution, bank holding company or savings and loan holding company from acquiring or merging with an insured depository institution in another state if, after consummation of the acquisition, the applicant would control more than 10 percent of the total amount of deposits of insured depository institutions in the United States. [3]

Section 622 provides a more comprehensive limitation on growth by acquisition because it requires non-deposit liabilities and any off-balance sheet exposures that are counted under capital rules to be taken into account. Prior to the passage of Section 622, the deposit cap provided incentives for banking firms near, at, or over the cap to shift liabilities from deposits to potentially more volatile on- and off-balance-sheet liabilities. A firm wishing to acquire a banking organization but constrained by the deposit cap could shed deposits in exchange for more volatile liabilities, thereby reducing its national deposit share while maintaining the same volume of total assets. Similarly, because the deposit cap was measured based solely on deposits, it did not constrain a banking organization from increasing its exposure to non-deposit liabilities.

The intent of Congress for Section 622 is reflected in the questions directed for study by the Financial Stability Oversight Council before the Federal Reserve Board prepared its rule. These questions included the impact of the limit on financial stability, moral hazard, and the cost and availability of credit and other financial services to households and businesses in the United States. [4] The FSOC concluded that the limit would have "a positive" impact on U.S. financial stability by reducing risks. Limits would prevent firms from growing so large for officers to manage and regulators to supervise.

Generally, we support the rule as proposed, including the various timetables for measuring industry liabilities. While Section 622 falls short of an absolute limit on bank size, and we believe the size of the largest financial institutions still creates significant moral hazard problems in the financial sector, the rule should help prevent the problem from growing worse.

Community Bankers of America, May 1, 2014, available at http://www.federalreserve.gov/newsevents/speech/yellen20140501a.htm .

[2] "JP Morgan Chase Whale Trades," US Senate Permanent Subcommittee on Investigations, (March, 2013), available at: http://www.hsgac.senate.gov/subcommittees/investigations/hearings/chase-whale-trades-a-case-history-of-derivatives-risks-and-abuses

[3] See 12 U.S.C. §§ 1828(c), 1843(i), and 1467a(e)(2).

[4] Study and Recommendations regarding Concentration Limits on Large Financial Companies, Financial Stability Oversight Council, (January, 2011) , available at: http://www.treasury.gov/initiatives/Documents/Study%20on%20Concentration%20Limits%20on%20Large%20Firms%2001-17-11.pdf

However, given the intent of Congress to curb bank size, we disagree with certain proposed exemptions that will permit bank acquisitions that may result in exceeding the 10% threshold. The Board proposes to permit expansion without regard to the concentration limit through merchant banking and the acquisition of assets in the course of collecting debt previously contracted (so-called 'DPC assets'). We believe this is misguided.

The statute does not provide an exemption for the acquisition of these assets. The statute does provide for certain other exemptions, which are enumerated. Specifically, Section 622(c) of the statute provides exemptions for the acquisition of bank "in default or in danger of default," or that would "result only in a de minimis increase in the liabilities" of the financial company. Congress might have enumerated other exemptions, but it chose not to and that should be honored in the rule.

By exempting merchant banking and DPC assets, the Board is leaving a potentially significant loophole in the rule that could clearly undermine the intent of the statute. The acquisition of an ownership share through either merchant banking activities or the process of collecting collateral on a debt can clearly lead to the effective ownership and / or control of another company. A justification given for these exemptions in the rule text is that in these activities "shares are generally held for a limited time period or do not involve the expansion of the firm" (CFR 27809). Yet this is not necessarily true or true in every case. Should the Board wish to exempt cases in which shares are held for a limited time period or in which new assets do not involve the expansion of the firm (perhaps because the bank does not exercise any effective control over the entity in which it has an ownership stake), then it should specify an actual time period or a definition of control which would exempt a brief ownership stake from triggering the Section 622 limitation on acquisitions.

The Board also exempts several other activities from the definition of 'acquisition' that can involve the acquisition of equity shares in a company, including market making and underwriting. We feel that an explicit exemption for these activities is likely unnecessary, since they would generally fall under the statutory de minimis exemption in Section 622(c). But in any case, the activities of underwriting and market making are fundamentally different from merchant banking or taking possession of collateral for an unpaid debt. Underwriting and market making involve ownership of equity shares generally for a period ranging from hours to weeks, at most months in the case of an underwriter which has significant problems in distributing shares. Market making and underwriting also involve no control over the outside company.

The situation is very different in the case of merchant banking or ownership of DPC collateral assets. In the case of merchant banking, the Federal Reserve's rule on merchant banking permits direct merchant banking investments to be held for up to ten years (fifteen years if held through a private equity fund), and for such investments to include full ownership of the portfolio

company.[5] It is true that banks are limited in their ability to engage in 'routine operation and management' of a company owned under merchant banking authority. However, they are permitted to exert a significant degree of control over the company, including placement of bank personnel on the company board of directors, a broad range of consulting arrangements, exerting control of activities outside the routine course of business, and even stepping in to provide routine management of operations in cases where this is deemed necessary to safeguard the return on the bank's investment. In this sense, the Board's statement in Part D(1)(d) of the proposed rule (CFR 27809) that merchant banking is a "passive investment", held for a "limited period of time" and does not involve "managerial control" is highly misleading, since merchant banking permits very long holding periods and significant managerial influence.

Assets acquired through a debt previously contracted (or so-called 'DPC assets') can be held for up to five years (ten years for real estate). It appears that during this period, the bank is also permitted substantial or even complete control over the owned assets. A five year period is a significant period of time, and would seem to represent the acquisition of an asset.

Finally, the broad and sometimes ill-defined nature of merchant banking and DPC arrangements invites the use of these exemptions to evade the Section 622 ban on acquisitions.

The Board should not permit such broad exemptions. AFR instead urges the Board to eliminate the broad exemptions for merchant banking and DPC assets in the final rule, and to replace the listed exemptions with a specified time period and level of control that would define an 'acquisition' under Section 622. The specified time period should be less than one year, and 'control' should be based on either majority ownership or substantial influence over the business decisions of the company.

Thank you for your consideration of these comments. For more information, please contact Bartlett Naylor, Financial Policy Advocate at Public Citizen, at bnaylor@citizen.org, or 202.580.5626, or Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform

Public Citizen

[5] Federal Reserve System, 12 CFR Part 225, Regulation Y, Docket No. R-1065, available at http://www.federalreserve.gov/BoardDocs/press/boardacts/2001/20010110/Attachment.pdf

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International

- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club

- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC

- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending

- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- UNET