Consumer Finance Monitor (Season 5, Episode 33): Regulatory and Economic Challenges Currently Facing Banks: An In-Depth Conversation with Special Guest Keith Noreika, Executive Vice President and Chairman of Patomak Global Partners' Banking Supervision and Regulation Group, and Former Acting Comptroller of the Currency

Speakers: Alan Kaplinsky and Keith Noreika

Alan Kaplinsky:

Welcome to Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer finance. I'm Alan Kaplinsky, Senior Counsel at Ballard Spahr and the former chair of our Consumer Financial Services Group for 25 years, and I'm very pleased to be hosting our podcast show today. Today, I have a very special guest, who I will introduce to you in just one moment. But we're going to be talking about a potpourri of important issues, things that are very current today and things that are important not only in the legal sense, but we're going to be talking about the economy in general and the impact it has had so far and may have on the banking industry. We're going to be discussing technological developments and as I said, a very wide array of topics, and I can't really think of anybody that could address these topics better than our guest today.

Alan Kaplinsky:

Our guest today is Keith Noreika. Keith is Executive Vice President and chairman of the Banking Supervision and Regulation Group at Patomak Global Partners. In that position, he leads Patomak's projects related to the US banking industry, as well as those clients that span beyond traditional banking, including financial technology, or fintech, and cryptocurrency companies. Prior to joining Patomak, Mr. Noreika was a partner at Simpson Thatcher & Bartlett, a law firm based out of New York, although Keith worked out of its DC office, and he was the lead lawyer in the firm's financial institution's regulatory practice.

Alan Kaplinsky:

In 2017, and that's when I first got to meet Keith, he served as acting Comptroller of the Currency, where he led the 4,000 person independent agency responsible for chartering, regulating, and supervising all national banks and federal thrifts, as well as federal branches and agencies of foreign banks in the United States. In his capacity as acting comptroller, he worked very hard to make regulation more accountable, to improve the efficiency of chartering and licensing decisions, and sought to enhance the value of the national bank and the federal thrift charters and their ability to meet the credit and banking needs of their communities. In this role, he also served as a director of the Federal Deposit Insurance Corporation and a member of the Financial Stability Oversight Council. So, Keith, a very warm welcome to you.

Keith Noreika:

Well, thank you for having me, Alan. You're a legend in the consumer law space and I'm happy to join you today.

Alan Kaplinsky:

Okay. Well, I've got a lot to cover with you, so let's get right into it. I'm going to roll back the clock a little bit to your time as acting Comptroller of the Currency. I'm curious, and I'm sure our listeners will be curious, as to what was the most significant challenge you faced as acting Comptroller of the Currency?

Keith Noreika:

Well, thank you, Alan, for asking. It's hard at the time to say there was one thing because everything was new. I was the first new administration bank regulator, boots on the ground, just after an unexpected election result, trying to guide the ship, if you will, until the regular appointees arrived. I think in retrospect, now we have a few years to look at it, probably the biggest issue facing me and facing the agency as well as the industry was this process of technological innovation in the banking industry. It's transforming everything, as we're seeing. I think it's coming to banking a little bit late and there's resistance, I think, both from regulators and industry. But it's coming and I think we were seeing it with smaller community banks. Now, we're seeing it with larger banks of how the business is being transformed. And regulation has to keep up with that, right? It can't ossify the past. It has to adapt, in some ways, get out of the way to allow the industry to change.

Alan Kaplinsky:

It always seems, Keith, that unfortunately, regulation seems to be several steps behind technology always. It's been that way throughout my entire career. I guess I'd like to get your reaction to what I'm about to say, and that is that it's not all that surprising, right? Because the people who are at the forefront, who are at the vanguard of technological changes aren't likely to seek a job at a federal government agency because that's not their mindset. Many of them are entrepreneurs. There's not too many opportunities for entrepreneurship working in a government agency.

Alan Kaplinsky:

So, all these things happen. Artificial intelligence gets employed in the banking industry and other kinds of changes are occurring. The latest thing is the metaverse and how is that going to affect banking? And it just seems like that's the way it is. I mean I know right now, CFPB is out there trying to hire technologists because they don't have nearly the level of expertise that's in the industry and they can't pay enough money for people to do it and the people that are really good in the area aren't going into government. Do you agree with me on that?

