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COMMENTS ON BANK REGULATORY REFORM

Submitted by

Frank Wille, Chairman
Federal Deposit Insurance Corporation

to the

Subcommittee on Financial Institutions,
Supervision, Regulation and Insurance
Committee on Banking, Currency and Housing
House of Representatives

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For the past six months, a top-level staff group within the Federal Deposit Insurance Corporation has been attempting to identify significant and demonstrable points of friction within the present Federal bank regulatory structure which might justify recommendations for major Congressional reform. That group has also reviewed the Federal supervisory experience over the past five years in dealing with large problem banks and a number of large bank failures to determine if that experience might justify similar recommendations. Finally, the group has attempted to analyze the potential advantages and disadvantages of a single Federal bank regulatory agency which might exercise all of the powers which are today vested in the Comptroller of the Currency and the FDIC as well as the examination and supervisory powers presently vested in the Federal Reserve System.

Stated succinctly, the group has identified only two significant and demonstrable points of friction within the present structure: one relating to different agency attitudes toward bank acquisitions under the Federal Bank Merger Act, the other relating to the overlapping authority of the Federal Reserve System in connection with one-bank holding companies in which the only bank subsidiary is either a national bank supervised by the Comptroller of the Currency or a nonmember bank supervised by some State banking department at the State level and the FDIC at the Federal level. As the Subcommittee will recognize, neither of these items had anything to do with the failure or near failure of United States National Bank, Franklin National Bank or Security National Bank. The group further found that the existing

agency structure was not a significant factor in any of the recent failures which have been so widely publicized and that a different bank agency structure at the Federal level would not necessarily have prevented any of them. This finding reflects, I am sure, the truism that no agency will be any better than its leadership or the men and women who staff it.

If recent bank failures provide no justification in fact for major bank agency reform at the Federal level, the case for a consolidated, all-powerful bank agency must rise or fall on the weight which Congress attaches to its respective advantages and disadvantages. The creation of such an agency would be such a far-reaching and dramatic change in the existing order of things that I believe the Subcommittee might find useful our staff's summary of the pros and cons of such an agency.

ARGUMENTS IN FAVOR OF A SINGLE, ALL-POWERFUL FEDERAL BANK
REGULATORY AGENCY:

1. Simplification of Administration; Improved Internal and External
Communication.

A single agency would provide a single focal point for Congressional and Administration contact on matters of bank regulation and supervision. Additionally, all public inquiries on matters of banking and bank regulation could be addressed to the single agency. All agency actions and decisions would originate, presumably, from a single Administrator or a single Board. Instead of 14 FDIC regions, 14 National bank regions and 12 Federal Reserve Districts (few of which are today identical) a much simpler regional setup could be achieved.

2. Elimination of Conflicting Goals. The fact that the scope of responsibilities differs among the three Federal banking agencies results in a number of internal conflicts with respect to the handling of supervisory problems. This is thought by many to be a particular problem for the Federal Reserve System whose principal function is the formulation and implementation of monetary policy. These observers believe that where the implementation of monetary policy goals is combined with regular bank examination and supervision, the former will always be viewed as more important than the latter and will prevent a consistent, evenhanded approach to matters of bank supervision. This potential problem would be reduced by setting up a single bank regulatory agency divorced from monetary policy responsibilities.

3. Economy and Efficiency of Operation. Considerable economy could be achieved by combining the legal, research, training and other Washington Office functions of the three existing bank regulatory agencies. There would be a reduction in senior agency staff time spent communicating with and keeping current with the activities of other agencies.

More efficient use could be made of examiner time, training and specialized capabilities. A single agency would eliminate differences in the form and substance of reports of examination and would be able to issue uniform instructions to all examiners. Travel time of examiners could be reduced, and in many instances where it has not heretofore been feasible, all banks within a particular community could be examined simultaneously. A single agency could make more efficient use of specialized expertise to

handle complicated credits and to concentrate on such areas as trust activities, international departments and foreign offices of insured banks, certain data processing and other areas of automated activity, and compliance with Federal and State statutes in the consumer protection area. Economy could be achieved through a single training program which would not only reduce existing duplication, but facilitate the development of more advanced and specialized training.

