ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA

Testimony of

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Before the

Congress of the United States
House Committee on the Judiciary
Subcommittee on Courts and Competition Policy

on

"Too Big To Fail"
The Role of Antitrust Law in Government-Funded Consolidation In the Banking Industry

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Chairman Johnson, Representative Coble and members of the Committee, my name is Rusty Cloutier. I am the President and CEO of MidSouth Bancorp, Inc. MidSouth is a bank holding company located in Lafayette, LA, with total assets of $936.8 million as of December 31, 2008. Through our wholly-owned subsidiary, MidSouth Bank, NA, MidSouth offers complete banking services to commercial and retail customers in south Louisiana and southeast Texas. We have 34 locations in Louisiana and Texas. We are community oriented and focus primarily on offering commercial and consumer loan and deposit services to individuals, and small and middle market businesses. I am member and a former Chairman of the Independent Community Bankers of America. I am pleased to represent community bankers and ICBA's 5,000 members at this important hearing on "Too Big To Fail"; The Role of Antitrust Law in Government-Funded Consolidation In the Banking Industry.

ICBA agrees with the premise of this hearing and believe it is valid in a broader sense. Antitrust law, banking law, and banking regulation have all contributed to consolidation of the banking and financial industry. Excessive financial concentration was instrumental in creating the current financial crisis. Therefore, ICBA recommends bold and immediate action to deal with the systemic risk excessive financial concentration has created.

Summary of ICBA Systemic Risk Recommendations

ICBA commends the committee for tackling this issue quickly. The current crisis demands bold action, and we recommend the following:

- Congress should direct a fully staffed interagency task force to immediately identify financial institutions that pose a systemic risk to the economy.
- These institutions should be put immediately under prudential supervision by a Federal agency – most likely the Federal Reserve.
- The Federal systemic risk agency should impose two fees on these institutions that would:
    - compensate the agency for the cost of supervision; and
    - capitalize a systemic risk fund comparable to the FDIC's Deposit Insurance Fund.
- The FDIC should impose a systemic risk premium on any insured bank that is affiliated with a firm that is designated as a systemic risk institution.
- The systemic risk regulator should impose higher capital charges to provide a cushion against systemic risk.
- The Congress should direct the systemic risk regulator and the FDIC to develop procedures to resolve the failure of a systemic risk institution.

- The Congress should direct the interagency systemic risk task force to order the break up of systemic risk institutions over a five year period.
- Congress should direct the systemic risk regulator to review all proposed mergers of major financial institutions and to block any merger that would result in the creation of a systemic risk institution.
- Congress should direct the systemic risk regulator to block any financial activity that threatens to impose a systemic risk.

The only way to maintain a vibrant banking system where small and large institutions are able to fairly compete – and to protect taxpayers – is to aggressively regulate, assessing, and eventually break up those institutions posing a risk to our entire economy.

Congress Must Address Excessive Concentration

ICBA remains deeply concerned about the continued concentration of banking assets in the U.S. The current crisis has made it painfully obvious that the financial system has become too concentrated, and – for many institutions – too loosely regulated.

Today, the four largest banking companies control more than 40% of the nation's deposits and more than 50% of the assets held by U.S. banks. We do not believe it is in the public interest to have four institutions controlling most of the assets of the banking industry. A more diverse financial system would reduce risk, and promote competition, innovation, and the availability of credit to consumers of various means and businesses of all sizes.

Our nation is going through an agonizing series of bankruptcies, failures and forced buy-outs or mergers of some of the nation's largest banking and investment houses that is costing American taxpayers hundreds of billions of dollars and destabilizing our economy. The doctrine of too big – or too interconnected – to fail, has finally come home to roost, to the detriment of American taxpayers. Our nation cannot afford to go through that again. Systemic risk institutions that are too big or inter-connected to manage, regulate or fail should either be broken up or required to divest sufficient assets so that they no longer pose a systemic risk.

