NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

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Before the Federal Reserve Board
Washington, DC

"Capital One is a Toxic Recipe for Systemic Risk"

September 20, 2011

Good morning. My name is John Taylor and I am President and CEO of the National Community Reinvestment Coalition, NCRC. More than 600 community organizations belong to NCRC and have joined together for a common purpose. That purpose is to make sure that there is fair and equal access to credit, capital, banking services, and banking products for every American.

On behalf of NCRC, our members, and the millions of people that we serve, I want to thank the Federal Reserve for granting **our** request to hold public meetings on Capital One's bid to buy ING Direct. There are **critical issues** at stake in this proposal—issues like systemic risk, public benefits, the future of community-based banking, and the effectiveness of the Dodd-Frank Wall Street Reform and Consumer Protection Act. How the Federal Reserve handles those issues in reviewing Capital One's application creates the precedent for all future decisions. As Chairman Bernanke recently said:

It is important that you get this right.

Your choice to allow for a more robust process by extending the comment period and holding meetings is a crucial first step in the right direction. Still, in congratulating you, I want to make myself very clear:

This is only the first step.

Under our laws, the Federal Reserve bears primary responsibility for protecting our financial system from unwarranted increases in systemic risk. That means:

- It is **your duty** to make sure that banks involved in acquisitions follow safe and sound practices;

- It is **your duty** to make sure that allowing them to expand their activities will not put the American people at significant risk for another financial crisis;

- And it is **your duty** to make sure that any increase in systemic risk is offset by a net gain in benefits to the public. In this context, just any old public benefit will not do. As Board Governor Tarullo noted, **expansion should not occur unless the benefits to the public are clearly significant.**

Viewed within this framework, NCRC and our members believe that the Federal Reserve's duties with respect to this proposal should be very clear:

You have a duty to deny Capital One's application to buy ING Direct.

Allow me to devote the rest of testimony to explaining why.

First, let me be clear: **Capital One's business model is <u>NOT</u> sound.** When it bought Hibernia bank in 2005, Capital One told the world that it was moving away from its high-risk monoline strategy. Instead, it promised to diversify its business to a 55% credit-card/45% consumer banking ratio.

Six years and three bank purchases later, Capital One is <u>STILL</u> a monoline:

- 75% of its income **still** comes from credits cards;

- That means 3/4ths of its profits are extremely vulnerable—especially in times of economic stress when revolving credit shrinks and charge-offs increase.

- We all know that credit-card monolines are notorious for their high rates of failure in market downturns— Providian, Nextcard, Metris, and Advanta are just a few.

  This is why no other bank in the top five comes anywhere close to Capital One's excessive reliance on credit cards—**or any other single product for that matter:**

  - The nation's 4 largest banks have diversified income bases. They purposely limit their income from a single-source to a range of 19 to 32 percent. **Let me say that again:**

Capital One:	**75%**
Everyone else:	**19 to 32%**

  - Those numbers become even more pronounced when you look only at reliance on credit cards:

Capital One:	**75%**
Everyone else:	**Less than 19%**

Here's what all of this means. If you approve this acquisition, the next "too-big-to-fail bank" will be the "most-likely-to-fail bank" because it is the least diversified and most at-risk in economic downturns.

And there's more. 76.4% of Capital One's primary source of income—its credit card portfolio—is securitized. That means Capital One already makes up more than 20 percent of the entire credit card asset-backed securities market. Compare that with Countrywide.

Right before its failure played a key role in the collapse of the MBS market, Countrywide's market share was only 13 percent. If Countrywide's failure was capable of playing a central role in a financial crisis that we are **still** trying to recover from, it's hard to say that Capital One isn't already "too-big-to-fail."

And, if Capital One does what it says it will do—which is use ING Direct's deposits to buy HSBC's credit-card portfolio—it will become even bigger.

Understand this. Your decision to approve this acquisition would allow Capital One to potentially control **<u>32 percent</u>** of the credit card ABS market. That's 1 out of every $3—nearly twice as big as Countrywide was when it brought the market down.

