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Little Hoover Commission
925 L Street, Suite 805
Sacramento, CA 95814

Re: Governor's Reorganization Plan for 20Congressman Ken Calvert12

Dear Commissioners:

I am writing to express my opposition to the Governor's Reorganization Plan for 2012 with respect to: (i) the merger the consumer services portion of the State and Consumer Services Agency (SCSA) with the business regulation functions of the Business, Transportation & Housing Agency (BTHA); and (ii) the merger of the Departments of Corporations and Financial Institutions.

As a former Deputy Secretary and General Counsel to the BTHA, I am personally familiar with the operations of the BTHA, the Departments of Corporations (DOC), Financial Institutions (DFI) and Real Estate (DRE). I also have first-hand experience as a financial services regulator and as a securities regulator having served as the Commissioner of Corporations and the Interim Savings & Loan Commissioner.¹ As an attorney in private practice, I have more than two decades of experience in representing clients with respect to matters involving these departments and agencies. I also have previously served as a member of the Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions, Co-Chair of the Corporations Committee of the Business Law Section of the California State Bar, and Chairman of the Business & Corporate Law Section of the Orange County Bar Association. I have written extensively on corporate and securities law matters and presently serve as a practice editor to the leading treatise on California Securities Law² and a contributor to one of the leading treatises on California corporate law.³ I am currently an adjunct professor of law and the University of California, Irvine and I've previously served as an adjunct professor at Chapman University School of Law.

¹ When I served as Commissioner, the Department of Corporations administered and enforced the Credit Union Law. Oversight of Credit Unions and Savings & Loan Associations was transferred to the DFI in 1997.

² H. Marsh, Jr. & R. Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS.

³ MARSH'S CALIFORNIA CORPORATION LAW.

Based on my experience and for the reasons set forth below, I believe that merger of the DOC and DFI into a new Department of Business Oversight (DBO) will:

- Destroy California's dual bank system;
- Reduce the supply of credit to small businesses in California; and
- Weaken consumer protection.

Finally, consolidation of the DOC and the DFI will not result in significant cost savings for the state.

Merger of the consumer services portion of the SCSA with the business regulation functions of the BTHA will not improve regulation.

The business regulatory departments within the BTHA differ significantly from the boards and bureaus within the SCSA. Each of the principal business regulatory departments within the BTHA (alcoholic beverage control, corporations, financial institutions and real estate) is headed by a single commissioner who is appointed to the governor and reports directly to the Secretary of the BTHA (*See Appendix A*). In contrast, the SCSA through the current Department of Consumer Affairs provides executive and administrative services to numerous boards and bureaus regulating licensed professionals.⁴

⁴ These include: The Dental Board of California; The Medical Board of California; The State Board of Optometry; The California State Board of Pharmacy; The Veterinary Medical Board; The California Board of Accountancy; The California Architects Board; The Bureau of Barbering and Cosmetology; The Board for Professional Engineers and Land Surveyors; The Contractors' State License Board; The Bureau for Private Postsecondary Education; The Bureau of Electronic and Appliance Repair, Home Furnishings, and Thermal Insulation; The Board of Registered Nursing; The Board of Behavioral Sciences; The State Athletic Commission; The Cemetery and Funeral Bureau; The State Board of Guide Dogs for the Blind; The Bureau of Security and Investigative Services; The Court Reporters Board of California; The Board of Vocational Nursing and Psychiatric Technicians; The Landscape Architects Technical Committee; The Division of Investigation; The Bureau of Automotive Repair; The Respiratory Care Board of California; The Acupuncture Board; The Board of Psychology; The California Board of Podiatric Medicine; The Physical Therapy Board of California; The Arbitration Review Program; The Physician Assistant Committee; The Speech-Language Pathology and Audiology Board; The California Board of Occupational Therapy; The Osteopathic Medical Board of California; The Naturopathic Medicine Committee; The Dental Hygiene Committee of California; and The Professional Fiduciaries Bureau. Cal. Bus. & Prof. Code § 100.

The oversight challenges of providing administrative services to a numerous and diverse collection of boards and commissions are fundamentally different than the business policy oversight currently provided by the BTHA to the DFI, DOC and DRE. Placing these three critical business regulatory departments within a new super agency will eliminate the current business regulatory focus of the BTHA.

