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Statement on

S. 332
Consolidated Banking Regulation Act of 1979

Presented to

Committee on Governmental Affairs
and
Committee on Banking, Housing and Urban Affairs
United States Senate

by

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I welcome the opportunity to testify today on S. 332, the "Consolidated Banking Regulation Act of 1979."

However, I come before you with mixed feelings.

It is good to see that you are addressing the question of bank supervisory organization promptly, with a full Congress before you, so that uncertainties can be resolved for the general public, the banking industry, and our employees.

It is a matter of personal concern that I have not had the time to fully explore the implications of your proposal, and the alternatives, to the extent I would like with the FDIC staff and the other regulatory agencies.

I do not come to oppose this legislation in total, or to support it in full. Rather, I have some comments and suggestions on how to proceed. Further, I offer the cooperation of the FDIC in perfecting whatever legislation is to emerge.

Previous chairmen have testified several times that "the FDIC is not wedded to the existing structure." I would go further and state we are certain it can be improved. Questions are how and how soon? Should we first give the new Federal Financial Institutions Examination Council time to perform?

The issue before us today is not a new one. As I understand it the proposal tracks very closely the plan first outlined by the Brookings Institution in 1937, which was moved into public debate by Governor Robertson in 1962, and was the subject of hearings during the last two Congresses.

Earlier this month, I testified before the Senate Banking Committee to the effect that there presently are readily evident inefficiencies in the three-agency approach and we should use the

new Examination Council as a laboratory to test and try some things in cooperation.

In response to questions from Senators Proxmire and Garn, I stated that we may well conclude that merger of the agencies is the proper answer, but we should first see what we can learn from the Examination Council.

It is my judgment---and your judgment could well differ on this score---that we are not yet at the point of national consensus on the issue of a single bank regulatory agency. The great legislative reforms of our generation all were debated and refined for years until, finally, the time was right for change. Our banking environment is still evolving, and the distinctions among the various providers of financial services are narrowing. Because there is thus a real possibility that this legislation, as introduced, may not be enacted in this Congress, I suggest that you consider moving concurrently on three tracks.

First. Move immediately to enact legislation to broaden the mandate and the mission of the Federal Financial Institutions Examination Council to cover bank holding companies and their non-bank affiliates.

Second. Move quickly to enact legislation to specify that the supervisor of the lead bank supervises the holding company and its nonbank affiliates.

Third. In marking up your bill, consider the feasibility of reducing the federal bank regulatory structure from three to two, rather than three to one.

Now if I may turn to your bill, S. 332. I have asked the appropriate divisions in the FDIC for detailed analyses and commentary

on the legislation you propose and we will be prepared to work with you on specific suggestions when you go into markup on the bill. For example, we have questions on how to assure, in the political environment, that a state's certification could be terminated if the quality of the state banking department declined. At this point I am prepared to discuss the general proposition put forth by S. 332.

ARGUMENTS FOR CONSOLIDATION

There is much to be said for this proposal in terms of economy and efficiency of operations, uniformity of approach, simplification of administration and external communication, elimination of policy conflicts, facilitation of the handling of failing banks, and targeting of resources to adjust to a rapidly changing bank environment. Our FDIC staff analysis points to the following advantages:

(1) Increased Efficiency: Greater centralization could eliminate duplication at the federal level and result in cost-reducing streamlining of certain administrative operations. The operations that most immediately come to mind are data processing and reporting, training programs, and the allocation of examiner time and examiner resources. The latter is probably most important, for at the present time there are 14 FDIC regions, 14 National Bank regions and 12 Federal Reserve districts that handle bank supervision, all with extensive headquarters offices. Apart from overlapping administration which affords potential for economy, each examination force covers a broader geographic area, necessitating greater travel cost and time than would be necessary under a consolidated scheme, with subheadquarters strategically located throughout the Nation.

It seems inefficient for three separate federal agencies to employ separate computer facilities to process, in many cases, the same reports and similar survey information collected from banks under three regulatory jurisdictions. Moreover, needed revisions of the substance of these reports and surveys may be achieved more economically if this administrative function were consolidated in one agency. Decisions regarding the coordination of examinations and revisions in the scope of examinations as conditions warrant could be arrived at more expeditiously under one federal administrative level. There would also be potential for economizing if legal activities, economic research, activities to develop improved bank monitoring systems, activities related to

financial control, and various other headquarters-type functions were carried on by a single agency.

