MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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Chair Powell said a week ago that, thanks to commercial real estate risk, some banks will need to be "closed" or "merged out of existence," hopefully adding that these will be "smaller banks for the most part." That this may befall the banking system sooner than Mr. Powell suggested is all too apparent from NYCB's travails. The OCC's new merger proposal flies in the face of this hard reality, dooming mergers of size or maybe even small ones until it's too late. A surprising source – a super-progressive analysis of bank merger policy – makes it clear why the OCC's approach is not only high-risk, but also ill-conceived.

The paper comes from Saule T. Omarova, President Biden's nominee to be Comptroller who was forced to withdraw, and the Administration's most recent Assistant Secretary for Financial Institutions, Graham Steele. As befits their longstanding views, the paper presses for stringent bank-merger policy to combat what Justice Brandeis first called the "money trusts." Ms. Omarova and Mr. Steele say that banks of all sizes are still "money trusts" despite the role of omnipotent private-equity and asset-management firms, but so goes much of their analysis. What's more interesting in their report and a new petition filed by a like-minded academic is their ground-breaking, hard look at how much of bank regulation is actually intended to curtail undue market power. Taking this into account could lead to sound merger policy without the adverse consequences evident in the OCC's drop-dead proposal.

There are in fact many safety-and-soundness standards that are also expressly designed to prevent problematic concentration and unfair market advantage. A short list of my own prompted by these papers includes limits on inter-affiliate transactions and anti-tying restraints intended to prevent holding companies from powering up their profits thanks to unique bank privileges and proprietary knowledge about the subsidiary bank's customers. Statutory management interlocks also prevent concentrated market power. Further, banks are required to have at least two independent directors to guard against the use of public subsidies to empower private profit at the parent holding company. Loan-to-one-borrower and other concentration restrictions are both to prevent undue bank exposures and limit a company's ability to provide so much financing that the bank gains implicit control over its borrowers and counterparties.

Even bigger-picture standards sharply restrict bank and BHC powers to prevent unfair competition empowered by privilege provided via public subsidies such as deposit insurance, discount-window access, and other unique bank privileges. First and foremost among these are product restrictions that prevent banking/commerce interlocks long feared in the U.S. despite the global preponderance of "universal" banks. The law also limits bank deposit share gained via acquisition, a direct market-power prophylactic. Bank regulators also have the power even to break up banks or revoke their charters, limiting both risk and market footprint. The fact that no one can charter a bank unless a regulator allows it entry under terms designed by law to safeguard public trust and prevent undue

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alignment between privileged banks and commercial entities is also directly aimed at preventing undue market power.

All of these statutory barriers to risk and market power are unique to banking organizations. Every other business lives or dies by its own hand regardless of compliance with rules addressing public interests such as pollution or drug safety unless it violates civil or criminal law or its M&A desires attract federal antitrust interest. No other line of business also has an express duty under law (the CRA) to serve the public good even though many others enjoy direct and direct public benefits and subsidies.

The OCC's merger policy is a tacit acknowledgement that regulators have not used the authority they have to contain bank market power – the Fed for example ignored the anti-tying rules when it came to SVB and it and all the other agencies are now fourteen years past the time Congress told them to force parent holding companies to support subsidiary banks. This is the agencies' fault, not that of banks no matter their sometimes-undue agility working around all of the safeguards set in law and rule.

Some bank mergers are indeed bad bank mergers, but unless the agencies use the tools they have to contain market power at individual companies that transgress the safeguards briefly described above, a simple ban on most mergers will do nothing to contain banks willing and able to work their way around key guardrails while blocking transactions essential for the economies and efficiencies of scale sound banks must have to withstand all the nonbank market power gunning for them.