Keith Noreika:

Yes. So, I think there are probably three different schools of thought or three different buckets that regulators can fall in. I think maybe the largest bucket is the one you're describing. It's sort of react. First of all, I think in general, regulation and regulators are reactionary, right? Not a lot of people are going out and starting the new, new thing. You get that occasionally, but by and large, you deal with what comes to you and the world changes and the industry changes and you're forced to adapt because of it. So, the first bucket, I think, are people who are just more of that mindset and they maybe don't like change. So, they try to keep the world as it is, as regulators, which I think in itself gives rise to its own what I would call safety and soundness, and larger systemic issues that actually may be caused by regulators.

Keith Noreika:

So, again, I'm sort of skeptic about everything. I question everything. But I do think, for frame of reference, there's a small C conservative bent of "this is the way things have always been done at the agency and in the industry. Why change?" The second school of thought may be more of what I subscribe to which is that markets are dynamic, that regulation needs to be tailored to what the industry is or is becoming, but generally [regulators] should stay out of the way of the marketplace to allow markets to develop and innovate, but keeping in mind first principles of why we regulate so that if we see the risks develop that cause a systemic risk when in a banking context or other type of risks of harm to consumers, something like that, regulators can then step in.

Keith Noreika:

Then there is a third school of thought that's very unusual. I would put maybe Brian Brooks in this category, which is people who are innovators who may know the technology and can push that. Now, usually, a lot of times that comes from industry and Congress rather than federal agencies. But occasionally, we do get a sort of innovative thinking regulator like Brian was who can raise very important issues and hopefully try to put the regulators or put the industry in a position of strength going forward.

Alan Kaplinsky:

Yeah. I know Brian very well. Knew him before he became a technologist, when he was just a class action lawyer, I think, at the O'Melveny firm, and always knew he was very, very bright. Yeah. I agree with you on that. But that was a very unusual stint that he had at the comptroller.

Keith Noreika:

But I think in general, just to reemphasize, we don't know what we don't know and people in the private sector, the people you're talking about who are going out and trying to make money and innovations, at least they're trying to overcome the knowledge barrier through the promise of profits. I think again, regulators can either approach it one of two ways, which is to go out and try to learn with the industry and keep track of those trends that they know or should know, bedrock principles of why they're there in the first place, or they become, as I said, somewhat more reactionary and small C conservative and maybe hostile to the innovation because it thwarts their ability to implement their regulation in their head of the world they know, but the world that may not really exist because it's dynamic.

Alan Kaplinsky:

Let me ask you another question that relates to the consumer financial services world, and two very important questions, one of which became an issue after the Second Circuit decided a case called the Madden case several years ago, and the other being the true lender issue, the issue of a usury question of who is the real lender when a bank partners with a non-bank to offer loans, typically over the internet, and after the loans are originated, they get sold back to the bank, usually right away. I know that you and Brian Brooks made some major strides to deal with both of these serious issues, and one of the issues, I think, was largely put to bed, and I'm thinking of the Madden issue. You can describe what happened there in a moment.

Alan Kaplinsky:

Despite the efforts that you and Brian made to deal with the true lender issue, unfortunately, that did not become a final regulation. It got overturned. I think it was through the Congressional Review Act, although I'm not 100% certain. So, my question for you is how do you see this ending up? We still have the true lender issue. It hasn't gone away. California Department of Financial Institutions has got a lawsuit out there against a company called Opp Finance, dealing with that issue. I started litigating that issue when I did work years ago for payday lenders who had partnered with banks all over the country to make payday loans online and that issue never got resolved at that point. So, I'd like your reaction to Madden and true lender.