(2) Unified Policies: A second major benefit of consolidation might flow from unified policy decisions and improved procedures on matters pertaining to bank safety and soundness and public welfare. The handling of failing banks by three federal banking agencies has in some instances complicated an appropriate resolution of that problem. Moreover, differences in approach among the agencies in areas such as loan classifications, capital adequacy policies, and other related examination guidelines may delay the timely recognition of distressed situations.

Policies on charters, branches, and mergers, all of which affect the degree of competition in banking markets (and ultimately the quality and costs of services to the public), should be treated uniformly. Similarly, uniform enforcement of consumer statutes, disclosure regulations, insider regulations and use of cease and desist powers also have public benefits. Moreover, efforts to work out these policy differences among three agencies require significant resource expenditures by each agency.

(3) Greater Specialization and Competency: Consolidation affords the opportunity to exploit specialized skills and divisions of labor more efficiently. For example, better use of specialized personnel to concentrate on shared credits, trust activities, and international loans and investments may be gained from centralization of these activities.

(4) Improved Communications: The present tripartite structure is complex and difficult, at least for the uninitiated, to understand. A single agency would be able to more readily and clearly enunciate our federal policies on bank supervision. This could result in improved communications with bankers, congressional bodies, state regulators, the general public, and foreign banking authorities.

ARGUMENTS AGAINST CONSOLIDATION

You also are familiar, I am sure, with the arguments against such consolidation: the present system has worked reasonably well; such an agency will not be a panacea; there would be an increased concentration of power; elimination of regulatory choice could cripple the dual banking system as we know it; benefits of diversity would be lost.

Our FDIC staff analysis points to the following disadvantages:

(1) Present System Works: The present system has worked reasonably well. There have been selective problems in banking in recent years and some large institutions have failed. However, the overall impact of problems and failures on the economy and on bank depositors has not been substantial.

Better decisions sometimes flow from two or three agencies independently studying similar banking problems, comparing conclusions, and arriving at mutually acceptable solutions than could come from any one of them acting alone. Moreover, with two or three federal regulatory agencies there should be more receptivity to change, a greater opportunity to experiment, and more flexibility.

(2) Uniformity Is Not Assured: A single regulatory agency is no panacea to prevent or cure problems in the banking system. Uniformity in application of policies and principles would not be assured by a single agency. In fact, the existence of decentralized regional structures at each agency and the fact that banking and bank regulatory activities are often judgmental matters may well have fostered a wider diversity today within any one of the existing agencies than there is in general among the three of them.

(3) Preservation of the Dual Banking System: A two or three agency federal regulatory system is more compatible with continuance and strengthening of the dual banking system. The concentration of power in a single federal bank regulatory agency could be overpowering to the regulatory systems of the individual states.

"(4) Could be Seriously Disruptive: Finally, the difficulty of effecting a consolidation into a single banking agency could prove to be disruptive for a very substantial period of time. The banking agencies are already heavily burdened with the implementation of such new laws as the Community Reinvestment Act, the International Banking Act, and the Financial Institutions Regulatory and Interest Rate Control Act."

Now, if I may return, in order of urgency, to the three-tier approach, that I briefly alluded to earlier.

FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The addition of bank holding companies to the definition of financial institutions would help us address one of our primary concerns---the fragmented supervision of the separate components of what is essentially one entity---the holding company.

Our legal division comments as follows:

> The Federal Financial Institutions Examination Council Act of 1978 establishes a Council consisting of representatives of the five financial institutions regulatory agencies. It charges the Council with responsibility for providing uniform standards for bank examinations of financial institutions, and making recommendations for uniformity in other supervisory matters. Section 1003(3) of the Act defines "financial institution" to mean a commercial bank, a savings bank, a trust company, a savings and loan association, a building and loan association, a cooperative bank or a credit union. This definition would clearly exclude supervision of bank holding companies and nonbank affiliates.

Also, the commonality of interest in the three bank regulatory agencies suggests changing the makeup of the Council to make the National Credit Union Administration and the Federal Home Loan Bank Board advisory members and adding a Treasury representative in a like capacity.

The Council should then be financed through equal contributions of the three banking agencies and assessment of cost to those using special services such as examiner schools. The present financing is a five-way split.

