Banking Legislation in Retrospect: Whence Came the Deluge?

Remarks of John D. Hawke, Jr.
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One of the afflictions of aging is that one tends to remember things that happened a long time ago, while becoming somewhat hazy about more recent events. Although, as my late partner Thurman Arnold was fond of saying, "I am an old man, and some of the things I remember best never really happened."

On the other hand, youth has its own afflictions. Among others, not having lived through earlier times the young may not fully appreciate what the world used to be like.

I recall a time when banking regulation was hardly noticeable, and banking legislation was not quite as rare as a sighting of Halley's Comet. I suspect that most of you, who toil today in the maze of banking regulation, may think it was always as it is today, and that new and significant banking legislation can be expected every year or so.

When I started practicing law the head of supervision at the Federal Reserve was once asked how much capital a bank needs. His answer was "I can't tell you, but I know it when I see it." Compare that with mind-numbing complexity of Basel II and the 160 Federal Register pages of implementing regulations intended to prescribe just how much capital a bank should have.

In 1958, Professor Kenneth Culp Davis, in his landmark treatise on administrative law, cited banking regulation as the "outstanding example" in the federal government of the regulation of an entire industry through informal methods -- once characterized by someone as "regulation by raised eyebrow." While he subsequently moderated that view, I think he would be staggered by the prescriptiveness of modern bank regulation. Today, the formal regulations of the four federal banking agencies -- OCC, FDIC, OTS and FRB -- take up almost 3,000 pages in the Code of Federal Regulations.

As I was thinking about what I might say this evening, I pondered what has caused this change.

As background for this discussion let me briefly review the chronology of major federal banking legislation--and by this I mean to include those significant laws enacted to affect the structure and fundamental regulation of the industry.

We can pass over quickly the legislation creating the First and Second Banks of the United States, in 1791 and 1816. This early experiment in central banking came to an end in 1836 when Andrew Jackson threatened to veto the renewal of the Second Bank's charter.

Almost 30 years passed before Congress again visited serious banking legislation by enacting the National Currency Act in 1863, reenacted as the National Bank Act in 1864, creating the national banking system and the Office of the Comptroller of the Currency. And this was intended less as bank regulatory legislation than as a means of implementing a system of national currency.

It took another 50 years for Congress to make fundamental change in the structure and regulation of banking, when in 1913 it created the Federal Reserve. Another 14 years passed before it enacted the McFadden Act, regulating branching of national banks and prohibiting interstate branching.

The Depression years of 1932 to 1935 understandably brought a wave of banking legislation--the Federal Home Loan Bank Act of 1932, creating the Federal Home Loan Bank Board and the Federal Home Loan Banks; the Homeowners Loan Act; the Glass-Steagall Act; the National Housing Act of 1934 and the Banking Act of 1935, creating the FSLIC and the FDIC.

But after the Depression more than 20 years passed before Congress returned to banking in a serious way. It enacted the Bank Holding Company Act in 1956 (which it amended in 1966 to close two large loopholes), and the Bank Merger Act in 1960, which was also amended in 1966 in response to some Supreme Court decisions. 1966 and 1967 also saw the enactment of the Saving and Loan Holding Company Amendments and the Financial Institutions Supervisory Act, which substantially enhanced the enforcement powers of the bank regulators.

But I mark the beginning of the era of really major -- and virtually continuous -- banking legislation with the passage of the Truth in Lending Act in 1968, which set out disclosure requirements for consumer loans, and the Bank Holding Company Act Amendments of 1970, which brought one-bank holding companies under regulation and tightened the standards for nonbanking activities. These laws were the precursors of an avalanche of far-reaching regulatory and consumer protection laws that cascaded over the banking industry for more than the next 40 years. During that time Congress legislated fundamental changes in the regulatory environment in more than 60 new laws, whose length exceeded by far anything that had ever been seen before. Indeed, it was common for a single bill to serve as a vehicle for the enactment of multiple individual new laws.

Without pretending to be exhaustive, and without going into the details of each enactment, let me list the major ones--and I warn you the list is long:

1970

I've already mentioned the Bank Holding Company Act Amendments of 1970, which may have been the most significant of the new laws, for it was the means by which the Federal Reserve took on a major role in banking supervision. But that year we also had:

--- The Fair Credit Reporting Act.

