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Section 622 of the Dodd-Frank Act: Self-Defeating Liability Concentration Limits

I. INTRODUCTION

The recent financial crisis has demonstrated that, under “unusual and exigent circumstance,” the Federal Reserve Board (“Fed”) is willing to allow mergers that are unlikely to be approved during normal times.¹ At the height of the crisis, the Fed was not only playing the role of an impartial regulator but also that of a matchmaker by actively arranging mergers among the troubled financial institutions.² As a consequence, the banks that were too-big-to-fail (“TBTF”) got even bigger after the crisis:³ the assets of the five largest banks as a share of GDP increased from 43% in 2006 to 56% in 2011.⁴

A TBTF firm is “one whose size, complexity, interconnectedness, and critical functions are such that, should the firm go unexpectedly into liquidation, the rest of the financial system and the economy would face

1. Press Release, Bd. of Governors of the Fed. Reserve Sys., Statement Regarding the Application and Notices by Wells Fargo & Company to Acquire Wachovia Corporation and Wachovia’s Subsidiary Banks and Nonbanking Companies 2 (Oct. 21, 2008), <http://www.federalreserve.gov/newsevents/press/orders/orders20081021a1.pdf>.

2. See ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM—AND THEMSELVES 456 (2009) (describing how Timothy Geithner, then the president of the FRB New York, tried to arrange bank mergers with Goldman Sachs and Morgan Stanley who were in danger of failing).

3. In contrast to their U.S. counterparts, the European banks that received government aid did not increase their market share. Gert-Jan Koopman, *Stability and Competition in EU Banking during the Financial Crisis: The Role of State Aid and Control*, 7 COMPETITION POL’Y INT’L 17 (2011). It has been argued that what made the difference was the active involvement of the EU competition authority, who took actions against policies that would favor local companies of the member states. Albert A. Foer & Don Allen Resnikoff, *Competition Policy and “Too Big” Banks in the European Union and the United States*, 59 ANTITRUST BULL. 11–19 (2014). This suggests that competition policy could play a larger role in addressing the TBTF problem. A formal analysis of this topic is beyond the scope of this Note. For a discussion, see Xavier Vives, *Competition and Stability in Banking* (IESE Bus. Sch., Working Paper No. 852, 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1593613.

4. David J. Lynch, *Big Banks: Now Even Too Bigger To Fail*, BLOOMBERG BUSINESSWEEK, Apr. 23–29, 2012, at 33, 33.

severe, adverse consequences.”⁵ However, providing assistance to and preventing the collapse of a TBTF firm during a financial crisis creates several long term problems for the economy.⁶ First, it generates a moral hazard problem where TBTF firms “take more risk than desirable” expecting to receive assistance “if their bets go bad.”⁷ Second, it creates an uneven playing field between large and small firms.⁸ Third, TBTF firms can themselves become risks to financial stability.⁹

Conceptually, there are three different ways to resolve the TBTF problem: (1) prevent banks from becoming too big; (2) prevent big banks from failing; and (3) allow big banks to fail in an orderly fashion.¹⁰ The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) adopted all three of the above approaches.¹¹ Section 622, as part of the first line of defense in Dodd-Frank against the TBTF problem, requires that the liabilities of a financial company after a merger should not exceed 10% of the liabilities of all financial companies in the United States.¹²

Like many other Dodd-Frank provisions, section 622 has been criticized on several different grounds.¹³ It has been argued that the concentration limit puts U.S. financial companies at a competitive disadvantage against foreign financial institutions.¹⁴ Others have

5. *Causes of the Recent Financial and Economic Crisis: Testimony Before the Fin. Crisis Inquiry Comm’n* 20 (Sept. 2, 2010) (statement of Ben S. Bernanke, Chairman, Bd. of the Governors of the Fed. Reserve Sys.), <http://www.federalreserve.gov/newsevents/testimony/bernanke20100902a.htm>.

6. *Id.*

7. *Id.* at 20–21.

8. *Id.* at 21.

9. *Id.*

10. There is wide-ranging disagreement on whether all (or any) of the three approaches need to be taken. See H. Rodgin Cohen, *Preventing the Fire Next Time: Too Big To Fail*, 90 TEX. L. REV. 1717, 1737–38 (2011–2012) (arguing that empirical evidence does not support the premise that larger banks are more risky); Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435, 489 (2010–2011) (questioning whether Orderly Liquidation process under Dodd-Frank will be better able to contain the systemic risk than Chapter 11 process).

11. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 622, 12 U.S.C. § 1852 (2012). For a general discussion of Dodd-Frank and TBTF problem, see Lissa Lamkin Broome, *The Dodd-Frank Act: TARP Bailout Backlash and Too Big To Fail*, 15 N.C. BANKING INST. 69 (2011).

12. Dodd-Frank § 622, 12 U.S.C. § 1852.

13. See generally VIRAL V. ACHARYA ET AL., *REGULATING WALL STREET: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE* (2011); DAVID A. SKEEL, *THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES* (2011).

14. See, e.g., *Financial Regulatory Reform: The International Context: Hearing Before*

questioned whether it is desirable to maintain a hard-and-fast rule like the 10% limit on liability concentration.¹⁵ This Note argues that the strongest criticism, however, comes from the observation that section 622 is not entirely consistent with other Dodd-Frank provisions. Furthermore, this Note points out that there are other clauses in Dodd-Frank that can be used to block the types of mergers that threaten the stability of the financial system. What distinguishes section 622 is that it is a bright-line rule that limits the Fed's discretionary power. This Note shows, however, that this provision allows exceptions that give discretion back to the Fed, and hence, defeat the purpose of the legislation.

Although unsuccessful, several attempts have been made to correct the deficiencies inherent in section 622. Before the passage of the final bill, Senators Sherrod Brown and Ted Kaufman proposed an amendment ("Brown-Kaufman Amendment") containing a provision that addressed this problem by eliminating the Fed's discretion.¹⁶ The Brown-Kaufman Amendment ultimately failed to be adopted.¹⁷ In 2012, the amendment was modified and reintroduced as the SAFE Banking Act.¹⁸ Although this bill also was not enacted, it contained a section similar to section 622, but without the crippling exceptions.