Here's what this means in terms of systemic risk:

This is a toxic recipe for growth.

You don't have to take NCRC's word for it:

- Financial analysts, federal regulators, and Members of Congress have all identified credit card securities as the likely trigger for America's next financial crisis. To quote one financial analyst, "mortgages were simply the first storm to make landfall; credit cards are next."

- To quote the FDIC, "banks involved in securities activities, subprime credit card securities in particular, have experienced a multitude of problems, including some bank failures." Just in case you forgot, nearly 1/3 of Capital One's credit card portfolio is subprime. If you approve this deal, and make it possible for Capital One to buy HSBC, that subprime number only gets bigger.

The thing about credit card securities and systemic risk is that the entire market is heavily interconnected to key nonbanking and banking financial institutions.

- The primary investors in credit card securities are pension funds, insurance companies, and the existing "too-big-to-fail" banks. That is the very essence of interconnectedness.

In sum, this is an unsafe, monoline business that relies on a highly sensitive single-source of income and then spreads 3/4ths of its risk to the public through selling its securities to America's retirement funds and insurance companies.

AND, they are asking you to allow them to become the nation's 5th largest bank. They want to turn ING Direct's deposits into **EVEN MORE** credit cards to sell **EVEN MORE** securities to a market that everyone says is the next to implode. Make no mistake—there is a significant systemic risk posed by this transaction.

The law says that Capital One must show that the public benefits of this deal outweigh systemic risk. Otherwise, it must be denied.

Here's what Capital One seems to think will suffice: They think that they can waltz in here today—after having spent a mere 4 sentences in its application on the issue—wave a few isolated examples of community investment in the Federal Reserve's face, and pretend that it's enough to tip the scales in their favor.

Well, let me tell you this. It doesn't matter what Capital One did in the past; and it certainly doesn't matter that this deal will allow them to offer more ATMs and products. The **<u>ONLY</u>** thing that should tip the scale in Capital One's favor is if it actually puts forward a meaningful plan showing a true commitment to do more for the public. **That, they have failed to do.**

Here's what I want you to think about:

- Every time someone gets up here and tells you how Capital One invested in their business, I want you to remember that Capital One's 7(a) small business lending actually decreased by 99.73 percent—from $228 million to less than $600,000.

- Every time someone gets up here and tells you how Capital One invested in their communities, I want you to remember that Capital One's community lending fell off a cliff after its purchase of Chevy Chase Bank—dropping by 41 percent.

- And every time someone gets up here and suggests to you that Capital One has a genuine interest in serving communities of color, I want you to remember that HMDA data shows that time and time again, their lending to African-Americans, Latinos, and Low- and Moderate-Income borrowers trails their peers.

Everything we know about Capital One's track record makes it clear that allowing them to grow means moving away from legitimate community banking. In fact, Capital One's track record and claims of public benefits are outdated and, if you believe they are not, then the standard for public benefits needs to be reexamined. Asserted benefits of consolidation and growth in the banking industry are inflated and have been thoroughly rebuked.

That's why the so-called benefits of this deal don't even come close. There is no greater efficiency or economies of scale involved in this transaction. In fact, Moody's has put Capital One's credit rating on watch because they believe it will be difficult for them to make good on any of its integration or efficiency claims.

We believe that the only public benefit that can outweigh this kind of increase in systemic risk is a forward commitment to do those things that generate wealth for Americans. Things like:

- Increasing homeownership through fixed-rate mortgages;
- Offering small businesses stable and affordable access to capital, not just credit cards; **AND**
- Demonstrating a commitment to communities of color by locating branches and offering banking services in their neighborhoods.

These benefits should bear a proportional relationship to the increased risk. For example, if you just use size as a measure of that, Capital One must make a forward commitment to increase its public benefits by more than 70 percent.

Until they do, this is an acquisition that must be denied.

Thank you for allowing me the opportunity to speak with you today. I am happy to answer any questions that you may have.