Keith Noreika:

Yeah. So, first of all, I guess they're distinct issues. The Madden case, I think, dates from around 2015, or maybe before, from a Second Circuit decision that had to decide whether the interest rate exportation allowed to national banks and frankly all FDIC insured banks under the FDI Act would carry on with the sale of a loan that was validly originated and valid when made by the originating bank, but then sold to a non-bank lender. The Second Circuit there, I think, caught everyone by surprise by raising questions as to whether that sort of term in the contract, which was you can charge any rate allowed by the home state under federal law of the originating bank, can be transferred to the seller.

Keith Noreika:

I think ultimately, when you got down into the nuts and bolts there, there was really just a question the court had about whether there was federal authority to make that transfer and that, something I think I got started when I was acting controller, of really just putting a little extra step in the ladder of the logic, if you will, that would make clear, as a matter of federal law, the interest rate exportation was valid when made, its valid when assigned, and its valid in the hands of the subsequent holder. That seems to have calmed everything down. Subsequently, I think the rule was promulgated finally when Brian was there and has withstood the test of challenge to date.

Keith Noreika:

The true lender side was always much harder, and as you say, they get addressed together. That is the question is on the incoming side. When there is a partner, often a technological partner, the loan is really made by the bank that is in partnership with the entity that's out finding the customers, if you will, and that entity may [already] have a customer relationship with the borrower. They may ultimately get possession and ownership of the loan after it's originated by the bank. When I was acting controller, I set the staff off to look at both issues, but really realizing true lender was probably a lot harder.

Keith Noreika:

The case law is all over the place, there are many different factors, there's no set test, and the thought was to maybe try to come up with some more clear rules of the road so it wouldn't be the Wild West out there, that banks could partner with financial technology firms, which I think is a good thing for the industry. It's a good thing for consumers to have an industry that's evolving up to date rather than ossifying and dying. So, I think that sort of solution that was worked out in the rule that was promulgated, ultimately overturned by Congress and the Congressional Review Act, was one idea. Right?

Keith Noreika:

Maybe it wasn't the best idea. As you'll recall, I think only the OCC adopted that rule and the FDIC did not on the true lender side, as opposed to the Madden side. So, the Congressional Review Act obviously will be an issue going forward. I don't think the FDIC would be barred from doing something in the future, and maybe there's a different formulation that would allow those technological partnerships to really prosper and drive a convergence of technology firms and the banking industry because I think we are seeing, I think, an artificial separation of the two. But the banking industry, especially as you get below the biggest banks, really needs an infusion of new life, if you will, from the efficiencies that can be generated from financial technology, and it's very expensive to build that all up on your own. If the CFPB can't hire someone for a certain amount, what can a community bank do? But these partnerships allow a great opportunity for local banks to engage and compete with the larger banks.

Alan Kaplinsky:

The thing I'm sure you had to deal with and Brian certainly had to deal with after he promulgated the true lender reg is the knee jerk reaction of a lot of people, mostly consumer advocates and plaintiff's class action attorneys, that "how can you condone this rent-a-bank scheme?" They use this very pejorative phrase, rent-a-bank, to which everybody immediately recoils. It doesn't sound nice, renting a bank. Buying a bank is one thing, but renting a bank is not so good. So, how do you deal with that? That's the thing, the rallying cry of the people who want don't want these partnerships to exist.

Keith Noreika:

Well, look. I think again, there's perhaps some self-interest on their part of obviously, if they're class action lawyers, they may want to sue banks and get recovery. I'm not saying that's not justified in some circumstances, but you have to take everyone's self-interest into account. In some ways, I guess another reaction to that is that everyone rents a bank to some extent, right? Every business is using a bank as a platform to run its business, to balance its accounts, to do its accounts payable, to get loans from, or perhaps loan money to customers to buy things. So, I think financial technology obviously broadens the base of

potential borrowers and customers of the business that does business with the bank, the commercial enterprise, but we can be pejorative all we want.

Keith Noreika:

Obviously, throughout the history of our country, the banking industry has been viewed suspect and a punching bag politically, but it also serves a larger purpose. Everyone's seen the musical Hamilton and what banking and credit can do for this country and has done. So, at some point, we need to be reasonable and think about the cost and benefits. Now, I will say in the true lender sphere, the OCC, even far back as the Hawke era, when Jerry Hawke was Bill Clinton's Comptroller of the Currency, did put out some guidance of which type of partnerships the OCC as a supervisory matter wouldn't stand for, ones that were viewed as abusive to consumers. But if they weren't viewed as abusive to consumers, then why shouldn't banks and consumers be able to use that partnership as a means by which to access credit at a lower cost than, say, going to a payday lender or a pawn shop?

