FDIC

SOME THOUGHTS ON RESTRUCTURING THE FEDERAL BANK REGULATORY AGENCIES

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Before the
92nd Annual Convention of the Iowa Bankers Association,
Des Moines, Iowa, September 25, 1978

SOME THOUGHTS ON RESTRUCTURING THE FEDERAL BANK REGULATORY AGENCIES

Today I will offer for your consideration some ideas on restructuring the Federal bank regulatory agencies. I want to arouse your interest, stimulate your thought processes, and receive your reactions on this subject. The thoughts that I will express are my own and do not necessarily reflect FDIC policy.

Numerous suggestions for restructuring the agencies have been made over the past 40 years or so. I believe that regulatory reform has taken on added import in view of the current legislative proposals designed to stop the erosion of membership from the Federal Reserve System. State banks* operate under a dual regulatory burden. They are examined by both a State and Federal agency, and whenever they file applications — including applications for mergers, branches, deposit insurance, the issuance of capital notes, or the exercise of trust powers — State banks must file with both the State and the Federal agency. This system not only involves a good deal of delay and duplication of effort and expense, it subjects a State bank to the very real risk that an application deemed acceptable at either the State or Federal level will be denied at the other level.

To date this dual regulatory burden has not been sufficient to drive the smaller State banks into the national system because it has been offset on the other side by the cost of membership in the Federal Reserve System and by generally higher State bank lending limits. A number of proposals have been advanced for eliminating or substantially reducing the burden of Federal Reserve membership. These proposals include universal reserve requirements, the payment of interest on reserves, and the reduction of reserve requirements.

The reserve requirement and membership issue is a complicated one into which I do not intend to delve in this speech. But a few general observations are in order. I believe that Congress should and will act to substantially reduce the cost of membership in the Federal Reserve System. When and however that occurs, I believe that many State banks will begin to look more seriously at the dual regulatory burden under which they operate. They might well conclude that conversion to national bank status is desirable. I believe in the dual banking system and would like to see it preserved. It is extremely unfortunate, but I believe accurate, that the viability of our State banking system currently rests in part on the fact that national banks are subject to a special tax in the form of sterile reserves maintained at the Federal Reserve.

I believe that at least some reformation of our system of financial institution regulation is overdue. I would like to consider a few possibilities for reform. But first let me review some of the other proposals which have been advanced for regulatory restructuring.

OTHER PROPOSALS TO RESTRUCTURE THE FEDERAL AGENCIES

Consolidation into a Single Agency

A number of proposals have been made over a great many years to consolidate all three Federal bank regulatory agencies into one. Included are suggestions of the Brookings Institution in 1937, of various task forces of the Hoover Commission in 1949, of the Commission on Money and Credit in 1961, of Federal Reserve Governor J. L. Robertson in 1962, and more recently of Senator Proxmire. A single agency, it is argued, would be more efficient, tougher in enforcement of laws and of safety and soundness factors, and better able to provide Congress and others with accurate information about the banking system. The principal objections to a single agency are the negative impact that they might have on the dual banking system, concern over the concentration of power, and a fear that the agency might stifle innovation.

Consolidaton into Two Federal Regulatory Agencies

Several proposals also have been made to consolidate the examination and regulatory activities of the present three agencies into two. Frequently they contemplate creating an additional board or agency to perform some special function. Most such proposals envision a Federal regulator of national banks and a Federal regulator of the national aspects of State-chartered banks. Almost without exception the proposal is that the Office of the Comptroller be continued as the regulator of national banks, whether the name itself is continued or not. In one proposal, however, merging the Office of the Comptroller of the Currency into the Federal Reserve System was contemplated.