In a recent speech Federal Reserve Chairman Ben S. Bernanke outlined the risks of the too-big-to-fail system:

> [T]he belief of market participants that a particular firm is considered too big to fail has many undesirable effects. For instance, it reduces market discipline and encourages excessive risk-taking by the firm. It also provides an artificial incentive for firms to grow, in order to be perceived as too big to fail. And it creates an unlevel playing field with smaller firms, which may not be regarded as having implicit government support. Moreover, government rescues of too-big-to-

> fail firms can be costly to taxpayers, as we have seen recently. Indeed, in the present crisis, the too-big-to-fail issue has emerged as an enormous problem.[1]

The Chairman of the FDIC, Sheila Bair, appearing on 60 Minutes, recently suggested that too-big-to-fail institutions shouldn't be allowed to exist in the future. She said, "I think we need to really review the size of these institutions and whether we should do something about that, frankly."[2] The Group of 30 report on financial reform stated that, "To guard against excessive concentration in national banking systems, with implications for effective official oversight, management control, and effective competition, nationwide limits on deposit concentration should be considered at a level appropriate to individual countries."[3]

The 10% nationwide deposit concentration cap established by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 should be immediately reduced and strengthened. The current cap is insufficient to control the growth of systemic risk institutions the failure of which will cost taxpayers dearly and destabilize our economy.

Unfortunately, government interventions necessitated by the too-big-to-fail policy have exacerbated rather than abated the long-term problems in our financial structure. Through Federal Reserve and Treasury orchestrated mergers, acquisitions and closures, the big have become bigger.

Congress should take chairman Bair's suggestion and not only consider breaking up the largest institutions, but order that it take place. It is clearly not in the public interest to have so much power and concentrated wealth in the hands of so few so that they can destabilize our entire economy.

Banking and Antitrust Laws Have Failed to Prevent Undue Concentration

Together with my colleagues I have spent years warning policy makers of the systemic risk that was being created in our nation by the unbridled growth of the nation's largest banks and financial firms. But, I was told that I didn't get it, that I didn't understand the new global economy, that I was a protectionist, that I was afraid of competition, and that I needed to get with the "modern" times.

Sadly, we now know what modern times look like and it isn't pretty. Our financial system is imploding around us. Why is this the case, and why must Congress take bold action?

One important reason is that banking and antitrust laws fail to address the systemic risks posed by excessive financial concentration. Their focus is too

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[1] Financial Reform to Address Systemic Risk, at the Council of Foreign Relations, March 10, 2009
[2] March 8, 2009
[3] "Financial Reform; A Framework for Financial Stability, January 15, 2009, p. 8.

narrow. Antitrust laws are designed to maintain competitive geographic and product markets. So long as the courts and agencies can discern that there are enough competitors in a particular market, that is the end of the inquiry.

This type of analysis often prevents local banks from merging. But, it has done nothing to prevent the creation of giant nationwide franchises competing with each other in various local markets. No one asked, is the nation's banking industry becoming too concentrated and are individual firms becoming too powerful, both economically and politically.

The banking laws are also subject to misguided tunnel vision. The question is always whether a given merger will enhance the safety and soundness of an individual firm. The answer has been that "bigger" is almost necessarily "stronger." A bigger firm can – many said – spread its risk across geographic areas and business lines. No one wondered what would happen if one firm, or a group of firms, decides to jump off a cliff as they did in the subprime mortgage market. Now we know.

It is time for Congress to change these laws and direct that the nation's regulatory system take systemic risk into account and take steps to reduce and eventually eliminate it.

State of Community Banking is Strong

Despite the challenges we face, the community bank segment of the financial system is still working and working well. We are open for business, we are making loans, and we are ready to help all Americans weather these difficult times.

Community banks are strong, commonsense lenders that largely did not engage in the practices that led to the current crisis. Most community banks take the prudent approach of providing loans that customers can repay, which best serves both banks and customers. As a result of this commonsense approach to banking, the community banking industry, in general, is well-capitalized and has fewer problem assets than other segments of the financial services industry.

That is not to suggest that community banks are unaffected by the recent financial collapse. The general decline in the economy has caused many consumers to tighten their belts and reduce the demand for credit. Commercial real estate markets in some areas are stressed. Many bank examiners are overreacting, sending a message that contradicts recommendations from Washington that banks maintain and increase lending. That is why it is essential that the government continue its efforts to stabilize the financial system.