Alan Kaplinsky:

Right. Of course, the consumer advocates seem to very conveniently forget that even when you have these kinds of partnerships, that the bank is held fully accountable for complying with all the regulations to which it's subject, safety and soundness guidelines and other consumer protection regulations. It's got to comply with it all. It's not absolved from any of that, subject to examination, and whoever the controller is, if in examining the non-bank, they found something abusive of consumers, they would not hesitate to call them out. So, it's not like it's a free ride, that the bank does nothing but put its name on a document.

Keith Noreika:

No, that's quite right, and the more I've investigated these partnership type arrangements, the actual [benefit of] being able to use the bank for interest rate exportation is a small factor, right? I do get the feeling a larger part of the relationship is really using the bank's compliance function to comply with all of these relevant consumer regulations, safety and soundness, Bank Secrecy Act, any money laundering requirements, know your customer. That all falls to the bank. That's a very expensive activity. But you can see it being much more efficient to do in one place. It's like having one of these cars that you go out and you rent for the day rather than owning your own car because you don't have to do the service on it. You don't have to get the state inspection. You don't have to pay the taxes or get the registration changed.

Keith Noreika:

You definitely get the sense of that is coming to banks as well. You see it with the hotel industry, with Airbnb, ride sharing. So, of course, this is a natural step into the banking industry for players that don't have the wherewithal to do it. Frankly, you want those people to do it through the banking industry because our federal regulatory apparatus is set up to look at banks and it's not so good at looking at non-bank players in all of these very important laws to our national security and anti-criminal activity.

Alan Kaplinsky:

It seems to me, just one, I guess, final point on the subject that we've been talking about, that the question in my mind is even though the comptroller, whoever the next comptroller may be, we still have an acting comptroller, although the comptroller was confirmed. Am I right?

Keith Noreika:

No. He's acting like I was.

Alan Kaplinsky:

Okay. But the question is, will the comptroller step up to the plate in one of these class action lawsuits and file an amicus brief supporting the position of the bank? Or are they just going to take a hands off attitude towards the thing?

Keith Noreika:

Yeah. I think it's unusual. Yeah. I've seen it both ways. Sometimes, the agency where there's a big interest to the agency itself and its jurisdiction will take a leading role, like you saw when Gene Ludwig and Jerry Hawke were comptroller. Other times, not so much in the post Dodd-Frank era, either way works because the law is fairly strong and clear, as far as what the preemptive force of the National Bank Act is. There are Supreme Court cases out there saying it ordinarily preempts, that there's a presumption in favor of preemption. So, it's not like in my experience, it's been needed by banks that the act and the case law can speak for itself.

Alan Kaplinsky:

Right. Well, let's turn to another subject, and that is, I'm not going to turn the CFPB and director Rohit Chopra, and what I'm going to say, I'd like to get your reaction to it. But at least from my observation, I think he's demonstrated a fair degree of hostility toward fintech, including the use of artificial intelligence in underwriting consumer loans. He's totally changed the mission of the Office of Technology that got created several years ago under, I think it was under Kathy Kraninger when that happened. He's de facto eliminated the use of no action letters and compliance stand boxes. He's focused on reigning in big tech and does not seem to like new fintech products, like buy now, pay later, earned wage access, income share agreements, etc., etc. At least for one, I'm very concerned about at least the attitude that I've seen so far. What your take on that?

Keith Noreika:

Well, look. I think first, having served in one of these positions, I grant a lot of deference to whoever is serving, that they may have their agenda that is hopefully the elected official's agenda and give them some deference to pursue it. I think everything you've described in your question goes back to my three buckets of regulators. Again, when you try to be in control of everything, you have to deal with the unknown and one way to shut down the unknown is to shut down innovation, and hopefully that's not the case. Certainly, I've seen democratic administrations be quite open to innovation. Tom Curry was, for instance, before I got there with the adoption of the fintech charter and the like. His thought was better to bring innovation into the banking sphere than to cast it out where it's unregulated.