1974

---The Equal Credit Opportunity;

---The Fair Credit Billing Act; and

---The Real Estate Settlement Procedures Act.

1975

---The Home Mortgage Disclosure Act.

1977

---The Community Reinvestment Act.

1978

1978 was a banner year, which saw the enactment of:

---The Financial Institutions Regulatory and Interest Rate Control Act, which included six separate new laws:

--The Depository Institutions Management Interlocks Act;

--The Change in Bank Control Act and the Change in Savings and Loan Control Act;

--The Federal Financial Institutions Examination Council Act;

--The Right to Financial Privacy Act;

--The National Credit Union Central Liquidity Facility Act; and

--The Electronic Fund Transfer Act.

In the same year we got:

---The International Banking Act, and

---The Fair Debt Collection Practices Act

1980

Congress resumed its onslaught in the early 1980s, with:

---The Depository Institutions Deregulation and Monetary Control Act of 1980, which brought with it three new laws:

--The Consumer Checking Account Equity Act;

--The Truth in Lending Simplification and Reform Act; and

--The Financial Regulation Simplification Act.

1982

The Savings and Loan crisis of the late 70s and early 80s gave us:

---The Garn-St Germain Depository Institutions Act of 1982, which brought along five more new laws:

--The Net Worth Certificate Act;

--The Thrift Institutions Restructuring Act;

--The Banking Affiliates Act;

--The Bank Service Corporation Act; and

--The Alternative Mortgage Transaction Parity Act.

1983

---The International Lending Supervision Act.

1987

In 1987 we got:

---The Competitive Equality Banking Act of 1987, which included four new laws:

--The Federal Savings and Loan Insurance Corporation Recapitalization Act;

--The Thrift Industry Recovery Act;

--The Financial Institutions Emergency Acquisitions Amendments; and

--The Expedited Funds Availability Act.

1989

And in 1989 came the 370-page

---Financial Institutions Reform, Recovery, and Enforcement Act of 1989, up to then the largest single piece of banking legislation in our history.

1991

Not long after came:

---The Federal Deposit Insurance Corporation Improvement Act of 1991, which subsumed four separate new laws:

--The Bank Enterprise Act;

--The Foreign Bank Supervision Enhancement Act;

--The Truth in Savings Act; and

--The Qualified Thrift Lender Reform Act.

<u>1994</u>

A breather of five years passed until 1994 brought us:

---The Riegle Community Development and Regulatory Improvement Act of 1994, which included four more new laws:

--The Home Ownership and Equity Protection Act;

--The Small Business Loan Securitization and Secondary Market Enhancement Act;

--The Money Laundering Suppression Act; and

--The National Flood Insurance Reform Act.

And, as if Senator Riegle had not done enough during his tenure as chairman of Senate Banking, the same year we got:

---The Riegle-Neal Interstate Banking and Branching Efficiency Act.

<u>1996</u>

In 1996, someone in Congress must have looked back with a bit of embarrassment, because they enacted:

---The Economic Growth and Regulatory Paperwork Reduction Act of 1996, which required the agencies "to identify any outdated, unnecessary or unduly burdensome regulatory requirements imposed on insured depository institutions"--proving the old adage that there is no gamekeeper like an old poacher.

<u>1999</u>

But that moment of apparent remorse was overcome in 1999, with the enactment of:

---The Gramm-Leach-Bliley Act, which dragged along two new laws:

--The Federal Home Loan Bank System Modernization Act; and

--The ATM Fee Reform Act.

The 21st Century saw no abatement in the deluge. We had:

2001

---The International Money Laundering Abatement and Financial Anti-Terrorism Act

2003

---The Fair and Accurate Credit Transactions Act of 2003, which included:

--The Financial Literacy and Education Improvement Act.

And then:

---The Check Clearing for the 21st Century Act.

2006

---The Financial Services Regulatory Relief Act of 2006.

2009

---The Credit Card Reform Act of 2009.