This Note proceeds as follows. Part II provides the background with a brief legislative history behind section 622 and its relation to the existing 10% deposit cap.¹⁹ Part III examines the main elements of section 622 and its relation to other Dodd-Frank provisions.²⁰ Part IV examines two minor issues regarding section 622: economies of scale and the rigid 10% cap.²¹ Part V discusses the problematic exceptions allowed and the two failed attempts to amend section 622—the Brown-Kaufman Amendment and the SAFE Banking Act.²² A summary and a conclusion follow in Part VI.²³

the H. Comm. on Fin. Serv., 112th Cong. 161 (2011) [hereinafter Scott] (statement of Hal S. Scott, Professor, Harvard Law School).

15. See ACHARYA ET AL., *supra* note 13, at 197.

16. S. Amend. 3733, 111th Cong. (2010).

17. 156 CONG. REC. S3352 (daily ed. May 6, 2010).

18. Safe Accountable Fair, and Efficient Banking Act, H.R. 5714, 112th Cong. (2012).

19. See *infra* Part II.

20. See *infra* Part III.

21. See *infra* Part IV.

22. See *infra* Part V.

23. See *infra* Part VI.

II. BACKGROUND

A proper understanding of section 622—or any statute, for that matter—requires context. For this purpose, a brief legislative history is provided for necessary background. Following is a discussion of the relation of Section 622 to the existing nationwide deposit cap.

A. *Legislative History*

Dodd-Frank was the U.S. government's response to the financial crisis of 2008. It was first proposed by the Obama Administration ("Administration") in June 2009.²⁴ A version of the bill passed the House on December 11, 2009,²⁵ and passed the Senate, with amendment, on May 20, 2010.²⁶ A conference committee was convened to resolve the differences, and the final bill passed both houses by July 15, 2010.²⁷ The bill was signed into law by President Obama on July 21, 2010.²⁸

Section 622 was neither in the House bill nor in the Administration's original proposal—instead, it was added later by the Administration, along with the Volcker Rule, after the bill was passed by the House.²⁹ It is not exactly clear how section 622 made its way into the bill. One story attributes its genesis to President Obama's outrage at the news that Wall Street executives were getting larger year-end bonuses in 2009 than they had in 2007.³⁰ The White House formally announced the new proposal on January 21, 2010.³¹

24. See Press Release, U.S. Dep't of the Treasury, U.S. Treasury Dep't Releases Fin. Regulatory Reform (June 17, 2009), <http://www.treasury.gov/press-center/press-releases/Pages/20096171052487309.aspx> (proposing a "new foundation for financial regulation and supervision").

25. 155 CONG. REC. H14804 (daily ed. Dec. 11, 2009).

26. 156 CONG. REC. S4078 (daily ed. May 20, 2010).

27. 156 CONG. REC. S5933 (daily ed. July 15, 2010).

28. Remarks on Signing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 DAILY COMP. PRES. DOC. 3 (July 21, 2010).

29. 156 CONG. REC. S2377 (daily ed. Apr. 15, 2010).

30. Michael Hirsh, *Paul Volcker: First He Challenged Obama, Then He Changed Wall Street*, THE ATLANTIC (Dec. 11, 2013), <http://www.theatlantic.com/business/archive/2013/12/paul-volcker-first-he-challenged-obama-then-he-changed-wall-street/282259/>.

31. Press Release, The White House, President Obama Calls for New Restrictions on Size and Scope of Financial Institutions to Rein in Excesses and Protect Taxpayers (Jan. 21, 2010), <https://www.whitehouse.gov/the-press-office/president-obama-calls-new-restrictions-size-and-scope-financial-institutions-rein-e>.

Section 622 did not get significant attention from Congress before it was enacted. Its insignificant impression is especially apparent when compared with the Volcker Rule. For example, while the Senate conference report does not mention section 622 at all, it mentions section 619's Volcker Rule seventy-one times.³² One reason for this might be that the proposed legislation looked similar to the existing nationwide 10% deposit limit.³³ In fact, this is how the Administration marketed section 622 at the Senate hearing—as a provision designed to “supplement” the existing deposit cap.³⁴ There were, however, significant differences between the two.

B. Relation to the Riegle-Neal Act

The Riegle-Neal Interstate Banking and Branching Efficiency Act (“Riegle-Neal Act”) was signed into law by President Clinton on September 29, 1994.³⁵ As the title suggests, the legislation was introduced to eliminate then existing restrictions on interstate branching.³⁶ To address the concern about excessive concentration of the banking industry, the Riegle-Neal Act prohibited banks from controlling more than 30% of statewide deposits or 10% of nationwide deposits after a merger.³⁷

Despite the apparent similarity, there are two important differences between section 622 and the deposit cap under the Riegle-Neal Act. First, section 622 is not limited to regulating deposits—it regulates total liabilities.³⁸ This has important consequences in

32. See 156 CONG. REC. S5870–933 (daily ed. July 15, 2010). In the House report, section 622 is not mentioned and section 619 or the Volcker Rule is mentioned eight times. See Cong. Rec. H5233–61 (daily ed. June 30, 2010).

33. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (“Riegle-Neal Act”) § 101(a), 12 U.S.C. § 1842(d) (2012).

34. *Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 111th Cong. 4–5 (2010) (statement of Neal S. Wolin, Deputy Secretary of the Treasury).

35. Remarks on Signing the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, 30 WEEKLY COMP. PRES. DOC. 1896 (Sept. 29, 1994).

36. For the history of interstate banking and the significance of Riegle-Neal Act, see LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES: CASES AND MATERIALS 633–62 (4th ed. 2011).

37. Riegle-Neal Act § 101(a), 12 U.S.C. § 1842(d).

38. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 622, 12 U.S.C. § 1852 (2012).

controlling the systemic risk that results from bank failures. Given the deposit insurance offered by the Federal Deposit Insurance Corporation (“FDIC”), having a large amount of deposits does not necessarily make a bank vulnerable to a bank run.³⁹ Focusing on liabilities rather than just deposits was, therefore, a significant change.

Second, section 622 covers more institutions than the Riegle-Neal Act. The 10% deposit cap only applies to a “bank” under the Bank Holding Company Act (“BHC Act”).⁴⁰ This definition of a bank excludes several bank-like institutions such as savings and loan associations, savings banks, and industrial loan companies.⁴¹ During the financial crisis, Bank of America acquired Merrill Lynch.⁴² Although their combined deposit share would reach 11.9%, the 10% cap did not apply because the acquired companies were a savings bank and an industrial loan company.⁴³ Section 622 closed this “loophole” by expanding the institutions covered.⁴⁴

C. *Implementation of Section 622*

Section 622 provided that the Financial Stability Oversight Council (“FSOC”) conduct a study⁴⁵ and that the Fed issue regulations in accordance with FSOC’s recommendations.⁴⁶ The section specifically required that the FSOC study examine the effects of the concentration

39. A bank with a large amount of uninsured deposits—those exceeding the current limit \$250,000—could, however, be subject to a bank run. *See, e.g.*, Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401, 412 (1983) (showing that, without deposit insurance, a bank run may arise from self-fulfilling panics among rational depositors).