Keith Noreika:

I have a certain sympathy for that, but I also know it's just very hard to deal with things and there becomes a reaction, if you will, to deal with specific boxes and try to take care of them and also to hold out the specter of enforcement to make people act cautiously. Whether that's the right thing or not, again, I think is more of a political judgment. So, I defer to the director on that. But there are consequences, obviously. You may be driving things out of the regulated bank space. You may be driving things out into areas where there's no regulation or you can't find it or it would take you a long time to find it and there may be more abuse going on to consumers.

Keith Noreika:

Hopefully, people are thinking about that at the highest levels of the agency because there are a lot of times where the best intentions to do one thing creates a lot of unforeseen circumstances that magnify the negative effect that's trying to be remediated by doing the first objective, and I would really hate to see that happen. I think a lot of times when regulation is pursued single-mindedly, you get a lot of bad results. So, we'll just have to see how things end up.

Keith Noreika:

Overall, I think the director's doing a good job raising awareness of issues, like big tech has a big place in American society. I think we should all be talking about what they're doing with people's data, how they're doing it. They have a special place in

the law that maybe isn't the best, and maybe we should talk about that, and to the extent he's raising issues that raise those larger issues for discussion and potential legislative change, I would be supportive of that, for sure.

Alan Kaplinsky:

Right. Let me ask you one more question about something that has created a quite a flare up in the consumer finance industry by banks and others that are subject to supervision and examination and enforcement by the CFPB. So, Director Chopra recently made a change to the UDAAP exam manual. For our listeners, UDAAP means unfair, deceptive, and abusive acts and practices. He made a change to that exam manual, which it concluded that discrimination in the sales of products and services constitute unfair practices. He further took the position that that covers both credit and non-credit products, like deposits and remittances. He's gotten an enormous amount of pushback from the banking industry, and even the Chamber of Commerce is threatening a lawsuit.

Alan Kaplinsky:

I'd like to get your reaction to that development because in my mind raises it the question, actually a larger question of how do you go about communicating with a regulated industry? Do you do it in a predictable and transparent way and do you give the industry and other stakeholders an opportunity to comment on something that you're going to do instead of just doing something by fiat and doing it by using an examination manual, of all things? So, what do you think of that development? Overall, what's the right way to regulate? You use exam manuals and advisory letters, interpretations, which are done by fiat, or do you actually go through the APA and adopt a full blown regulation where everybody's given an opportunity to comment?

Keith Noreika:

Well, obviously, important issue. I guess where I come out on all this is if I were a director and something meant a lot to me, and certainly it does mean a lot to me that consumers are treated equally, not based on immutable characteristics they may have, whether that's legal or not, I think is then the next question and certainly the one I would be asking if I were the director. That, I think, is the whole ballgame here is part of abusive practices include something that maybe was not thought of at the time the law was enacted. Now, I think legally, I'm a recovering former lawyer at this point, you have this EPA case, West Virginia against EPA, that's going to transform, I think, our industry of financial services where you're going to have to start to ask that question, was this contemplated by Congress at the time that Title X of Dodd-Frank was enacted?

Keith Noreika:

I actually think, Alan, there's the whole question of rules vs. guidance and the like. Maybe just having grown up as a Washington administrative lawyer in my youth, I actually, in some ways, think there aren't enough lawsuits brought by industry against their regulators and I do think we need to do more that allows challenge. If we talk about credible challenge in boards of banks, why can't we have credible challenges of regulators? If a regulator wants to do something, great. He should be or she should be free to do that if he or she believes that's within the oath he took when assuming the office. But part of that oath is also being subject to the Administrative Procedures Act and being subject to judicial review for arbitrary, capricious, and contrary to law type actions.