2010

Finally, and most recently we had the 850-page

---Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the most sweeping piece of financial legislation in our history, which included no less than eleven new banking laws:

--The Enhancing Financial Institution Safety and Soundness Act;

--The Federal Insurance Office Act;

--The Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act;

--The Wall Street Transparency and Accountability Act;

--The Payment, Clearing, and Settlement Supervision Act;

--The Investor Protection and Securities Reform Act;

--The Consumer Financial Protection Act;

--The Improving Access to Mainstream Financial Institutions Act

--The Pay It Back Act;

--The Mortgage Reform and Anti-Predatory Lending Act; and

--The Expand and Preserve Home Ownership Through Counseling Act.

There are undoubtedly a number of lesser enactments during this period, but I'm sure you get the idea. And I apologize for inflicting this feast on top of your full stomachs. I am sure you will agree that this past 40 years has seen an absolutely staggering volume of banking laws. It is no wonder that financial institution regulation has become recognized as a major area of specialization for lawyers.

To be sure, one can point to specific motivating causes for each of these laws--particular abuses that had gone unremedied for a long time, stresses in the economy, unreasonable competitive disparities, regulatory anomalies, and so on. Garn-St Germain in 1982 and FIRREA in 1989 were responses to the S&L crisis of the 1980s and problems in the banking industry later in the decade, just as Dodd-Frank was a response to the more recent financial meltdown.

But what is it about the last quarter of the 20th century and the first decade of the 21st that so dramatically distinguishes this period from 180 years of our prior history? What were the environmental factors that supported, if not encouraged, this time of unprecedented legislation affecting banks?

This is obviously a complex question, and I will not try to relate any particular factor to particular legislation. But it seems to me useful to ponder some of the broader social, political and economic changes that have taken place during the last five decades that might have a relationship to the legislative blizzard I have described.

A few come to my mind:

<u>Changes in the complexion of Congress.</u> Legislative reapportionment at the state level and the expansion of voting rights certainly were factors. As conservative rural southerners

began to lose their grip on leadership positions in Congress, and more liberal urban members assumed positions of leadership, there was clearly more appetite for legislative activism.

From 1931 to 1943 the House Banking Committee was chaired by Rep. Henry Steagall of Alabama, and from 1943 to 1963 by Brent Spence of Kentucky. Spence was followed by Wright Patman, a Texas populist who served from 1963 to 1975, and whose main purpose in life was to stick it to the Federal Reserve on monetary policy. Then things changed. Patman was followed by Henry Reuss of Wisconsin, Henry Gonzalez of Texas, and Fernand St Germain of Rhode Island, all of whom can readily be characterized as legislative activists.

On the Senate side Senator William Proxmire of Wisconsin, also an activist--you will recall his periodic “Golden Fleece” awards--succeeded southern senators who had reigned for 15 years.

These new committee chairmen commissioned an unprecedented study of bank supervision by the General Accounting Office in 1976. The GAO report called for revisions in the conduct and frequency of bank examinations, more aggressive enforcement actions, better training of examiners, more stringent handling of charter applications, and greater coordination among the agencies. Congressional interest in the banking agencies became more intense in the following years.

<u>The emergence of a strong consumer movement.</u> Over the last 40 years we have also seen the emergence and maturation of a strong, well organized and aggressive consumer movement. As commentators on proposed rules, intervenors and protestants in administrative proceedings, petitioners to Congress, and litigants in court, such groups as Consumers Union, the Consumer Federation of America, the National Community Reinvestment Coalition, the Greenlining Institute, and the Ralph Nader organization, have had a material impact on the development of banking legislation and regulation. Nader’s scrupulously detailed 1973 report on Citibank was a wakeup call and had a significant impact on banks, regulators and legislators.

Developments in technology. During this time we also saw significant developments in technology. The evolution of electronic funds transfer and payment systems and the greatly increased use of ATMs and on-line bill paying -- called for new ground rules and new protections for consumers. In the early days of ATMs, for example, the question was seriously raised whether the deployment of ATMs should be subject to the restrictions on branching.

Globalization. As U.S. financial institutions found their customers doing more and more of their business overseas they had a strong incentive to expand into foreign markets themselves. By the same token, foreign banks found U.S. markets attractive. Disparities in the regulatory and supervisory environments for U.S. and foreign banks called out for a legislative response.