But, Congress must recognize that these efforts are blatantly unfair. Almost every Monday morning for months community banks have woken up to news that the government has bailed out yet another too-big-to-fail institution. On many Saturdays they hear that the FDIC has summarily closed one or two too-small-to-save institutions. And, just recently, the FDIC proposed a huge special premium to shore up the Deposit Insurance Fund to pay for losses imposed by large institutions. This inequity must end, and only Congress can do it. The current situation – if left uncorrected – will damage community banks and the consumers and small businesses that we serve.

Government Funding Through TARP

ICBA has had to work hard to ensure that community banks were eligible for the Troubled Asset Relief Program's Capital Purchase Program. While the nation's largest banks had ready access to TARP funds, the vast majority of community banks were left out in the beginning stages. Thousands of community banks could not even apply for funding because the Treasury's original term sheet for the program applied only to publicly traded institutions. Privately held banks, banks in Subchapter S form, and mutual banks simply could not apply. There is still no term sheet for mutuals.

Mr. Chairman, the program has changed so much that I believe many of my colleagues are having serious second thoughts about participating, so the question of equity between large and small banks may be moot. Even so, many community banks, like mine, stand ready to aid in our economic recovery. This remains the case, whether or not we receive government capital.

In response to the understandable anger over $50 million private jets and multi-million dollar bonuses and golden parachutes for CEOs who led their companies into insolvency, or near insolvency, Congress recently enacted executive compensation and corporate governance limits for TARP recipients. The new statutory restrictions in some cases went beyond restrictions put in place by the Obama Administration and took away Treasury's discretion to focus these remedies where the problems actually occurred – in some large TARP recipient institutions.

MidSouth Bank does not engage in the compensation practices that have created the public ire. While we appreciate the changes that diminished the impact of these limits on community banks, we are frustrated by being tarred by the same brush used on the large financial institutions that caused the current economic crisis. MidSouth Bank is a solid, healthy community-minded financial institution and should be treated as a responsible partner in the effort to revitalize the economy.

We saw the CPP as an opportunity to encourage and support economic expansion in every market we serve during a national recession that could last, at least, another 12 to 18 months. After completing the CPP transaction on January 9, 2009, we began to actively promote the availability of $250 million in loan opportunities to small businesses and community leaders throughout our service area. MidSouth conducted town hall meetings in 14 communities in south Louisiana and southeast Texas from the end of January through February 19th. We focused on small businesses because small businesses drive the economy and create new jobs in our communities.

In addition to the general business community, we are also reaching out to the minority business community, through town hall meetings with the Black Chambers of Commerce of Baton Rouge and Southwest Louisiana and the Group of 100 Black Men, another African-American business organization. Our efforts to publicize the lending program continue with more meetings scheduled with homebuilders, industrial companies and other business groups.

We have also directed an ad campaign at consumers and the general public. We have placed billboards in every market in our service area advertising the availability of $250 million in loans.

MidSouth's agreement with the government carries significant monetary and other obligations. If the government changes that agreement and adds new burdensome conditions, MidSouth will have to reevaluate its continued participation in the CPP. We are pleased that the economic recovery bill included Chairman Frank's idea to allow TARP participants to repay TARP funds early without penalty. This allows MidSouth and other community banks to keep their options open.

However, community banks interested in returning TARP/ CPP funds are reporting that they are being told they would have to pay or forfeit hundreds of thousands of dollars to the Treasury through payments and warrants even if they held the TARP capital for a short period. This is outrageous and unacceptable and not the intent of Chairman Frank's provision to allow banks to easily return the TARP capital without penalty.

But it would be a shame if new conditions forced us to withdraw from the program. Those community banks that chose to participate in the TARP and CPP did so with the conviction to put those funds to good use through loans to small and mid-sized businesses and consumers. MidSouth has taken the purpose of the CPP seriously by aggressively marketing the credit opportunities afforded by Treasury's investment in the bank. Policymakers should be encouraging the participation of more community banks like MidSouth bank who are willing and ready to be active leaders in our economic recovery.

Maintain a Diversified Financial Regulatory System

Equitable treatment under the TARP and similar programs is important in the short run, but we are especially concerned about the long-term future of the nation's financial regulatory system.