40. Bank Holding Company Act (“BHC Act”) § 2(c) (1956) (current version at 12 U.S.C. § 1841(c) (2012)).

41. *Id.*

42. Press Release, Fed. Reserve Bd., Approval of Proposal by Bank of America to Acquire Merrill Lynch 1 (November 26, 2008), <http://www.federalreserve.gov/newsevents/press/orders/20081126a.htm>.

43. *Id.* at 2, n.6.

44. *See infra* Section III.A.1.

45. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 622, 12 U.S.C. § 1852(e) (2012) (Although § 622 is codified in its entirety at 12 U.S.C. § 1852, § 622 does not have the matching subsections of § 1852. This is because § 622 is structured so that it adds a new section to the existing BHA Act. This Note adopts the convention that, whenever it cites a subsection of § 1852, it parallel cites Dodd-Frank § 622 in order to show its origin, even though, strictly speaking, there is no matching subsection in § 622).

46. Dodd-Frank § 622, 12 U.S.C. § 1852 (d).

limits in four particular areas: (1) financial stability; (2) moral hazard in the financial system; (3) efficiency and competitiveness of U.S. financial firms and financial markets; and (4) cost and availability of credit and other financial services.⁴⁷

The FSOC study concluded that the concentration limit will reduce the risk to the U.S. financial system and, in the long run, enhance the competitiveness of U.S. financial firms.⁴⁸ The impact on moral hazard and the availability of credit were expected to be neutral.⁴⁹ FSOC made three recommendations: (1) measure liabilities of financial companies not subject to consolidated risk-based capital rules using the U.S. generally accepted accounting principles (GAAP) or other applicable accounting standards; (2) use a two-year average to calculate aggregate financial sector liabilities and publish annually by July 1 the current aggregate financial sector liabilities applicable to the period of July 1 through June 30 of the following year; and (3) extend the “failing bank exception” to apply to the acquisition of any type of insured depository institution currently in default or in danger of default.⁵⁰ On May 15, 2014, the Fed announced a proposed rule that reflected FSOC’s recommendations.⁵¹

III. LIABILITY CONCENTRATION LIMITS ON LARGE FINANCIAL COMPANIES

Effective January 1, 2015, the Fed approved a final rule that implemented section 622 of Dodd-Frank.⁵² The rule prohibits “covered acquisitions” that result in a financial company having consolidated liabilities greater than 10% of the aggregate consolidated liabilities of all financial companies in the United States.⁵³ A covered acquisition is a

47. Dodd-Frank § 622, 12 U.S.C. § 1852(e)(1)(A).

48. FIN. STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS REGARDING CONCENTRATION LIMITS ON LARGE FINANCIAL COMPANIES 4 (2011) [hereinafter COUNCIL STUDY], <http://www.treasury.gov/initiatives/Documents/Study%20on%20Concentration%20Limits%20on%20Large%20Firms%2001-17-11.pdf>.

49. *Id.*

50. *Id.* at 16–22.

51. Concentration Limits on Large Financial Companies, 79 Fed. Reg. 27801 (proposed May 15, 2014) (to be codified at 12 C.F.R. pt. 251).

52. Concentration Limit (Regulation XX), 12 C.F.R. pt. 251 (2015).

53. 12 C.F.R. §§ 251.2(f), 253(a).

transaction in which a company: (1) merges or consolidates with; (2) acquires all or substantially all of the assets of; or (3) otherwise acquires control of another company.⁵⁴ This does not prevent, for example, increasing liabilities in excess of the cap through internal, organic growth.⁵⁵ The elements of section 622 and its relation to other Dodd-Frank provisions are discussed in some detail below.

A. *Elements of Section 622*

Section 622 prohibits a “financial company” from holding “liabilities” greater than 10% of the liabilities of all financial companies in the United States subject to certain exceptions. The meaning of financial company and liabilities as well as the three exceptions allowed are examined in turn.

1. Financial Company

A “financial company” is (1) an insured depository institution; (2) a bank holding company (“BHC”); (3) a savings and loan holding company; (4) a company that controls an insured depository institution; (5) a nonbank financial company supervised by the Fed;⁵⁶ or (6) a foreign bank or company that is treated as a BHC for the purposes of the BHC Act.⁵⁷ Thus, this definition includes commercial or industrial firms that control an insured depository institution (e.g., an industrial loan company or limited-purpose credit card bank).⁵⁸ On the other hand, the definition excludes credit unions as well as insurance or securities companies that are not affiliated with an insured depository institution unless the company is a nonbank financial company supervised by the Fed.⁵⁹

54. *Id.*

55. COUNCIL STUDY, *supra* note 48, at 9. Also, acquisitions in the ordinary course of collecting a debt or in a fiduciary capacity in good faith are not covered. 12 C.F.R. §§ 251.2(f)(1), (f)(2).

56. Section 113 of Dodd-Frank provides that the FSOC may require that a nonbank financial company be subject to the supervision by the Fed if the FSOC determines that the company could pose a threat to the financial stability of the United States. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 113, 12 U.S.C. § 5323 (2012).

57. Dodd-Frank § 622, 12 U.S.C. § 1852. A foreign company is treated as a bank holding company if it, or one of its subsidiaries, is a foreign bank or has a commercial lending subsidiary in the U.S. 12 U.S.C. § 3106 (2012).

58. COUNCIL STUDY, *supra* note 48, at 5–6.

59. *Id.* at 6.