It is also a mistake to move the DRE into the Department of Consumer Affairs (*See Appendix B*). Although the DRE does regulate real estate professionals, it has significant regulatory overlap with the DOC with respect to real estate lending. I believe that the consistency of policy and regulation will be diminished if the DRE and the DOC are separated into different departments within the BCSA.

Consolidation will destroy California's dual banking system.

For nearly 150 years, the United States has had a dual banking system pursuant to which a bank may choose to either be chartered by a state or the federal government.⁵ The dual charter system strengthens regulatory oversight of the entire banking and credit union system.

- *Dual chartering promotes healthy regulatory competition.* Competition results in efficient regulation that benefits banks and credit unions whether they operate under a federal or state charter. Increased efficiency not only reduces costs for existing institutions, it promotes competition by reducing barriers to entry. Regulatory competition also encourages a more responsive bureaucracy.
- *Dual chartering promotes innovation.* As U.S. Supreme Court Justice Louis Brandeis observed,

"To staid experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."

New State Ice Co. v. Liebman, 285 U.S. 262, 311 (1932) (J. Brandeis,

⁵ The DFI issues charters and regulates both state banks and credit unions. The Comptroller of the Currency issues charters to and serves as the primary regulator for national banks. Like banks, credit unions may choose either a state or federal charter. The National Credit Union Administration charters, regulates and insures national credit unions.

dissenting). According to the DFI, innovations like branching, deposit insurance, trust services, variable rate mortgages, home equity loans, interest-bearing transaction accounts, and checking accounts first appeared in state chartered banks.

- *Dual chartering promotes a California focus.* California's DFI is focused on maintaining the safety and soundness of banks in California and the overall vitality of California's economy. When banking policy is made in Washington D.C., the focus is necessarily on those policies and financial institutions that impact the national economy. Smaller and community banks have virtually no voice in Washington, D.C.

The Governor's Reorganization Plan will shake confidence in the continued viability of the dual charter system. Banks and credit unions will perceive a lack of regulatory focus if the DFI is merged into a department that regulates a variety of activities unrelated to depository institutions. This is why the DFI's federal counterpart is not a division of the Securities and Exchange Commission or the Federal Trade Commission. The downgrading of the Commissioner of Financial Institutions to Chief Deputy status will also shake confidence in the effectiveness of the state charter.⁶ The Commissioner of Financial Institutions is a gubernatorial appointee. This is analogous to the appointment of the Comptroller of the Currency by the President of the United States.

If the Governor's Reorganization Plan is adopted, I expect that many of the larger state chartered banks will convert to federal charters. The new DBO will be left with the weaker banks. This will engender a "death spiral" that results in the eventual demise of the state charter alternative. As interim Savings & Loan Commissioner, I am very familiar with this phenomenon. Once there was a vibrant state chartered savings and loan industry in California. Now, there is none.

The Governor's Reorganization Plan will reduce the availability of small business credit in California.

One significant consequence of the demise of the state charter will be the diminution of credit to small businesses. Small business depends on smaller community banks as a significant lending source. The U.S. Small Business Administration released data in February 2011 that show that since 2009 there has been a decrease in small business loans by the largest banks. At the same time, lending by smaller banks (those with less than \$500 million in assets) remained

⁶ As illustrated in Appendices A and B, the Governor's reorganization plan will introduce a new intermediate department and will thus have the effect of demoting the DFI and DOC commissioners to the status of deputy commissioners who report to a commissioner who then reports to the secretary of the Business and Consumer Services Agency.

stable. Another study by the National Federation of Independent Business (NFIB) concluded:

Small-business owners whose primary institution is a regional/community bank were more successful obtaining a new line than those whose primary institution is a large bank. Fifty-one (51) percent of the former received approval and obtained their new line compared to 33 percent of the latter.

William J. Dennis, Jr., "Small Business, Credit Access, and a Lingering Recession" p. 26 (Jan. 2012).

Consolidation of the DFI and DCI will weaken consumer protection.

The DFI and the DOC administer and enforce laws with fundamentally different objectives. Although both the DFI and the DOC are generally concerned with regulating financial services, the industries that they regulate are fundamentally different. The DFI primarily regulates banks and credit unions.⁷ Although there are significant differences between these two types of institutions, they share the common element of being depository institutions. The principal objective of all depository institution regulators is to ensure the "safety and soundness". The DFI has an experienced staff that is trained and focused on the department's mission of ensuring the safety and soundness of its licensees.