While ICBA strongly supports creation of an effective systemic risk regulator, we oppose the establishment of a single, monolithic regulator for the financial system. Having more than a single federal agency regulating depository institutions provides valuable regulatory checks-and-balances and promotes "best practices" among those agencies – much like having multiple branches of government. The collaboration that is required by multiple federal agencies on each interagency regulation insures that all perspectives and interests are represented, that no one type of institution will benefit over another, and that the resulting regulatory or supervisory product is superior.

A monolithic federal regulator such as the U.K.'s Financial Service Authority would be dangerous and unwise in a country with a financial services sector as diverse as the United States, with tens of thousands of banks and other financial services providers. Efficiency must be balanced against good public policy. With the enormous power of bank regulators and the critical role of banks in the health and vitality of the national economy, it is imperative that the bank regulatory system preserves real choice, and preserves both state and federal regulation.

For over three generations, the U.S. banking regulatory structure has served this nation well. Our banking sector was the envy of the world and the strongest and most resilient financial system ever created. But we have gotten off the track. Non-bank financial regulation has been lax and our system has allowed – and even encouraged – the establishment of financial institutions that are too big to manage, too big to regulate, and too big to fail.

Congress need not waste time rearranging the regulatory boxes to change the system of community bank regulation. That system has worked, is working, and will work in the future. The failure occurred in the too-big-to-fail sector. That is the sector Congress must fix.

Identification and Regulation of Systemic Risk Institutions

ICBA recommends that Congress establish an interagency task force to identify institutions that pose a systemic financial risk. At a minimum, this task force should include the agencies that regulate and supervise FDIC-insured banks – including the Federal Reserve – plus the Treasury and Securities and Exchange Commission. This task force would be fully staffed by individuals from those agencies, and should be charged with identifying specific institutions that pose a systemic risk. The task force should be directed by an individual appointed by the President and confirmed by the Senate.

Once the task force has identified systemic risk institutions, they should be referred to the systemic risk regulator. Chairman Bernanke's March 10th speech provides a good description of the systemic risk regulator's duties: "Any firm whose failure would pose a systemic risk must receive especially close supervisory oversight of its risk-taking, risk management, and financial condition, and be held to high capital and liquidity standards." Bernanke continued: "The consolidated supervisors must have clear authority to monitor and address safety and soundness concerns in all parts of the organization, not just the holding company."

Of course, capital is the first line of defense against losses. Community banks have known this all along and generally maintained higher than required levels. This practice has helped many of our colleagues to weather the current storm. The new systemic risk regulator should adopt this same philosophy for the too-big-to-fail institutions that it regulators.

Clearly, the systemic risk regulator should also have the authority to step in and order the institution to cease activities that impose a systemic risk. Many observers warned that many players in the nation's mortgage market were taking too many risks. Unfortunately, no one agency attempted to step in and stop imprudent lending practices across the board. An effective systemic risk regulator must have the unambiguous duty and authority to block any financial activity that threatens to impose a systemic risk.

Assessment of Systemic Risk Regulatory Fees

The identification, regulation, and supervision of these institutions will impose significant costs on the systemic risk task force and systemic risk regulator. Systemic risk institutions must be assessed the full costs of these government expenses. This would entail a fee, similar to the examination fees banks must pay to their chartering agencies.

Resolving Systemic Risk Institutions

Chairman Bair and Chairman Bernanke have each recommended that the United States develop a mechanism for resolving systemic risk institutions. This is essential to avoid a repeat of the series of the ad hoc weekend bailouts that have proven so costly and infuriating to the public and unfair to institutions that are too small to save.

Again, Bernanke's March 10th speech outlined some key considerations:

> The new resolution regime would need to be carefully crafted. For example, clear guidelines must define which firms could be subject to the alternative regime and the process for invoking that regime, analogous perhaps to the procedures for invoking the so-called systemic risk exception under the FDIA. In addition, given the global operations of many large and complex financial firms and the complex regulatory structures under which they operate, any new regime must be structured to work as seamlessly as possible with other domestic or foreign insolvency regimes that might apply to one or more parts of the consolidated organization.