2. Liabilities

“Liabilities” are computed by subtracting total regulatory capital⁶⁰ from total risk-weighted assets.⁶¹ For foreign financial companies, liabilities include only those of their U.S. operations.⁶² The aggregate liabilities of all financial companies are calculated as the average of the year-end liabilities for the preceding two calendar years.⁶³ This measure is then used from July 1 of each year until June 30 of the following year.⁶⁴ For the first period between July 1, 2015, and June 30, 2016, the aggregate liabilities are equal to the year-end liabilities figure as of December 31, 2014.⁶⁵

Section 622 requires that the risk-weighted assets be adjusted to reflect exposures that are deducted from regulatory capital.⁶⁶ The Fed set the adjustment formula in its final rule.⁶⁷ For a U.S. company subject to applicable risk-based capital rules, the liabilities are equal to: (1) total risk-weighted assets; plus (2) the amount of assets deducted from the regulatory capital, times a “multiplier,” minus (3) total regulatory capital of the company.⁶⁸ The “multiplier” is the inverse of the company’s total risk-based capital ratio minus one.⁶⁹

This seemingly complicated adjustment is necessary because, by construction, certain intangible assets like goodwill are deducted—from both capital and assets—before risk-based capital ratios are calculated.⁷⁰

60. Total regulatory capital is defined as the sum of (1) common equity tier 1 capital; (2) additional tier 1 capital; and (3) tier 2 capital. 12 C.F.R. § 217.2.

61. For a large BHC with total consolidated assets greater than or equal to \$250 billion, total risk-weighted assets are defined as: (1) the sum of (i) credit-risk-weighted assets; (ii) credit valuation adjustment risk-weighted assets; (iii) risk-weighted assets for operational risk; and (iv) advanced market risk-weighted assets, if applicable; minus (2) excess eligible credit reserves not included in the BHC’s tier 2 capital. 12 C.F.R. §§ 217.2, 217.100(b).

62. 12 C.F.R. § 251.3(d).

63. 12 C.F.R. § 251.3(a)(2).

64. *Id.*

65. *Id.*

66. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 622, 12 U.S.C. § 1852(a)(3)(A)(i), (B)(i) (2012).

67. 12 C.F.R. § 251.3(c).

68. *Id.* When a company is not subject to risk-based capital rules, liabilities are calculated using U.S. generally accepted accounting principles (GAAP) or other accounting standard approved by the Fed. 12 C.F.R. §§ 251.2(a), 251.3(e).

69. 12 C.F.R. § 251.3(c).

70. Concentration Limits on Large Financial Companies, 79 Fed. Reg. 27801, 27803 (proposed May 15, 2014) (to be codified at 12 C.F.R. pt. 251).

The effect of this deduction is to require companies to hold a dollar of capital against each dollar of such assets.⁷¹ The adjustment is thus designed to add these deducted assets back—after converting them into their risk-weighted-asset equivalents by properly inflating them.⁷²

On July 1, 2015, the Fed announced that, as of December 31, 2014, the aggregate financial sector liabilities were \$21.6 trillion.⁷³ The 10% concentration limit for the year beginning July 1, 2014, is therefore set at \$2.16 trillion. This amount does not seem particularly restrictive because it would only affect the largest financial companies in the country. For example, it would prohibit a merger between any pair of the four largest BHCs: JPMorgan Chase, Bank of America, Citigroup, and Wells Fargo.⁷⁴ It would also block a merger between Bank of America and MetLife or any combination of JPMorgan Chase with MetLife, Prudential Financial, GE Capital, or Goldman Sachs.⁷⁵

3. Exceptions

Three exceptions to the liability concentration limit are allowed: acquisition of a depository institution (1) “in default or in danger of

71. *Id.*

72. *Id.* A simple numerical example will clarify this procedure. Suppose that the only deducted asset is goodwill worth \$2 billion. Assume also that the total risk weighted assets are \$100 billion and the regulatory capital is \$8 billion. The company’s capital ratio is thus 8%. How much assets should be added for a proper adjustment? Adding \$2 billion is surely not enough because it would require only additional \$160 million (= \$2 billion x 0.08) of capital. The right amount for the adjustment in this case is \$2 billion x $1/0.08$ = \$25 billion. To confirm, consider having additional risk weighed assets worth \$25 billion. Given that the capital ratio is 8%, the company would need additional capital worth \$25 billion x 0.08 = \$2 billion in order to keep the capital ratio constant. When the goodwill is added back to assets, it has to be added back to capital as well. Therefore, the capital needs to be adjusted upward as well by \$2 billion. But this means that total liabilities—total risk-weighted assets minus capital—now becomes \$100 billion + \$25 billion – (\$8 billion + \$2 billion) = \$115 billion. It is straightforward to verify that applying the formula delivers exactly the same result: \$100 billion + \$2 billion x $(1/0.08 - 1)$ – \$8 billion = \$115 billion.

73. Press Release, Board of Governors of the Fed. Reserve Sys., Federal Reserve Board Releases First Determination of the Aggregate Consolidated Liabilities of All Financial Companies in Accordance with Section 622 of the Dodd-Frank Act (July 1, 2015), <http://www.federalreserve.gov/newsevents/press/bcreg/20150701a.htm>.

74. COUNCIL STUDY, *supra* note 48, at 8.

75. As of December 31, 2014, the ten largest financial companies in terms of their liabilities were: JPMorgan Chase (\$1.71 trillion), Bank of America (\$1.40 trillion), Citigroup (\$1.28 trillion), Wells Fargo (\$1.21 trillion), MetLife (\$0.83 trillion), Prudential Financial (\$0.72 trillion), GE Capital (\$0.51 trillion), Goldman Sachs (\$0.50 trillion), Morgan Stanley (\$0.42 trillion), and AIG (\$0.41 trillion). The liability figures were computed by the author from each company’s Form 10-K for year 2014.

default; (2) with respect to which assistance is provided by the [FDIC] . . . ; or (3) that would result in a *de minimis* increase in the liabilities of the merged [financial] company.”⁷⁶

First, the acquisition of an insured depository institution that is in default or in danger of default may be allowed despite the concentration limit (“failing bank exception”).⁷⁷ Whether an institution is in default or in danger of default is determined by its appropriate federal banking regulator in consultation with the Fed.⁷⁸ Second, an exception may be made for an acquisition for which the FDIC provides assistance (“FDIC assisted acquisition”).⁷⁹ The law allows the FDIC to provide such assistance to prevent a default, to restore a bank in default to normal operation, or to mitigate the risk to the FDIC under severe financial conditions that threaten the stability of depository institutions.⁸⁰ Third, *de minimis* increases in liabilities are allowed.⁸¹ An increase in liabilities is *de minimis* if it does not exceed \$2 billion.⁸²

These exceptions are likely motivated by cost-effectiveness concerns. The benefit from regulating *de minimis* acquisitions, for example, will mostly be outweighed by the cost to the merging banks as well as to the regulator. Similarly, the first two exceptions could be justified by the fact that, in many cases, it is more costly to liquidate a bank than to have it acquired by a healthy bank.

