

## RESEARCH SUMMARY

## Politicization in the Provision of Financial Services: When Banks Operate under a Regime of Privilege

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The provision of financial services has become increasingly politicized. Banks like JPMorgan Chase and Citigroup have refused financial services to firms and industries they disfavor. While this practice may not raise concerns under ordinary circumstances, banks are not like most other businesses but exist and operate within a “regime of privilege.” In other words, they may be using what amounts to public power to attempt to impose their own private preferences on the market.

Brian Knight and Trace Mitchell consider whether this public power, granted to banks to facilitate lawful commerce, is being misused when banks try to regulate downstream markets by withholding their services. In “[Private Policies and Public Power: When Banks Act as Regulators within a Regime of Privilege](#),” they discuss how policy-makers might address this behavior.

### WHY BANKS ARE PRIVILEGED IN THE FINANCIAL SERVICES MARKETPLACE

- *Barriers to entry.* The need to obtain a bank charter and Federal Deposit Insurance Corporation insurance serves as a barrier to entry that limits competition. It provides a competitive advantage to those firms that have received a charter and insurance at the expense of those that have not.
- *Government-granted advantages over nonbank competitors.* Banks receive advantages over their nonbank competitors in the areas of lending and money transmission. In addition, they receive considerable benefits through the government’s issuance of deposit insurance and their provision of the different payments systems.
- *Explicit bailouts and implicit subsidies.* These guarantees can provide significant value to banks. They protect banks from insolvency and allow them to attract investment on more favorable terms than they would receive without those protections.

### WHY IT MAY BE INAPPROPRIATE FOR BANKS TO ACT AS DE FACTO REGULATORS

Banks frequently enjoy protection from competition and from the full burden of their risk-taking. When a bank’s actions are inconsistent with how its government-granted advantages are justified, that inconsistency calls into question whether the public is actually obtaining the benefit of the bargain it struck with banks—and whether banks should continue to enjoy those advantages.

None of the justifications for banks’ privileges stem from a desire to bestow on them the ability to act as de facto regulators. In fact, many of the justifications are directly undermined by a bank’s decision to act as a de facto regulator, when it seeks to use its power to influence others to adopt its preferred policies by threatening to cut off access to services.

### THREE WAYS TO ADDRESS BANKS ACTING AS DE FACTO REGULATORS

- *Remove, or at least minimize, the government-granted privilege enjoyed by banks.* This would address the very source of the problem, while preserving banks' freedom of association. However, it may not be politically feasible.
- *Prohibit de facto regulatory efforts, but allow banks to use private alternatives.* This would prevent banks from misusing government-granted benefits while allowing them to pursue private alternatives if they still wanted to engage in de facto regulatory behavior.
- *Condition becoming a bank, or providing bank services, on a forswearing of de facto regulation.* This would be the most aggressive approach and would do the most harm to freedom of association, but it would also be the most direct solution.