The recommendations of the Hunt Commission (The President's Commission on Financial Structure and Regulation) follow this pattern. The most significant aspect of the Hunt Commission plan is the proposed restructuring

*The discussion of dual regulatory burdens relates to State nonmember banks insured and regulated by the FDIC. State member banks are subject to similar but not identical regulation by the Federal Reserve.

on a functional basis. One agency would be continued to supervise national banks, one would be created to take over the examination-related activities of the FDIC and the Board of Governors of the Federal Reserve System, and another agency would be created to supervise the Federal deposit insurance activities. Under some conditions, savings and loan associations and credit unions offering third-party payments would be regulated by the banking agencies. The Board of Governors would remain as the monetary policy authority and would retain activities relating to the monetary policy and central bank functions.

In 1975 Frank Wille, then Chairman of the FDIC, proposed a similar arrangement of regulatory agencies at the Federal level, but he made no recommendations about savings and loan associations or credit unions. Also, his recommendations about bank holding companies differed from those of the Hunt Commission. He, too, would have a board take over the deposit insurance functions of FDIC. This board would rely on the reports of examination made by the Comptroller of the Currency and by the Federal supervisor of State banks, but it would annually examine a small percentage of both national and State banks to evaluate the quality of those examination reports. Mr. Wille also suggested that the Federal Banking Board pay all costs of examination and supervision incurred by the two Federal agencies and some of the costs of qualified State banking departments. He would have the Federal Reserve System continue as the formulator of monetary policy, the Nation's central bank, the lender of last resort, and the Nation's representative among central banks of the world.

Continuance of Three Federal Regulatory Agencies

Despite the numerous proposals to consolidate the three Federal agencies into one or two agencies, there has remained a strong sentiment in favor of the current structure. The present agencies would be continued and a Financial Institutions Examination Council would be created under the Financial Institutions Regulatory Act of 1978, currently under Congressional consideration. The Council would fulfill many of the same responsibilities as the present Interagency Coordinating Committee, but would have some additional powers, too. It would establish uniform examination principles and procedures, would maintain liaison with State agencies, and would conduct schools for examiners including those from State agencies.

Some reassignment of functions within the regulatory agencies may be desirable even if the present three agencies are continued. The FDIC has contended that the present arrangement for the examination and supervision of bank holding companies is one of the areas that should be altered regardless of the regulatory structure that is finally adopted.

A FEW THOUGHTS

An essential first step in discussing the restructuring of the Federal bank regulatory agencies is identification of the characteristics that one believes to be desirable for such a structure. In my mind there are at least five important characteristics:

(1) A strong dual banking system;
(2) A strong Federal Reserve System with all powers necessary for carrying out monetary policy;
(3) Unified bank and bank holding company supervision;
(4) A strong and efficient regulatory system which will ensure a sound, responsive, and innovative banking system; and
(5) Coordination between bank regulation and the conduct of monetary policy.

Longer range, we may also desire closer coordination between the regulation of bank and nonbank financial institutions, a single insurance system for bank and nonbank financial institutions, and greater control over nonbank financial institutions for monetary policy purposes. Any system that we devise should allow evolution to meet these additional objectives should they be deemed important at some future date.

A strong State banking system is necessary if we are to realize the full potential of the dual banking system. There are two principal problems with it at present. One is the diversity in the competence and performance of State regulatory authorities. There are some excellent State banking departments that are well financed and staffed with an adequate number of well-qualified, professional staff members — but there are not enough of them. The second is that the delays, irritations, frustrations, and costs of dual supervision and regulation are discouraging to State-chartered banks. Both of these problems are susceptible to resolution.

I believe that we ought to consider the possibility of discontinuing the role of the Federal Reserve in bank and bank holding company regulation, substantially reducing the involvement of the FDIC in bank regulation, and transforming the Office of the Comptroller of the Currency into an independent National

Banking Commission headed by a board of directors. In suggesting a realignment of functions, I do not want to leave the impression that I am dissatisfied with the performance of the present agencies or their staffs. I believe that all three Federal agencies are ably staffed and have performed well. Nevertheless, I believe that our system of bank regulation can and should be improved. Let us examine the three elements of this proposal, beginning with the Federal Reserve.