This resolution process will, obviously, be expensive. Therefore, Congress should direct the systemic risk regulator to establish a fund to bear these costs. The FDIC provides a good model. Congress has designated a minimum reserve ratio for the FDIC's Deposit Insurance Fund and directed the agency to assess risk-based premiums to maintain that ratio. Instead of deposits, the ratio for the systemic risk fund should apply as broadly as possible to ensure that all the risks that are covered are assessed.

Some of the systemic risk institutions will certainly include FDIC-insured banks within their holding companies. These banks would certainly not be resolved in the same way as a stand-alone community bank; all depositors would be protected beyond the statutory limits. Therefore, the Congress should direct the FDIC to impose a systemic risk fee on these institutions in addition to their regular premiums.

Last week's news that AIG was required by contract to pay hundreds of millions of dollars in bonuses to the very people that ruined that company point to another requirement for an effective systemic risk regulator. Once a systemic risk institution becomes a candidate for open-institution assistance or resolution, the regulator should have the same authority to abrogate contracts as the FDIC when it is appointed conservator and receiver of a bank. If the executives and other high-paid employees of these institutions understood that they could not design employment contracts that harmed the public interest, their willingness to take unjustified risk might diminish.

Breaking up Systemic Risk Institutions & Preventing Establishing New Threats

ICBA believes that imposing systemic risk regulation and imposing systemic risk fees and premiums will provide incentives to firms to voluntarily divest activities or not become too big to fail. However, these incentives may not be adequate. Therefore, Congress should direct the systemic risk task force to order the break up of systemic risk institutions over a five year period. These steps will reverse the long-standing regulatory policy that has favored the creation of ever-larger financial institutions.

ICBA understands that this will be a controversial recommendation, and many firms will object. Let me be clear. We do not advocate liquidation of ongoing, profitable activities. Huge conglomerate holding companies should be separated into business units that make sense. This could be done on the basis of business lines or geographical divisions. Parts of larger institutions could be sold to other institutions. The goal is to reduce systemic risk, not to reduce jobs or service to consumers and businesses.

Maintain and Strengthen the Separation of Banking and Commerce

Congress has consistently followed one policy that has prevented the creation of some systemic risk institutions. The long-standing policy prohibiting affiliations or combinations between banks and non-financial commercial firms (such as Wal-Mart and Home Depot) has served our nation well. ICBA opposes any regulatory restructuring that would allow commercial entities to own a bank. If it is generally agreed that the current financial crisis is the worst crisis to strike the United States since the Great Depression, how much worse would this crisis have been had the retail commercial sector been intertwined as well? Regulators are unable to properly regulate the existing mega financial firms, how much worse would it be to attempt to regulate business combinations many times larger than those that exist today?

This issue has become more prominent with recent Federal Reserve encouragement of greater equity investments by commercial companies in financial firms. This is a very dangerous path.

Mixing banking and commerce is bad public policy because it creates conflicts of interest, skews credit decisions, and produces dangerous concentrations of economic power. It raises serious safety and soundness concerns because the companies operate outside the consolidated supervisory framework Congress established for owners of insured banks. It exposes the bank to risks not normally associated with banking. And it extends the FDIC safety net putting taxpayers at greater risk. Mixing banking and commerce was at the core of a prolonged and painful recession in Japan.

Congress has voted on numerous occasions to close loopholes that permitted the mixing of banking and commerce, including the non-bank bank loophole in 1987 and the unitary thrift holding company loophole in 1999. However, the Industrial Loan Company loophole remains open.

Creating greater opportunities to widen this loophole would be a serious public policy mistake, potentially depriving local communities of capital, local ownership, and civic leadership.

Conclusion

ICBA greatly appreciates this opportunity to testify. We recommend that Congress take a number of steps to regulate, assess, and ultimately break up institutions that pose unacceptable risks to the nation's financial system. At the same time, Congress should avoid doing damage to the regulatory system for community banks, a system that has been tremendously effective. Finally, Congress should prevent the unwise concentration of financial and commercial power that would result if commercial firms like Wal-Mart could combine with federally insured banks.

The current crisis provides you an opportunity to strengthen our nation's financial system and economy by taking these important steps. ICBA urges Congress to quickly seize that opportunity.