A single agency would eliminate differences in reports filed by insured banks, thereby eliminating some duplication or redundant effort in administering and processing such reports, in computer costs and in publication costs.

4. Elimination of Actual or Potential Policy Conflicts. A single agency would bring uniform treatment to all insured banks in such matters as rules, regulations, standards and procedures. For example, a single, rather than three separate guidelines on a subject, such as insider transactions, could be effected. Also, uniform application of statutory powers, such as cease and desist powers, would result. Banks would also be subject to greater uniformity with respect to loan classifications, policies on capital adequacy and other areas related to bank examinations.

Consolidation would result in a single policy on chartering, branching and mergers. ^{*/}

*/ The Comptroller is the only Federal banking agency having chartering and branching authority, but the FDIC and to a lesser extent the Federal Reserve each play an important role in the establishment and branch expansion of State banks.

5. Facilitating the Handling of Failing Banks. It has been alleged that the involvement of three Federal banking agencies in the handling of some failing banks prolongs and overly complicates an appropriate resolution of the problem. A single agency probably could reduce the time involved. Under present arrangements, it is difficult to consider all alternatives more or less simultaneously, because the three agencies have somewhat different powers related to solving these problems (e.g., the Comptroller has somewhat more flexibility in arranging a National bank merger which does not require special Government financial assistance or guaranties, while the Federal Reserve can provide liquidity assistance and the FDIC can provide other types of financial assistance to insured banks regardless of charter).

6. Improved Regulation of Bank Holding Companies, Their Affiliates, and Certain Other Bank Relationships. A single Federal bank agency would have responsibility for examining banks and their holding company affiliates, thereby facilitating a more complete picture of the entire operation and the assessment of the overall risk exposure of the bank(s) and the holding company. Under present arrangements the Federal Reserve has certain regulatory authority over the activities of holding companies whose principal assets may be banks subject to the regulation of the other two Federal banking agencies.

When Congress addressed the bank holding company issue in 1970 and concentrated regulatory authority within the Federal Reserve, Congress was primarily concerned with the range of permissible nonbank but bank-related activities to be made available to such holding companies. In more

recent years issues related to financial arrangements of holding companies and their impact on bank risk have become more important than permissible activities, and the present regulatory arrangement does not seem to be well suited to deal with these issues. Even apart from the holding company framework, there exist in today's banking system many complicated financial arrangements associated with joint ventures and shared credits where the present Federal regulatory structure makes it difficult to get a complete picture of a bank's risk exposure in a particular transaction. A single agency could ameliorate this situation.

7. Gains to Banks and Bank Customers from a Single Federal Agency.

Differences in regulations, in examination standards and reporting requirements among the Federal banking agencies may result in different treatment of similar situations and, as a result, in some inequities. In addition, there are costs imposed on the banks and the public in having to work with and understand these differences.

8. Adjusting to a Rapidly Changing Environment. Rapid changes have been occurring in banking in recent years -- for example, in such developments as the growth of bank-related activities across State lines through holding companies, innovations in the payment system and the growing importance of international operations in the activities of large banks -- and there is no reason to assume that this process will decelerate. A single Federal banking agency may be in better position to command the technical and specialized

resources and to exercise the administrative flexibility necessary to cope with this changing environment.

ARGUMENTS AGAINST A SINGLE, ALL-POWERFUL FEDERAL BANK REGULATORY AGENCY:

1. The Present System Has Worked Reasonably Well. Despite what appears to be a cumbersome structure on paper, the present system, for the most part, has worked well. In considering the substantial revision necessary to bring about a single all-powerful agency, it is important to realize that this would involve a considerable disruption in orderly operations and that it might take years for a smooth-running agency to be established. The cost of this disruption should be weighed against the assumed benefits of such a single agency.