Keith Noreika:

What we saw a lot of, say, before the Gramm-Leach-Bliley Act, where the industries were very separate, so banking was separate from securities, which was separate from insurance, like the securities industry and the insurance industry, they didn't think two seconds before they would sue some banking regulator for allowing a bank to do something outside their jurisdiction. We've lost that, I think, because the industry doesn't want to challenge the regulators because they feel like, oh, well, then I have to live with them afterwards.

Keith Noreika:

I don't know how we get to a culture where it's like a whistleblower or somebody where you can't have retaliation against you, but there's nothing wrong with regulators having to follow the law just as they're insisting on their regulated industries having to follow the law. Certainly, that was the number one commandment when I was comptroller is we follow the law just as much as we insist others follow the law. I think again, this using of abusive practices expanding it may be a gray area and it may be something that's just right for judicial review, but we should have that judicial review, we should have a forum for it, and we should just accept what the result is that the courts ultimately determine.

Alan Kaplinsky:

Right. Right. So, let me do a slight, I guess you could say, a 180. We're going to turn away from the regulatory things that we've been talking about, Keith, and talk a little bit more about other challenges facing the banking industry, particularly as a result of our economy now. I'm wondering, what do you consider to be the significant headwinds that are facing banking institutions as concerns of a recession continue to grow?

Keith Noreika:

So, inflation has to be number one, two, and three just because it's very invidious, right? You don't know how it's going to affect your borrowers. You don't know how it's going to affect your loan books. Banks make loans for long times, but inflation hasn't really been an issue in our country for the past 40 years. If people have misjudged that, and it's easy to do because you're dealing with the here and now, or do the Fed's stress test take into account double digit inflation, or were they taking that into account over the past decade? Probably not. We're looking at other factors, but not that one, and so it's a hidden issue. It has invidious results. We've seen the legacy of that. If you're a student of the banking industry with the S&L crisis and the like back in the late '80s, early '90s, big deal, right?

Keith Noreika:

So, I would be very much worried about that, trying to get in front of that. But the other ones are maybe more on the supply side of how do you take advantage of technology without letting technology wipe you out? So, I think that is another one where the inside of the banking industry is very clunky. When I want to send a wire overseas, there's one wire I think I sent for my wife's cell phone bill in a foreign country where I don't think it's ever arrived 18 months later, right? It's when you see the potential of technology there to make that much more efficient, move the supply curve out. You need to have that brought into the banking industry.

Keith Noreika:

That's one of the things, frankly, I'm working on now as a consultant is bringing that technology into the banking industry in a responsible and safe and sound way where there's risk management of it. But it's a big investment. A lot of times for big investments, banks won't want to be the first player. But here, there's almost no choice. Either you're going to be at the front or you're going to be left behind. So, I think, maybe there's the immediacy of the unknown economy, is double digit inflation going to be here to stay for a few years? If you think about the early '80s, that was three years of double digit inflation. The value of the dollar decreased by a third in three years. That's quite tremendous and what the impact on banks' assets are going to be.

Keith Noreika:

But then on the other side of how banks operate as they're dealing with those challenges, one way is to become different, to become leaner and meaner, and to do more in a more cost effective and efficient way. The technology's sitting out there, whether we call it cryptocurrency or blockchain or digital assets, there's a role for banks clearly because banks are a trusted intermediary. Trusted intermediaries are needed for transactions and they've certainly become more important in that space of whether we call it decentralized finance or whatever. If you think about everything a bank does, they're a trusted intermediary, but that will change the nature of it, and so banks need to start thinking about that going forward.

Alan Kaplinsky:

Yeah. So, inflation, as you pointed out's been at the highest rate it's been in 40 years, and that poses significant risks to banks. I think one of the major risks is a credit risk, that their borrowers, both consumers and commercial borrowers, if the interest rates go up, they're not going to be able to repay their loans and delinquencies are going to rise. But on the other side of the coin, at least that hasn't really happened yet. At least, I haven't seen any evidence of delinquencies shooting up the way some people had predicted.