Federal Reserve System

Under the proposal, the Federal Reserve would give up all of its responsibilities for bank and bank holding company regulation and for promulgation of consumer and civil rights regulations. It would focus on the conduct of monetary policy (although it would retain its central bank and lender of last resort functions) and would have sole jurisdiction (at least at the Federal level) over reserve requirements, interest rate ceilings, and margin requirements.

Most proposals for consolidation of the banking agencies have called for removing the Federal Reserve from bank and bank holding company regulation. Three principal reasons have been advanced: (1) Placing monetary policy and bank regulatory authority in the hands of one agency is too great a concentration of economic and financial power, (2) Monetary policy and bank regulatory activities are each full-time jobs and need full-time agency attention, and (3) Conflicts inevitably arise between monetary policy and bank regulatory considerations and the same agency should not be required to resolve them. As I noted at the outset, an extremely important concern should be the impact that the present regulatory structure might have on the dual banking system once the burden of Federal Reserve membership is made less onerous.

If there is validity to the above arguments for taking the Federal Reserve out of bank regulation, then it becomes important to determine the validity of, and to weigh, the argument advanced by some that the Federal Reserve's bank regulatory activities are important to the conduct of monetary policy. It would seem that the other bank regulatory agencies could provide the Federal Reserve with any information about the banking system that is needed to conduct monetary policy. Further, if the Federal Reserve were represented on the boards of directors of both the National Banking Commission and the FDIC, there would be a continuous interchange among these agencies. This would facilitate close coordination between bank regulation and the conduct of monetary policy without placing both activities under the wing of a single agency.

Federal Deposit Insurance Corporation

Under this proposal the Federal Reserve's jurisdiction over State member banks would be transferred to the FDIC which would attempt to disengage from day-to-day regulatory and supervisory activities. It may not be feasible for the FDIC to withdraw completely from the day-to-day regulation of banks in all States. However, it seems to me that the FDIC could be given the authority to withdraw from active regulation in those States that have banking departments that meet certification standards established by the FDIC. In other words, if a State banking department were certified by the FDIC, then the FDIC's approval would not be required on branch, merger, insurance, and other applications of banks in that State, and the FDIC would not conduct routine examinations of those banks. If the department were not certified by the FDIC, then the FDIC would regulate and supervise the State-chartered banks to the same extent that it does today.

The principal inducement to States to upgrade their departments would be to ensure the survival of a strong dual banking system. If the Federal Reserve membership burden is substantially reduced, a certification program like the one described, or some other measure to reduce the burden of dual regulation, may be essential to prevent large numbers of conversions from State to national charters. As an added inducement, and to assist the States during a transition period, consideration might be given to at least a temporary Federal financial assistance program for States that meet the certification standards. This could be funded by the FDIC in an amount roughly equivalent to the savings realized by the FDIC as a result of the certification program.

The FDIC would retain its standby examination authority with respect to all banks and would conduct periodic examinations to monitor the performance of the chartering authority. The FDIC would retain its authority to terminate insurance in any bank and should have the authority to issue cease-and-desist orders with respect to any bank.

The criteria used by the FDIC in certifying State banking departments should be as objective as possible. Some of the criteria which could be used include:

(1) Authority of the department to investigate all matters relating to the safety and soundness of banks under its jurisdiction and the manner in which these banks meet the convenience and needs of their communities;
(2) Performance of the department in enforcing consumer and civil rights laws;
(3) Organization of the department with a board for review of quasi-judicial determinations;
(4) Adequacy of trained personnel to assist in administration;
(5) Independence of the department and staff from political pressures in the performance of duties;
(6) Adequacy and competency of examiner and supervisory personnel;
(7) Maintenance of research and legal departments to work on banking problems; and
(8) Adequacy of financing from State sources, possibly supplemented by funds expected from FDIC.

For the certification system to be effective, the certification should be subject to periodic evaluation by the FDIC. A department that lost its certified status would find the FDIC again involved in day-to-day regulation of banks in its State.

The program as outlined could result in a more efficient, vigorous, imaginative, and responsible regulatory system for State-chartered banks. It would be one in which the State sector would be able to reestablish itself as an effective, full partner in a revitalized dual banking system. Under such a system, a State charter could and probably would offer many advantages other than lower reserve requirements and higher loan limits, two of the principal reasons for presently maintaining such a charter.