2. Such an Agency Will Not be a Panacea. A single all-powerful agency will not assure uniform and quality performance in all examinations and in all supervisory activities. Quality differences will persist. Our own study of the examination process suggests that there are regional and quality differences within each agency which may exceed interagency differences. With respect to improving the flow of information, greater interagency coordination, even within the present system, might accomplish much of what could be accomplished through a single agency. Under the present system there may be considerable room for improving examination techniques and improving the allocation of supervisory resources, and we have been

devoting considerable effort in this direction at the FDIC. However, a single agency will not, by itself, bring about such improvements.

3. Concentration of Power and the Elimination of Regulatory Choice.

Creating a single, all-powerful agency would concentrate an extraordinary amount of power within a single unit of government. Banks and the public could be subject to relatively arbitrary or relatively inflexible behavior. One advantage of the present system or one containing more than a single agency is that such a system provides Congress and the agencies themselves with an informed group of potential critics which have no vested financial interest in the outcome of a particular course of action. This is a luxury that has not always been available in the case of other Government regulatory agencies, whose critics generally have come from the industry being regulated.

While the existing Federal and State agencies have at times appeared to be competing in their attempts to accommodate banks under their immediate supervision, differences in agency policy, sometimes influenced by the threat of a shift in supervisor(s), have also performed a positive role in limiting unreasonable, inflexible or arbitrary behavior on the part of one or more of these agencies. Not all "agency shopping" has been contrary to the public interest. Indeed, there are numerous instances where the opposite has occurred, where the initial agency was not sufficiently receptive to public need or changing practice or where it was too strongly influenced by the existing banking establishment, as for example in its chartering or branching policies. In such instances a change of supervisory authority by the dissatisfied

bank or its organizers may well have been in the public interest. The availability of a choice among supervisory authorities has, of course, been the lifeblood of the so-called dual banking system in this country.

4. Benefits of Diversity. While a single, all-powerful agency could more readily support specialized training and research, this may be outweighed by the potential benefits from the diversified and somewhat independent efforts of three separate Federal agencies, just as it is by the diversified and independent efforts of some State banking departments. There may be a greater tendency to experiment and to be receptive to change with three such agencies than with only one, since the odds are high that at least one of the three might be receptive to experimentation and change at any point in time. This is likely to be the case not only from the standpoint of developing examination and supervisory techniques, but also from the standpoint of accepting and encouraging innovation in banking practices. In the past this potential for flexibility and experimentation has produced substantial public benefit, and it is likely to do so in the future.

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Director LeMaistre and I ^{*/} believe it would be a grave mistake to consolidate the existing powers of all three Federal bank agencies into one single, all-powerful agency of the type described, largely because we believe

^{*/} The Comptroller of the Currency, who serves ex officio as the third member of the FDIC Board of Directors, has previously expressed to the Subcommittee his views on the general subject of bank regulatory reform, and reference is made to pages 1-5 of his statement of July 17, 1975, for an accurate statement of his position.

it would eliminate any meaningful choice between the regulatory options now available to the nation's insured banks. We believe that over the years the banking public has benefitted from the flexibility in chartering and supervision which that choice entails and that it should not be lightly discarded.

Such a consolidation represents one extreme, however, of the broad spectrum of proposals which might appropriately be considered by the Congress if it determines that significant change should be made in the existing structure of bank regulation at the Federal level. We believe, for example, that it may be possible to achieve many of the advantages of greater centralization without giving up the meaningful regulatory choice to which we have referred.

We have no specific proposal to lay before you today that would, in our judgment, accomplish this intermediate result, but we have asked our staff to continue their efforts to see if a feasible and detailed proposal can be developed that would meet our two objectives as well as the needs of other legitimate regulatory interests, such as the formation and implementation of monetary policy. Should those efforts prove successful, you may be sure that the results will be brought to the Subcommittee's attention.

I would conclude by stating that the FDIC is not wedded to the existing bank regulatory structure. It is quite prepared to see its own powers and responsibilities significantly changed if the Congress believes such changes are likely to lead to a more rational system of bank regulation in behalf of the American public. This is a complex area, however, for legislative reform, and I would urge the greatest care and deliberation on the part of the Subcommittee as it proceeds.