Changes in industry structure and the search for efficiencies. But in my judgment, the most significant factor was a fundamental change in the nature of banking and the banking industry itself.

As banking recovered from the disaster of the Great Depression, a highly fractionalized banking system evolved, characterized by pervasive unit banking and significant constraints on both geographic and product expansion. Of the more than 14,000 banks we had in 1935, almost 95 percent were unit banks. Only about 800 banks had any branches at all. The average number of branches per bank was 0.22.

By 1970 we still had almost 14,000 banks, but only about 70 percent were unit banks. Branching had increased five-fold, and the average branch-per-bank was up to 1.6. By 2009, however, the population of banks had decreased to 6,839, of which only 24 percent were unit banks, and the average number of branches per bank was up to 12.8.

This tremendous consolidation was fueled by several factors. First and foremost was the strong motivation among bankers to achieve greater efficiencies and economies of scale, and thus to increase earnings. A system of 14,000 banks may have had a lot to recommend it, but no one would argue that it was the most efficient system for delivering banking services. This drive is reflected in merger statistics. The average number of unassisted mergers per year in the period from 1970 to 2009 was almost three times that for the period 1935-1969. While new banks continued to be chartered in the latter period, the number of banks newly chartered was only 60 percent of the number disappearing by merger.

Acquisition activity was spurred by actions at the state level moderating unit banking and liberalizing geographic restrictions, thus allowing banks to do mergers outside the areas in which their branching had previously been limited. It was also spurred by increasing activity among the states to permit entry by out-of-state bank holding companies -- something that had been possible with state consent ever since the BHCA was passed in 1956, but not implemented until much later. Eventually, of course, almost all geographic restrictions have been done away with.

A desire to beef up earnings was also encouraged by the broadening of the markets for bank stocks. When the securities laws were amended in 1964 to require SEC registration of over-the-counter stocks, banks were given a special exemption that permitted them to register and make filings with the banking agencies. By the late 60s, however, there was a major movement in the industry -- spurred by Citibank -- to reorganize banks into the one-bank holding company format, and thus to realize opportunities for product diversification. One consequence of this was to make the exemption from SEC filing unavailable. Since holding companies were not banks they had to register and make filings with the SEC. Thousands of banks thus found that their stocks were being traded under big league rules, and the market undoubtedly paid more attention to them.

Of course, the 1970 amendments to the BHCA extended regulation to one-bank holding companies, cutting off most of the opportunities for product diversification -- undoubtedly leaving many bankers wondering why they had reorganized.

Nevertheless, product diversification crept forward as a result of permissive rulings by the Comptroller of the Currency and the Federal Reserve, so that by the time Gramm-Leach-Bliley gave the coup-de-grace to Glass-Steagall, banking organizations were already being permitted to engage in a broad spectrum of securities activities not thought possible at an earlier time. The repeal of Glass-Steagall did little to expand their permissible activities.

One might say that the banking system that developed between 1970 and 2009 was a new and materially different system than that of prior years. The size of the system alone was massively greater. Total assets in 2009 (not adjusted for inflation) were 480 times larger than in 1935 and 41 times greater than in 1970, and total equity capital was 436 times larger than in 1935 and 64 times larger than in 1970. Banking had been transformed, largely during the last 40 years, from a highly pluralistic, locally oriented and rather sleepy business, into an aggressive economic behemoth, with institutions competing both on a nationwide and worldwide scale -- a behemoth capable of inflicting massive damage on the economy, as we have only recently learned to our sorrow.

I'm not sure we need to look any further for an explanation of why financial legislation has become so popular.

When I started law practice some 50 years ago, and by pure accident became marked in my firm as the lawyer who handled banking matters, I was told by one older partner that I was "not in the main stream" of our practice. Today we have several dozen lawyers immersed in this area and the practice of financial regulation has become an enormously popular and important specialty. For you who labor in these vineyards, you can thank the Congress for paving the way for a tremendously interesting and challenging area in which to practice law, and I wish you good fortune as you attempt to deal with the deluge.