Office of the Comptroller of the Currency

Most plans for regulatory reorganization have suggested that the Office of the Comptroller of the Currency be continued as the regulator of national banks. Some have expressed the opinion that the Office should be made independent of the Treasury since the issuance of currency no longer is a function of that Office and since the other Federal bank regulatory agencies are independent. As a part of such a plan, the Office (which I will refer to as the National Banking Commission) might be given a board rather than being permitted to continue under the heading of a single administrator as it is now. There could be three appointive members on a five-person board who could divide the responsibilities of the Commission for day-to-day operations. With a board member from the Federal Deposit Insurance Corporation and with one from the Federal Reserve Board as ex-officio members, the board could serve as a deliberative body and as one means of coordinating the activities of all of the Federal regulatory agencies in the banking field.

Under a deliberative board, especially one with ex-officio members from the FDIC and the Federal Reserve System, the responsibilities of the Commission could be expanded beyond regulating national banks. It could assume, for example, some of the responsibilities presently assigned to the Federal Reserve System, such as promulgating regulations and passing on applications for all holding companies and examining and supervising all holding companies in which the lead bank is a national bank. Holding companies (and their nonbank subsidiaries) in which the lead bank is State chartered would be examined by the FDIC and/or the State regulatory agency. The Commission also could regulate Edge Act corporations and promulgate regulations in the consumer and civil rights areas, such as regulations B and Z relating to equal credit opportunity and truth-in-lending. As a matter of fact, it might promulgate all Federal regulations relating to banks where uniformity is considered desirable. The regulations then would be enforced by the FDIC and/or the State banking departments with respect to State banks.

Finally, if the Federal Reserve System were to move out of examination and regulatory activities, it might be advisable for the Comptroller of the Currency (or the head of the National Banking Commission) to be replaced on the FDIC Board by one of the Governors from the Federal Reserve Board. Doing so would give the Comptroller more time to devote to the very full regulatory responsibilities for national banks. Secondly, some would argue that the regulator of national banks should not be a member of the board of the Federal regulator of State banks. Thirdly, Federal Reserve representation on the FDIC Board and on the Commission's board would give the Board of Governors a means of viewing both State and national banking developments. Alternatively, the FDIC Board might be expanded to five members. The five-person Board would comprise three appointed members and two ex-officio members, one ex-officio member from the National Banking Commission and one from the Federal Reserve Board.

This proposal calls for both the FDIC and the Federal Reserve to relinquish some authority

— in part to the National Banking Commission and in part to the State Banking Commissions. I am not speaking on behalf of the FDIC and obviously cannot speak on behalf of the Federal Reserve, but I believe that both agencies would be prepared to-relinquish bank regulatory authority if doing so would bring about a sounder and more responsive banking system and regulatory structure.

The ideas that I have put forward today involve some far-reaching changes in our regulatory structure which would require Congressional action. I encourage you to consider these ideas and those which have been and will be put forward by others, to evaluate them and to consider whether they are necessary, and to then participate in the legislative process as the issue of regulatory reform is considered. Your full and constructive participation will be important to the quality of the end product.

I believe that there is a better chance in the next year or two that significant regulatory restructuring will occur than at any other time during the past 40 years. Senator Proxmire recently encouraged President Carter to make restructuring of the banking agencies "our number one Government reorganization project for next year." A recent report by a well-known bank consultant concluded with the following remarks which express clearly the task before us:

> It seems quite evident that Congress and the banking industry will be asked to give thoughtful consideration to major reorganization of the Federal bank regulatory structure, probably during the next session of the Congress. Any such reorganization could hardly mean a simple reshuffling of existing powers. The consequences to the banking industry, and to the public with which it deals, can be enormous. It is essential, therefore, that the forthcoming debate proceed on the solid ground of thoughtful analysis.

It is my hope that some of the ideas offered here today will be of some value during the course of that debate.

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