In contrast to the DFI, DOC currently does not administer laws governing depository institutions *per se*. Thus, the DOC's regulatory focus has been in different areas. For example, the DOC administers and enforces the Corporate Securities Law of 1968 and the Franchise Investment Law. The principal purpose of these laws is to protect investors and potential franchisees. Although the DOC regulates finance lenders and residential mortgage lenders, neither of these are depository lenders. Thus, neither the Finance Lenders Law nor the Residential Mortgage Lending Act is focused on safety and soundness in the same manner as the banking law.

Consolidation of the DFI and the DOC will not streamline or simplify regulatory oversight. As noted above, the laws administered and enforced by the DFI differ fundamentally from those administered and enforced by the DOC. Simply put, an application to be licensed as a bank has almost nothing in common with an application for a permit to offer and sell securities. Thus, consolidating supervision of these laws within a single regulator will not simplify or streamline the licensing processes currently in place. Combining the regulators within one department will not change the substantive requirements for a license or the rules governing the operation of licensees. While the creation of the DBO will give the outward appearance of a "one stop" regulator, the reality will be that the DBO will need to be internally organized along virtually the same lines as the DFI and the DOC are today.

⁷ The DFI also regulates industrial banks, trust companies, offices of foreign banks, business and industrial companies, and money transmitters. Each of these is closely related to the banking industry or banking industry functions.

In fact, the Governor's Reorganization plan specifically creates separate divisions within the DBO, each headed by a chief deputy.⁸

Consolidation will not result improve efficiency of regulation. The staffs of the DFI and the DOC are well trained and experienced. This does not mean that they can be easily substituted for one another. A bank examiner cannot be immediately turned into a securities regulator (or *vice versa*). Because the training and experience the DFI and DOC staff differ so significantly, I do not expect that any real efficiency would be realized by housing them under a single regulator. In fact, consolidation would likely dilute regulatory focus and efficiency because the Governor's plan introduces a new intermediate department – the DBO. See Appendix B.

Consolidation will likely disrupt the existing regulatory programs. Any consolidation would result in significant disruptions. The California economy is facing unprecedented stresses. At this critical time, regulators should not be distracted by regulatory consolidation.

No significant cost savings have been identified. When former Governor Arnold Schwarzenegger sponsored a similar proposal only three years ago,⁹ the Assembly Appropriations Committee concluded there are “unknown potential long-term savings”. These savings would only be realized if there are more streamlined services and operating efficiencies. For the reasons discussed above, I believe that there is very little opportunity for either streamlining services or improving operating efficiencies. In any event, both the DFI and the DOC are special fund agencies that are supported by licensee fees and assessments rather than the General Fund. In my experience, licensees already demand cost efficient regulation from the DFI and the DOC.

Please note that I am writing this letter in my individual capacity and not on behalf of any other person or group.

Very Truly Yours,

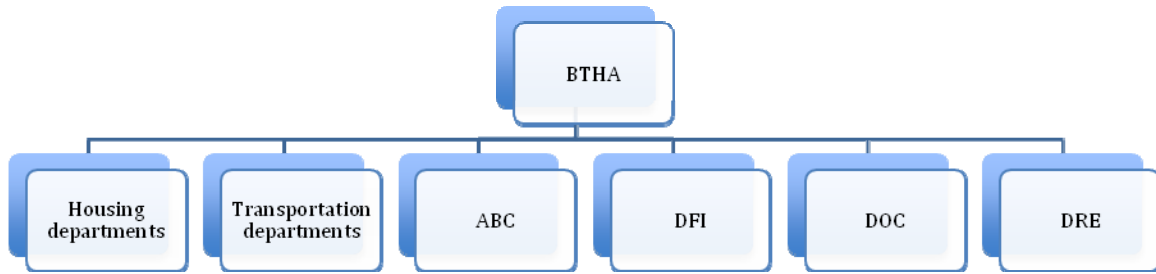
/s/ Keith Paul Bishop

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⁸ See Sections 41 and 51 of the Governor's Reorganization Plan.

⁹ AB 33 (Nava).

Appendix A Current BTHA



Appendix B Governors Reorganization Plan