But this *ex post* efficiency—the notion that a merger could be cheaper than liquidation *after* a bank fails—does not guarantee overall efficiency. Knowing that a troubled bank can be acquired by another bank, banks will have less incentive to run their businesses prudently. In other words, allowing mergers for failing banks will create *ex ante* inefficiency that could outweigh any *ex post* efficiency gains. In fact, this is what is at the heart of the TBTF problem—although bailouts may be the most cost-efficient way of resolving failing banks, they also make banks more likely to fail in the first place. The implications of these

76. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 622, 12 U.S.C. § 1852(c) (2012).

77. Dodd-Frank § 622, 12 U.S.C. § 1852(c)(1).

78. 12 C.F.R. § 251.4(a)(1) (2015).

79. Dodd-Frank § 622, 12 U.S.C. § 1852(c)(2).

80. 12 U.S.C. § 1823(c)(1).

81. Dodd-Frank § 622, 12 U.S.C. § 1852(c)(3).

82. 12 C.F.R. § 251.4(a)(3).

exceptions are discussed in detail in Part V.⁸³

B. Relation to Sections 604, 163, and 121.

There are other Dodd-Frank provisions that regulate mergers that threaten the stability of the financial system. Section 604 addresses mergers by a depository institution or those involving a BHC,⁸⁴ while section 163 deals with merger involving systemically significant nonbank financial companies.⁸⁵ With a supermajority vote of FSOC, section 121 gives the Fed comprehensive authority to regulate the activities—including mergers and acquisitions—of systemically important financial institutions (“SIFIs”).⁸⁶

The Bank Merger Act provides that an insured depository institution must get the approval of its federal agency⁸⁷ in order to merge with, or acquire the assets of any other insured depository institution.⁸⁸ The BHC Act, on the other hand, requires that a merger or acquisition that involves a BHC must be approved by the Fed.⁸⁹ Section 604 of

83. *See infra* Part V.

84. Dodd-Frank § 604(d), (e)(1), (f), 12 U.S.C. §§ 1842(c), 1843(j)(2)(A), 1828(c)(5).

85. Dodd-Frank § 163, 12 U.S.C. § 5363.

86. Dodd-Frank § 121, 12 U.S.C. § 5331. Dodd-Frank §§ 165 and 166 imposed enhanced supervision and prudential standards for BHCs with total consolidated assets greater than or equal to \$50 billion and the nonbank financial companies designated by the FSOC—collectively called Systemically Important Financial Institutions. Dodd-Frank §§ 165, 166, 12 U.S.C. §§ 5365, 5366.

87. This is the Office of the Comptroller of the Currency for a national bank or a federal savings association, the Fed for a state member bank, and the FDIC for a state nonmember insured bank or a state savings association. Bank Merger Act, Pub. L. No. 89-356, 64 Stat. 892 (codified as amended at 12 U.S.C. § 1828(c)(2) (2012) (amending Federal Deposit Insurance Act § 18(c)(2)).

88. *Id.* More precisely, this requires the approval by the agency that will regulate the resulting entity. *Id.*

89. Bank Holding Company Act, 12 U.S.C. 1842(a) (2012). More specifically, the Fed’s approval is required:

(1) for any action to be taken that causes any company to become a bank holding company; (2) for any action to be taken that causes a bank to become a subsidiary of a bank holding company; (3) any bank holding company to acquire direct or indirect ownership or control of any voting shares of any bank if, after such acquisition, such company will directly or indirectly own or control more than 5 per centum of the voting shares of such bank; (4) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank; or (5) for any bank holding company to merge or consolidate with any other bank holding company.

Id.

Dodd-Frank provides that the responsible agency—and the Fed, in case of a merger involving a BHC—should consider the “risk to the stability of the United States banking or financial system” in determining whether to approve or deny a proposed merger.⁹⁰

Section 163 of Dodd Frank provides that a systemically significant nonbank financial company is treated as a BHC for the purpose of mergers and acquisitions approval.⁹¹ The same section also requires that SIFIs receive the Fed’s approval prior to acquiring ownership or control of any voting shares of a company that: (1) is engaged in activities that are financial in nature;⁹² and (2) has assets of \$10 billion or more.⁹³

Section 121 of Dodd Frank provides that, when a SIFI is deemed to pose a “grave threat”⁹⁴ to the stability of the U.S. financial system, the Fed may take “mitigatory” actions with a vote of two-thirds or more of FSOC.⁹⁵ This is a comprehensive authority that allows (1) limiting mergers and acquisitions involving the SIFI; (2) restricting product offerings; (3) requiring termination of certain activities; (4) imposing conditions on activities; and (5) ordering divestiture of assets or off-balance-sheet items if necessary.⁹⁶

In terms of regulating mergers and acquisitions, sections 604, 163, and 121 cover most of the transactions that fall under section 622.⁹⁷ There is, however, a fundamental difference: section 622 prohibits such mergers and acquisitions as a rule while sections 604, 163, and 121

90. Dodd-Frank § 604(d), (e)(1), (f), 12 U.S.C. §§ 1842(c), 1843(j)(2)(A), 1828(c)(5).

91. Dodd-Frank § 163(a), 12 U.S.C. § 5363(a).

92. Those are activities that are: (1) financial in nature; (2) incidental to such financial activity; and (3) complementary to a financial activity. Financial Services Modernization Act of 1999 (Graham-Leach-Bliley Act), 12 U.S.C. § 1843(k) (2012).

93. Dodd-Frank § 163(b), 12 U.S.C. § 5363(b).

94. For the purpose of determining whether a company poses a “grave threat,” the Fed and the FSOC must consider the same factors used to designate a SIFI. Dodd-Frank § 121(c), 12 U.S.C. § 5331(c). The factors include, among other things, the leverage, off-balance-sheet exposures, nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company. Dodd-Frank § 113(a)–(b), 12 U.S.C. § 5323(a)–(b).