My purpose in recommending these changes is to afford the Council the best possible chance to succeed by giving it an improved mission and structure. The Council may not be the answer; it may prove insufficient, but it deserves our best effort.

BANK HOLDING COMPANY REGULATION

Let me move now to the matter of bank holding company regulation which our Division of Bank Supervision unanimously feels is our most pressing supervisory problem, a judgment in which I concur. Certainly, the inadequacies of our present system, in which regulation is divided among four agencies, has contributed to some of our largest bank failures. Both the Comptroller and the FDIC have repeatedly asked for reform of holding company regulation.

Presently, bank holding company regulatory authority is vested in the Federal Reserve Board, with the banks involved examined and otherwise supervised by one of the three federal banking agencies. We have now had the benefit of experience since the 1970 amendments to the Bank Holding Company Act, and this experience has clearly demonstrated that each holding company system must be regarded as an integrated unit.

I therefore recommend that the supervisor of the lead bank (or the sole bank, in the case of one-bank holding companies) be assigned the supervision of the holding company itself and its nonbank affiliates and that the lead supervisor be authorized to coordinate the examination of non-lead-bank affiliates by their respective supervisors. This arrangement would mean that the entire system would be examined and monitored as a single unit, but each bank would be reviewed by its primary regulator.

The Federal Reserve would retain its present role of determining permissible activities for holding companies and the responsibility for approving holding company formations and acquisitions.

If this proposal were enacted, the approximately 1,925 holding companies in existence at the end of 1977 and their banking affiliates would be supervised as follows: 133 by the Federal Reserve, 669 by the Comptroller, and 1,123 by the FDIC. I should note that these figures may be deceptive: most holding companies are of the smaller one-bank variety; the multi-bank holding companies are classified by lead bank as follows: 162 national, 50 Fed member and 93 non-member state banks and would be supervised accordingly.

The strength and performance of each entity depends on the management, earning capacity, asset quality, and equity position

of each of its parts---the holding company itself, the lead bank, the other component banks, and the nonbank subsidiaries. Experience has shown that problems in the operation of any holding company unit with the authority to use or draw on the credit standing and resources of the lead bank and the entire holding company enterprise can give rise to serious problems for constituent banks and for the lead bank in particular.

While most bank holding companies have performed responsibly toward their bank subsidiaries, some have not. For example, our bank examiners remind me that in 1974 the financial problems of Beverly Hills Bankcorp, Beverly Hills, California, resulted in the institution of a civil action against its banking subsidiary, Beverly Hills National Bank, as the result of alleged confusion of corporate identity between the bank and its parent on the part of the parent's commercial paper holders. While the bank itself was solvent, it had to be sold in order for the parent to retire its short term commercial paper obligations.

A second example is Hamilton Bancshares of Chattanooga, Tennessee, which attempted to help its floundering mortgage banking subsidiary by transferring $80 million of its problem mortgages to its lead bank, Hamilton National Bank. This led to the failure of the bank in 1976. The 1976 failures of American City Bank and Trust Company, National Association, Milwaukee, Wisconsin, and Palmer First National Bank and Trust, Sarasota, Florida, also stemmed largely from the unsound lending practices of the nonbanking affiliates of their respective holding companies.

I want to commend the Federal Reserve for the vigorous actions it already has taken to rationalize holding company supervision.

The Federal Reserve has made great strides, but the basic problem of split supervision remains with us.

THE TWO-AGENCY APPROACH

In marking up your bill, I would suggest consideration of an option to reduce the federal bank regulatory structure from three to two, rather than three to one, through the transfer of bank regulatory functions over state banks and bank holding companies from the Federal Reserve to the Comptroller of the Currency and the FDIC. If this were done, and you also decided to convert the Office of Comptroller into an independent board, you might also want to consider making a Federal Reserve representative a member of both the new board and the FDIC board.

Consolidation into two agencies:

a. would separate bank supervision from monetary policy, each important enough in its own right to merit the full-time attention of a single agency,

b. could be done without substantial disruption, simplifying the system and affording some consolidation advantages, and

c. would retain the dual banking system.

CONCLUSION

Again, I want to thank the Committee for this opportunity to testify, and I repeat, that the FDIC stands ready to assist you in any way we can.