Alan Kaplinsky:

On the other side of the coin, I think it's actually helped banks, strangely enough, in that while they're jacking up the rates they're charging on loans, on the deposit side, it's a lot more sticky. I have certain CDs at various banks and they come up for renewal and I don't see them jacking up the interest rates very much on a one year CD or a two year CD. They're pretty much the same, and they certainly haven't jacked them up as much as the Fed has jacked up interest rates. So, it actually helps the net interest margin of a lot of banks. So, I guess I could argue for some, it depends on the bank's balance sheet, but for some banks, as long as interest rates don't go too high and we don't go into a deep recession, it's actually a good thing. Is that making any sense to you?

Keith Noreika:

Well, I think it makes sense in the sense of the massive liquidity in the marketplace, right? The M1 or M2 has increased by, what, 50% in the last two years. So, where do people put that money? They put it in banks. Banks don't really have a lot of cost pressure to push up their interest rates. They can use that money to lend it out to people who need it at more of a market rate. So, yeah. I think the banks are benefiting from the spread right now. I think the issue will be over time of what the credit worthiness of the borrowers are on things like auto loans, mortgages maybe eventually, as rates continue to go up. If they're adjustable rates, as we've seen in the past, will that eventually price existing borrowers out of the marketplace and force delinquencies or not?

Keith Noreika:

And maybe banks are more fortified in their, hopefully they are, more fortified in their balance sheets than they were going into the financial crisis. I think the banking industry is tremendously strong. The weakness, if you will, is what next? It's a very expensive industry to be in, given all the costs of the regulatory, the capital, the liquidity, the technology, and marketing. It's very easy to have profitable businesses disintermediated by non-banking competitors, and what's the solution to that, I think, is a work in progress.

Alan Kaplinsky:

Right, right. So, I'm going to turn to move away from the economy and talk about M&A involving the banks. Some people have criticized mergers and acquisitions that create bigger and bigger banks. You're at least partly involved in advising banks on such mergers. How do you react to the criticisms of mergers and acquisitions and the specter of bigger and, some people would say, anti-competitive banks?

Keith Noreika:

Sure. Well, it's an area I've been heavily involved in over the past five years working on Wall Street, and I guess my response is this same notion, the same theme that we've been talking about since the beginning of our chat, Alan, which is the banking industry is dynamic, right? What are you trying to preserve? There's usually a reason behind mergers, which is trying to build up scale to deal with non-bank competitors, who don't have the same costs. So, you need scale to spread these large costs over and generate more efficiencies. The notion of stopping a bank merger just for the sake of it because, oh, a bank might be bigger doesn't make much sense because you're not going to hold the world the way it is now. You may just be driving one of the banks out of business, ultimately.

Keith Noreika:

Then you also have to think about this notion of being anti-competitive. I know there's a big debate. I'm not an antitrust lawyer. I never was. But generally, I would think Dodd-Frank has had the perverse outcome of creating very large banks that are very hard to compete with that have a moat around them. In the original Dodd-Frank, there was a $50 billion threshold that was almost impossible to cross. I think one bank crossed it in the history of that law, which was then repealed in 2018, and it came back down afterwards because it couldn't deal with the cost and the scrutiny that it had. So, there was effectively a moat around the largest banks that you talk about ending too big to fail. In some ways, Dodd-Frank ossified and codified too big to fail. So, I would think given we have these large trillionaire banks, it might be in everyone's interest to have more competitors to them.

Keith Noreika:

Certainly, the foreign banks seem to be leaving the United States with a number of high profile sales. Not in all cases. That's an overgeneralization. But where are you going to get this competition from? You're going to get it by building up locally scale to compete with the largest banks, and if you're not willing to do that in some ways, you may be in some ways giving up on the industry and we'll have to find some other way to intermediate finance in this country. So, I think I can understand the gut reaction of, geez, every bank merger is approved and we need to look more closely at this and certainly what the consumer and competitive effects are. But by and large, we have a lot of banks in this country, certainly more per capita than most industrialized countries. Consolidation is probably a good thing for the industry and I think we need to get more realistic about more holistically looking at the banks in the entire financial space of what their role is going to be and allow them to adapt to fulfill that role in the future.