95. Dodd-Frank § 121(a), 12 U.S.C. § 5331(a).

96. *Id.*

97. An exception will be a bank acquiring the assets of a non-depository institution through asset purchase. Section 604 does not apply here because the target is not a depository institution. Dodd-Frank § 604(f), 12 U.S.C. § 1828(c). Section 163 does not apply either because the bank does not “acquire ownership or control of any voting shares of” another company. Dodd-Frank § 163(b), 12 U.S.C. § 5363(b). Arguably, § 121 may still apply if the bank belongs to a SIFI. Dodd-Frank § 121(a), 12 U.S.C. § 5331(a).

provide the federal regulatory agencies with a discretionary power to prohibit the merger. As later discussion shows, however, this difference becomes moot once the exceptions to section 622 are taken into account.⁹⁸

IV. MINOR ISSUES

Section 622 raised several important issues, most of which were identified in the FSOC study.⁹⁹ These are mostly “minor” issues in the sense that they may have some potentially adverse effects, but not to the extent that they undermine the purpose of the legislation. Two such issues—economies of scale and the 10% threshold—are somewhat controversial.

A. *Economies of Scale*

It has been argued that section 622 will prevent U.S. financial companies from realizing economies of scale through mergers.¹⁰⁰ Given that the concentration limit affects only the largest of such mergers, the issue becomes whether economies of scale still exist for financial firms of very large size.¹⁰¹ But empirical evidence is mixed on this subject.¹⁰² Although most research prior to 2000 found that economies of scale are exhausted at a modest size, some recent research has found that economies of scale exist for even the largest banks.¹⁰³ Also worth noting

98. See *infra* Part V.

99. COUNCIL STUDY, *supra* note 48, at 8–13.

100. Scott, *supra* note 14, at 161.

101. See COUNCIL STUDY, *supra* note 48, at 11 (discussing the effects of the concentration limit on efficiency and competitiveness of U.S. financial firms).

102. *Id.* at n.22.

103. *Id.* at 11. For a summary of research prior to 2000, see GROUP OF TEN, REP. ON CONSOLIDATION IN THE FIN. SECTOR 23 (2001), <http://www.bis.org/publ/gten05.pdf> (“Evidence suggests that only relatively small banks could generally become more efficient form an increase in size.”). For studies that found economies of scale, see generally Guohua Feng & Apostolos Serletis, *Efficiency, Technical Change, and Returns to Scale in Large US Banks: Panel Data Evidence from an Output Distance Function Satisfying Theoretical Regularity*, 34 J. BANKING & FIN. 127 (2010); Joseph P. Hughes, et. al., *Are Scale Economies in Banking Elusive or Illusive? Evidence Obtained by Incorporating Capital Structure and Risk-Taking into Models of Bank Production*, 25 J. BANKING & FIN. 2169 (2001); David C. Wheelock & Paul W. Wilson, *Do Large Banks Have Lower Costs? New Estimates of Returns to Scale for U.S. Banks*, 44 J. MONEY, CREDIT & BANKING 171 (2012). A related question is whether keeping the market competitive will increase innovation in the long run. The empirical evidence on the link between market structure and innovation is mixed. Wesley M.

is the fact that the estimated economies of scale may reflect the value of the implicit government guarantee due to the TBTF concern.¹⁰⁴

A related issue arises from the fact that section 622 treats domestic and foreign institutions asymmetrically.¹⁰⁵ The concentration limit is based on global consolidated liabilities for U.S. financial companies, but only on the liabilities of the U.S. operations for foreign financial companies.¹⁰⁶ Consequently, a large U.S. financial company may not acquire a U.S. financial company of substantial size, whereas a large foreign financial company with a relatively small U.S. presence may be able to acquire the same U.S. financial company because only its U.S. liabilities after the acquisition will count for the purpose of section 622.¹⁰⁷

This asymmetric treatment could potentially put U.S. financial companies at a competitive disadvantage.¹⁰⁸ But the rationale behind the unequal treatment is not difficult to understand. If foreign companies were measured based on their global liabilities instead of the liabilities of their U.S. operations, it would create a potentially more serious competitive concern. It could put, for example, a foreign company with

Cohen, *Fifty Years of Empirical Studies of Innovative Activity and Performance*, in 1 HANDBOOK OF THE ECON. OF INNOVATION 129, 154 (Bronwyn H. Hall & Nathan Rosenberg eds., 2010).

104. See Loretta J. Mester, *Scale Economies in Banking and Financial Regulatory Reform*, THE REGION 10, 12 (Sept. 2010) <https://www.minneapolisfed.org/~media/files/pubs/region/10-09/scale2.pdf> (noting that “[t]oo-big-to-fail considerations may be a source of some gains” associated with scale economies). A simple numerical example will illustrate this issue. Suppose that an empirical study found that the average cost of large banks was lower than that of medium-size banks by 10%. The same study also found that the average cost of “very large” banks was lower than that of medium-size banks by 15%. Does this mean that economies of scale exist for the very large banks? Not necessarily. The problem is that some of the 15% cost advantage might be attributable to the implicit government guarantee enjoyed by the very large banks (for example, they may have been able to borrow at a lower rate because of the implicit government guarantee). Suppose that 7% out of the 15% cost reduction was due to this implicit guarantee. But this implies that, without the TBTF “premium,” the very large banks would have had only 8% cost advantage over medium-sized banks. This means that, net of the TBTF effect, there were some *diseconomies* of scale between the large and the very large banks. If the TBTF premium had been only 3% instead, the true cost reduction would have been 12%, and there would have been economies of scale between the large and the very large banks. The issue will be resolved if there is a reliable estimate of the TBTF premium. But such an estimate will be difficult—if not impossible—to obtain in practice.

105. COUNCIL STUDY, *supra* note 48, at 12.

106. *Id.*

107. *Id.*

108. See *id.* (noting that the concentration limit could increase the number of large foreign-based firms over U.S.-based firms).

a limited U.S. branch network at a competitive disadvantage against their much larger U.S. competitors. FSOC recommended that the Fed monitor the “competitive dynamics” between U.S. and foreign firms and make recommendations to Congress if necessary.¹⁰⁹ Given the subtlety of the issue, FSOC’s solution seems reasonable for now.

B. The 10% Threshold

Criticism has been raised that the hard-and-fast rule, which requires a 10% limit on liabilities, could have unintended consequences.¹¹⁰ A large financial company, for example, could break into two companies and one portion could acquire another financial company.¹¹¹ Although the two resulting companies will be separate corporate entities after the break-up, they may still inherit some of the systemic risk from their “former conglomerate.”¹¹² In addition to this break-and-merge possibility, there are further cases where a strict 10% rule may not achieve its intended goal.

