Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

Barnett Sivon & Natter, P.C.
ATTORNEYS at LAW
WASHINGTON, DC

Mom! They broke them![*]

Robert Barnett

May, 2013

If the biggest bank holding companies were broken up, a possibility that exists, directly or indirectly with some of the legislative and commentator proposals that have surfaced, what would be the landscape of the banking industry at that point?

For purposes of this hypothetical, assume that the BHCs that will be included are the top 6 (there seems to be a natural break either at about $500 billion which would add a seventh or at the 6^{th} largest). And let's make one further assumption that pursuant to some of the language in the FDIC single point of entry paper, the resolution of a TBTF institution would include breaking up the surviving parts so that none of them is TBTF.

The first question that would have to be asked is what is the largest size institution that the regulators would want to create in that situation? That is unpredictable, of course, because no one knows who the regulators would be at that point and up until now, neither the FDIC nor any other regulator has opined at just what size an institution could be without creating a TBTF scenario with its failures. Therefore, it would be left to the judgment of whoever was occupying the relevant regulatory seats at the time of the utilization of the single point of entry resolution.[1]

One way to do it is to assume that since the 6th largest is the smallest of the TBTF institution, the 7^{th} largest and those smaller than that BHC would not be TBTF. One could therefore use $550 billion, the size of the 7^{th} largest as of the first quarter of 2013, as the largest that any of the institutions could become. But to be safe — and the regulators would want to be very safe at this time, I would assume — let's say that the largest size

[*]The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

[1]It's difficult to answer the question for a further reason — the danger to the system is not based on the size of the institution, but rather on its essential connectivity to other major institutions or sectors of the economy, usually only the domestic economy but perhaps in some cases the economy of some additional parts of the world.

for any institution formed from a breakup would be no larger than the 10^{th} largest BHC, roughly $320 billion.

Breaking up each of the six institutions involved and magically creating institutions from each that are roughly the size of the 10^{th} largest, a total of 30 or so institutions would be created.[2]

For each of the newly created BHCs, a number of management and governance positions would be generated. Assuming a board of directors of 15 non-employee persons in each of the new entities, there would be a need for 450 new directors.

Directors are not easy to come by, and, in particular, as more and more intense scrutiny is focused on the relationships that directors have with other institutions and with individuals engaged in financial activities, they will become even more difficult to find. Finding 450 of them would be a colossal job.

One would have to find 30 new CEOs, and perhaps, depending upon the feeling of the regulators, 30 new Chairs of the Board, if the jobs are split. I suspect that the regulators would want to split the jobs. These are the top management jobs at very large financial institutions, most of which would be engaged immediately or soon thereafter[3] in a variety of financial services, some of them very sophisticated. There may be a hidden inventory of persons ready for such significant jobs, but there certainly would be scurrying to get the best of them.

CEOs don't run an institution by themselves. One of the BHCs about the size of the hypothetical new companies created by the break up has in its senior management team a President; an Executive Vice President-Human Resources; a Vice Chairman and Chief Financial Officer; an Executive Vice President-General Counsel; a Vice Chairman- Community Banking; an Executive Vice President-Chief Risk Officer; a Vice Chairman-Commercial Real Estate; a Vice Chairman-Payment Services; an Executive Vice President-Chief Operational Risk Officer; an Executive Vice President-Chief Strategy Officer; an Executive Vice President-Chief Credit Officer; a Vice Chairman- Wholesale Banking; and a Vice Chairman-Technology.

[2] Others have put the number considerably higher, based, in part, on the assets that do not appear as part of the BHC under the U.S. accounting systems.

[3] These institutions would not remain as created for very long. They would expand, move into specialized parts of the field, merge, move abroad, etc.

That is 13 very high-level significant positions within the institution. Rounding that up to 15, that would require the discovery of 450 significant officers with different very specialized skills and abilities. This would be yet another task that would not be easy to complete.

Of course, this proliferation of needs would run right through the organization to positions of other significant officers and employees.

In other words, the break-up of TBTF institutions into ones that are not so large as to reach that red flag status would require a massive number of highly trained and able officers and employees.

Similarly, it would require more examiners, examiners that were capable of dealing with the most difficult of financial questions. Because many of the institutions would be quasi start ups, at least insofar as operating as standalone entities, there may be a need in the beginning of a substantially larger examiner corps that would be needed once they had been operating for a number of years and had developed the leadership and skills necessary to run free-standing institutions. These institutions would present some of the most formidable examination and supervisory problems that the regulators had yet seen.

Once up and operating, the landscape would be full of $300-350 billion banks. As would any other bank, each of these would want to expand its operations and make a better return for its shareholders. Each would therefore have to devise an appropriate corporate strategy for itself, and for the strengths that it saw in its products, personnel, geographic location, creativity of top management, etc.

Some would see acquisition strategy as one way to go, although there may be limitations placed on that by the regulators in the break up documents. But assuming that acquisitions are sensible and permitted, then the trick would be getting as close as possible to the red flag status and then growing internally from there. That assumes one would not be broken up again because of successful internal growth. Using a strategy such as that, one or more of these institutions might be able to reach toward $1 trillion by the end of the first decade after the break up.

Others might stay with a strict internal growth and opportunistic acquisition strategy. Some might decide that the easiest picking would be found in the fields currently occupied by community banks and use their strengths in one-on-one competition with community banks.[4]

Of course, it is likely that one or more of these institutions would make some serious wrong choices along the way and would fail. A $320 billion pay out by the FDIC would not be a pretty sight, so they probably would be seeking new owners either of some or all of the institutions. The most likely candidates for such rescues, of course, would be the very BHCs that had been broken up.

For those who suggest breaking up the big banks, there are some knotty problems to solve.

Robert Barnett is a partner with the law firm of Barnett Sivon & Natter, P.C.

[4]See the pessimism expressed on the outcome that would befall community banks by Jeff Plagge, President and CEO of Northwest Financial Corp., a $1.5 billion community bank holding company in Arnolds Park, Iowa, in the American Banker (April 15, 2013).