Alan Kaplinsky:

Why do you suppose that the pace of bank mergers and acquisitions has been ... I would perceive it to be very sluggish. There's just not a lot of M&A going on, and it's been that case for several years. It's not just this year when bank stocks have, in general, been in decline. But prior, even last year when the stock market was treating banks very well, there still wasn't much M&A. Even among big banks or regional banks or small banks. What's your explanation for that?

Keith Noreika:

Well, I just think it's very hard. There's a lot of uncertainty. So, you think about going into a process of negotiating a deal, entering into trying to get approvals from multiple regulators in many cases. That may take a very long time. Are you willing to just go through with it or do you just make the best of a less than optimal situation and continue on? So, I think there are a lot of costs to doing a bank merger more than just hiring an investment banker and a lawyer. It is trying to manage the timeline to manage objections. It raises the cost of doing business. So, you probably have a suboptimal amount of consolidation in the industry as a result.

Alan Kaplinsky:

Yeah. Well, I've got one more area I want to explore to you in our remaining time, Keith, and that's the topic of crypto. Regulators continue to struggle with creating a framework for understanding and regulating cryptocurrency. The same time, we're seeing just how volatile that segment of the market is with a lot of consumers who I think foolishly got involved in investing in crypto without understanding what crypto was all about. What is stopping regulators from making more progress in terms of regulating crypto and ultimately, who's going to take the lead here and say we really got to get ahold of this product? Because if not, there's going to be a lot of people who are going to lose, in summon instances, their life savings because of crypto.

Keith Noreika:

Sure. Well, look. Very complicated question just to answer in a few minutes. But first, you have to understand what crypto is. It's a big universe. There are speculative currencies that have nothing behind them except the value that the market places on

them, things like Bitcoin and Ethereum, what their usefulness is. There are those that may be tied to a fiat currency, like a US dollar token or stable coin. Then there are other digital assets, like NFTs and the like. All of that technology, I see coming into the banking sphere, whether it be people needing to custody assets, like someone dies and they have an executor as a bank and they own Bitcoin, or they're a wealthy person and they want some of their assets there. NFTs are sort of a natural for banks in the sense of they may be digital wealth held that bank trust department would be the ideal place to store it.

Keith Noreika:

Stable coins, I think, we're seeing a debate even ongoing whether they should be an insured depository institution or not as the President's working group recommends, or the Fed should license them. All thoughts because there'll be some liquidity mechanism potentially behind it. So, again, that's one of those things when we talked about the different types of regulatory attitudes, it's somewhat like Niagara Falls descending on the federal banking agencies and they need to put on their raincoats and get ready for it because it's coming and it's coming for the industry and it's going to change. Now, as part of that, a lot of this technology, like we saw in the dotcom era, is speculative. So, there's betting going on of what's going to be the standard in the industry and not. That's a market sort of phenomenon. Obviously, the market regulators are all over that right now. But when it all shakes out, and we are seeing some shaking out right now, I do think that technology is going to revolutionize the way that banks behave in their interactions with society in general.

Alan Kaplinsky:

Yeah. Okay. Well, we have drawn to the end of our show for today, Keith. I want to thank you very much for being a part of the show and sharing your wisdom on, as I said at the outset, we were going to talk about a wide variety of topics and I think we covered a lot in the last hour. So, thank you again. I appreciate it.

Keith Noreika:

Well, thank you so much for having me. It's been my pleasure.

Alan Kaplinsky:

Great. I want to thank all of our listeners today for downloading our program and just remind everybody that a new podcast gets released Thursday morning of each week, except during a couple of holiday weeks in November and December. We were very, very pleased to be ranked last year by Good2BSocial, which is a consulting firm that specializes in giving advice to law firms on how to use social media, including the blogs and podcasts, etc.

Alan Kaplinsky:

We were ranked second in the country among the 200 largest law firms and we're very, very proud of that achievement. Our podcasts are available on any platform where you typically would go to listen to your podcasts. Spotify, Google Play, etc., etc. Or you can certainly find it on our firm's website, ballardspahr.com. So, we have it all archived and available to our listeners. So, with that, I hope everybody enjoys the rest of their day.