Suppose, for example, that there are two large financial companies, Company A and Company B. Both companies are considering an acquisition of a third firm, Company C. Let us assume that A’s share of liabilities is 10% and both B and C have liability shares of 5%. Under the 10% threshold rule, A cannot acquire C but B can. If B is successful in its acquisition attempt, there will be two equal-sized firms in the market: A (10%) and the merged firm of B and C (a combined 10%). Without the 10% rule, however, A may merge with C resulting in two firms of unequal size: B (5%) and the merged firm of A and C (a combined 15%). It seems unclear, however, which market configuration would be more desirable for the stability of the financial system.

These examples seem to suggest that perhaps regulators should choose a sliding-scale approach over a rigid rule. But this is not necessarily the best approach because the strict rule, requiring the 10% threshold, can provide a valuable strategic advantage.¹¹³ When a

109. *Id.*

110. VIRAL V. ACHARYA ET AL., REGULATING WALL STREET: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE 197 (2010).

111. *Id.* at 210 n.4.

112. *Id.*

113. Vives, *supra* note 3, at 38 n.43 (noting the interpretation of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) to reduce regulator discretion).

regulator becomes vulnerable to the industry's demands, it may help the regulator if it gives up its discretion and follows a rigid rule instead.¹¹⁴ This is an example of using a "commitment device," which has been studied extensively in economics and political science.¹¹⁵ A classic example is Odysseus tying himself to the mast before hearing the Sirens's song.¹¹⁶ As the following discussion shows, however, section 622 lacks such a commitment value because it contains exceptions that restore the regulator's discretionary power.¹¹⁷

V. PURPOSE-DEFEATING EXCEPTIONS

Section 622 has three exceptions.¹¹⁸ The *de minimis* exception, which allows an acquisition that does not increase liabilities by more than \$2 billion, does not seem particularly harmful. The other two exceptions from the 10% limit—the failing bank exception and the FDIC assisted acquisition—create serious loopholes that defeat the purpose of the legislation.¹¹⁹ The Brown-Kaufman Amendment and the SAFE Banking Act were notable—although unsuccessful—attempts to correct this problem.

A. *The Problem with the Exceptions*

One of the exceptions provides that the Fed may allow a merger that would exceed the concentration limit if the merger involves an acquisition for which the FDIC is providing assistance.¹²⁰ What is troubling about this exception is that such assistance is likely to occur

114. *Id.*

115. *Id.* at 41–43.

116. HOMER, *THE ODYSSEY* 214 (Robert Fitzgerald trans., Farrar, Straus and Giroux 1998).

117. *See infra* Part V.

118. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") § 622(c), 12 U.S.C. § 1852(c) (2012).

119. *See* Elizabeth F. Brown, *The New Laws and Regulations for Financial Conglomerates: Will They Better Manage the Risks Than the Previous Ones?* 60 AM. U.L. REV. 1339, 1411 (2011) (arguing that these exceptions undermine the purpose of the rule by allowing too-big-to-fail banks to become even bigger); Roberta S. Karmel, *An Orderly Liquidation Authority Is Not the Solution to Too-Big-To-Fail*, BROOK. J. CORP. FIN. & COM. L. 1, 42 (2011) (arguing that failing firm exception "could make the concentration limit superfluous").

120. Dodd-Frank § 622, 12 U.S.C. § 1852(c)(2).

during a financial crisis, which is exactly when the Fed needs its commitment power most. Given that the FDIC is bound by the law to choose the least costly way to resolve failed institutions,¹²¹ the logic behind the exception seems straightforward—if a merger that exceeds the liability concentration limit is the most efficient way to resolve a failed institution, the Fed should be able to allow it despite the concentration limit. But pursuing *ex post* efficiency in this manner creates *ex ante* inefficiency—moral hazard of insured institutions—the very problem that Dodd-Frank is trying to address.

The exception for a failing bank¹²² is equally, if not more, problematic. Apparently, it is inspired by the “failing firm defense” of antitrust law, which under certain conditions permits an otherwise anticompetitive acquisition.¹²³ Both permit an acquisition of a failing institution by another financially healthy institution even when such an acquisition would not be allowed under normal circumstances. However, these two situations differ in two significant ways.

First, the failing firm defense in antitrust law is subject to strict restrictions, while the failing bank exception is not. The failing firm defense is “rarely invoked” and, when it is invoked, it is “rarely successful” because a strict legal standard is applied.¹²⁴ There is no such standard in section 622 that limits the scope of the failing bank exception.¹²⁵

Second, the justification for the failing firm defense does not apply to the failing bank exception. The rationale for the failing firm defense is that, compared with the alternative scenario in which the

121. Federal Deposit Insurance Act § 13(c)(4), 12 U.S.C. § 1823(c)(4) (2012).

122. Dodd-Frank § 622, 12 U.S.C. § 1852(c)(1).

123. For failing firm defense and its efficiency justification, see generally John E. Kwoka, Jr. & Frederick R. Warren-Boulton, *Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis*, 31 ANTITRUST BULL. 431 (1986).

124. ORG. FOR ECON. CO-OPERATION AND DEV. COMPETITION COMMITTEE, THE FAILING FIRM DEFENCE 175 (2010), <http://www.oecd.org/competition/mergers/45810821.pdf>. More specifically, the failing firm defense requires that:

(1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.

U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES 32 (2010).

125. Dodd-Frank § 622, 12 U.S.C. § 1852.

failing firm exits the market, permitting the acquisition tends to increase industry output and hence lower prices.¹²⁶ Acquisition of a failing firm, therefore, normally does not raise an antitrust concern. Allowing an acquisition of a failing bank, however, increases the liabilities of the acquiring bank and hence makes it more vulnerable to the risk of default.¹²⁷ In other words, such an acquisition tends to exacerbate, not mitigate, the TBTF concern.

B. Failed Attempts: Brown-Kaufman Amendment and the Safe Banking Act

The problems with section 622 did not go unnoticed. Before the passage of Dodd-Frank, a group of senators proposed an amendment—known as the Brown-Kaufman Amendment—in order to address some of the issues pointed out by critics including the concentration limit.¹²⁸ On May 6, 2010, the Senate rejected the Brown-Kaufman Amendment in a sixty-one to thirty-three vote.¹²⁹

The Brown-Kaufman Amendment provided a concentration limit similar to the one in section 622.¹³⁰ More specifically, it prohibited a BHC from holding non-deposit liabilities that exceed 2% of the annual GDP of the U.S.¹³¹ Additionally, the Brown-Kaufman Amendment prohibited nonbank financial companies supervised by the Fed from holding non-deposit liabilities that exceed 3% of the U.S. GDP.¹³² If a violation occurred, the Fed would have been required to implement a corrective action plan by ordering a sale or transfer of assets, terminating one or more activities, or imposing conditions on the activities.¹³³

126. Kwoka & Warren-Boulton, *supra* note 123, at 445.

127. An implicit assumption here is that the acquiring bank will maintain roughly the same leverage ratio before and after the acquisition. Although unlikely, if the acquisition is substantially financed by newly raised capital, the acquiring bank could become less vulnerable to the risk of default after the acquisition.

