Lawmakers ask how big is too big for US banks

JP Morgan purchase of First Republic sparks debate over 10% cap on deposit market share

By Janice Kirkel

07 Jul 2023

JP Morgan's purchase of failed First Republic has reignited the debate over a rule designed to limit market concentration in the banking sector. Republican senator James (JD) Vance, who sits on the senate banking committee, wants the rule tightened up, and plenty of Democrats agree with him. But some suggest the original rule is at odds with the reality of the modern US banking system.

Thomas Hoenig, former vice-chair of the Federal Deposit Insurance Corporation, is firmly in the camp worrying about the build-up of concentration risk.

"If hypothetically you had more failures in the future of sizable regional banks, and the global systemic banks were the only buyers, then you're further going to concentrate the industry," he says.

In time, he warns, local lending could become a problem: "We still have 4,500 banks in the United States, but about 70% of those deposits are held by the largest 20 banks."

The Riegle-Neal Interstate Banking Act of 1994, which made it easier for banks to open branches in multiple states, also prevented any merger or acquisition if it would take a bank's share of US deposits over 10% of the total – or if the acquiring bank was already over that threshold.

We still have 4,500 banks in the United States, but about 70% of those deposits are held by the largest 20 banks

Thomas Hoenig, former FDIC vice-chair

But there's a catch. The law contains an exemption if the acquired bank is "in default or in danger of default", or if it receives assistance from the FDIC. This waiver allowed the takeover of First Republic, even though JP Morgan's market share was **already over 10%** through organic growth. As of March 31, statistics from the FDIC show JP Morgan Chase and Bank of America both had more than 10% of deposits – 11.81% and 11%, respectively, with Wells Fargo on 8.02%.

Now Vance wants to narrow the exemption. His amendment to the Recoup Act passed the committee stage on June 21 this year, with bipartisan support. It would strip out the waiver for failed banks that is currently part of the 10% restriction, unless the acquiring bank is the only bidder.

"One of the things that we learned from the Silicon Valley Bank crisis and much of the fallout is that the big banks have a lower cost of capital, they are able to absorb these things," Vance said in **remarks** to the committee. "But if that leads to concentration, and if we don't do anything to stop it, we're going to wake up in a country that has three or four massive banks and no small and regional banks."

The Recoup Act would also give the FDIC the power to claw back certain compensation from senior executives at failed banks, including profits made by executives when they sold holdings of the bank's stock.

Size before cost

Vance warned the depletion of regional banks could be a "disaster" for the US. His views are shared by some progressive lobbyists.

"Generally, we need more small banks and fewer megabanks, so we would not want to do away with an existing cap or increase it," says Alexa Philo, senior policy analyst at Americans for Financial Reform and a former New York Fed examiner. "We would like the Fed to actually stick to the cap it has in place, as it gives them more grounds on which to decide against allowing a merger to go forward."


Todd Phillips, Roosevelt Institute

Todd Phillips, a fellow at the Roosevelt Institute who was a member of Joe Biden's economic advisory team during his 2020 presidential campaign, says the carve-out for buying distressed banks does a disservice to the 10% threshold. He supports Vance's idea of tightening the rules.

"My understanding of what happened with JP Morgan buying First Republic is that they did have the least-cost bid, but the second bid to the FDIC to buy First Republic's assets was not that much worse," says Phillips. "However, the FDIC legally had to go with the lowest cost, and so couldn't consider the fact that they were letting JP Morgan grow even bigger."

Outdated rules?

Not all former regulators are so convinced by the 10% rule, however. Katie Cox, who oversaw mergers and acquisitions at the Federal Reserve Board for more than 20 years, says the number is arbitrary – especially almost 30 years after the original rule was introduced.

"My concern is that the 10% cap was implemented in 1994 as part of the Riegle-Neal Act and there was no empirical work done to justify it," says Cox. "At that time, there were no banks even approaching 5%, so Congress thought 10% was being generous."

Banks get treated differently because their stability and credit-allocation functions are important for the whole economy

Alexa Philo, Americans for Financial Reform

Cox compares the restrictions on bank M&A with the Herfindahl-Hirschman Index, first developed as a way to calculate concentration in the airline industry. The Department of Justice allows this to go up to 2,500 in other sectors, says Cox, but for banks, the limit works out at 1,800, and an acquisition can cause a bank's index to jump by 200 points.

Philo argues, however, that banks cannot be compared directly with other types of company: "Banks get treated differently because their stability and credit-allocation functions are important for the whole economy."

But Cox sees other flaws beyond the limit itself – specifically, she questions the total deposits figure used to calculate the ratio. In a sign that the rule has not kept pace with technology, the figure does not include internet banking deposits held by US citizens at digital banks that are based outside the US.

Keith Noreika, chairman of the banking supervision and regulation group at consultancy Patomak Global Partners, who previously served as acting Comptroller of the Currency under president Donald Trump, agrees with Cox that the whole concept of the 10% restriction may need updating.

"Banks face intense competition from entities that are not in the banking business, and you may want to capture that to get a true picture of their health," he says, citing technology companies and **private debt providers** as some of the new entrants into the space. "Banks are saddled with regulation others don't have, and the deposit concentration number may become less important depending on how we define the suite or product set a bank offers."

According to Noreika, the relatively tough regulation faced by banks generates the need for scale to absorb those extra costs while still providing a return on capital for investors.

"You can run around talking about banks needing to have higher capital, but somebody needs to buy the capital, and to sell it you have to offer a rate of return that's better than a Treasury bill, which is currently paying 5% or 6%," says Noreika.

However, Noreika notes that executives at the largest US banks have not so far lobbied to raise the cap above 10%. And the Roosevelt Institute's Phillips contests the cap is "already very, very high… and I don't know what a bank with, say, 15% of deposits could do that a bank with 10% couldn't."

Copyright Infopro Digital Limited. All rights reserved.

You may share this content using our article tools. Printing this content is for the sole use of the Authorised User (named subscriber), as outlined in our terms and conditions - **https://www.infopro-insight.com/terms-conditions/insight-subscriptions/**

If you would like to purchase additional rights please email **info@risk.net**