128. 156 CONG. REC. S2765 (daily ed. Apr. 28, 2010).

129. 156 CONG. REC. S3352 (daily ed. May 6, 2010).

130. S. Amend. 3733, 111th Cong. (2010).

131. *Id.* § 14(b)(1). For 2014, the amount would be \$347 billion. U.S. DEP'T OF COMMERCE, BUREAU OF ECON. ANALYSIS, <http://www.bea.gov/national/index.htm#gdp> (last visited Feb. 8, 2016).

132. S. Amend. 3733 § 14(b)(1). For 2014, the amount would be \$520 billion. U.S. DEP'T OF COMMERCE, BUREAU OF ECON. ANALYSIS, <http://www.bea.gov/national/index.htm#gdp> (last visited Feb. 8, 2016).

133. S. Amend. 3733 § 14(c).

The Brown-Kaufman Amendment also had clauses concerning the leverage ratios and the nationwide deposit cap.¹³⁴ It required that, for bank holding companies and nonbank financial companies supervised by the Fed, Tier 1 capital must be at least 6% of both average consolidated total assets and all outstanding balance sheet liabilities.¹³⁵ In addition, the proposed amendment strictly prohibited a BHC from holding more than 10% of the total deposits of all insured depository institutions.¹³⁶

In 2012, the amendment bill was modified and reintroduced under the title Safe, Accountable, Fair, and Efficient Banking Act (“SAFE Banking Act”).¹³⁷ Regarding the concentration limit, the SAFE Banking Act amended section 622 by prohibiting a financial company from holding more than 10% of the total consolidated liabilities of all financial companies.¹³⁸ The SAFE Banking Act thus essentially removed the exceptions from section 622. Any financial company exceeding the limit would be forced to sell or otherwise transfer liabilities to unaffiliated firms.¹³⁹

The concentration limit under the Brown-Kaufman Amendment did not have the “organic growth” exception allowed under both section 622 and the Riegle-Neal Act.¹⁴⁰ Had the Brown-Kaufman Amendment been adopted, therefore, “three [banks]—Bank of America, Wells Fargo, and JPMorgan Chase . . . would have had to shed” their deposits in excess of the 10% cap.¹⁴¹ Such a measure may have seemed too drastic to most members of Congress.

Another notable aspect of the Brown-Kaufman Amendment and the SAFE Banking Act was that, in addition to the deposit and liability cap, they both aimed to limit the non-deposit liabilities of financial

134. *Id.* §§ 13(b), 620(f)(1).

135. *Id.* § 13(b).

136. *Id.* § 620(f)(1).

137. Safe, Accountable, Fair, and Efficient Banking Act of 2012, H.R. 5714, 112th Cong. (2012).

138. *Id.* § 3(b).

139. *Id.* § 3(c). Another difference with the Brown-Kaufman Amendment was that the leverage limit was changed so that bank holding companies with assets of \$50 billion or greater and the nonbank financial companies supervised by the Fed are required to hold at least 10% of their total consolidated assets in tangible common equity. *Id.* § 5A. “Tangible common equity” is defined as qualifying common stockholders’ equity plus retained earnings. *Id.* § 2(a)(4).

140. COUNCIL STUDY, *supra* note 48, at 9.

141. David M. Herszenhorn & Sewell Chan, *Financial Debate Renews Scrutiny on Banks’ Size*, N.Y. TIMES (Apr. 21, 2010) at A1.

institutions in terms of the percentage of GDP.¹⁴² It has been argued that such an approach, “a real cap on bank size,” could have an advantage of limiting not only the systemic risk but also the political power of large banks.¹⁴³ Interestingly, the same approach has been advocated for by a Governor of the Fed, but on different grounds—it is simpler and has the advantage of limiting the size of financial firms to the economy’s “capacity to absorb losses.”¹⁴⁴ This suggests that the debate over the Brown-Kaufman Amendment and the SAFE Banking Act may not be over yet.

VI. CONCLUSION

Section 622 of Dodd-Frank limits the size of large financial institutions.¹⁴⁵ It requires that the total liabilities of a financial company after a merger may not exceed 10% of the total liabilities of all financial companies in the U.S.¹⁴⁶ Section 622 thus extends the existing nationwide deposit cap by expanding its coverage to non-deposit liabilities and non-bank financial institutions.¹⁴⁷

Yet section 622, as it stands now, does not seem to serve its purpose. The bright-line rule—the characterizing feature that distinguishes section 622 from other similar Dodd-Frank provisions—is eaten up by the exceptions that give discretionary power back to the Fed. Attempts have been made to correct the problem, although they have not been successful so far.

If section 622 does not do much, what should be done about it? The answer might be “nothing.” This will be the case, for example, if one believes that financial mega mergers are not worrisome or the Fed will not allow such mergers when proposed. Given that history has proven otherwise, such a belief seems rather unreasonable.

Assuming that a change is necessary, what should be the direction

142. S. Amend. 3733, 111th Cong. § 14(b)(1) (2010); H.R. 5714 § 5A(b)(1)(A).

143. *E.g.*, SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 219 (2010).

144. Daniel K. Tarullo, Governor, Fed. Reserve Bd., Fin. Stability Reg., Speech at the Distinguished Jurist Lecture, Univ. of Penn. L. Sch., 23 (Oct. 10, 2012), <http://www.federalreserve.gov/newsevents/speech/tarullo20121010a.htm>.

145. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 622, 12 U.S.C. § 1852 (2012).

146. *Id.*

147. *Id.*

of such a change? A good start would be taking out the exceptions in section 622. A more comprehensive reform—such as changing the measure of size or the coverage of the institutions—would require more elaborate analysis. For this purpose, the Brown-Kaufman Amendment and the Safe Banking Act seem to be a natural starting point.

S. KENNETH LEE