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Testimony by

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I am happy to be here to discuss the topic of regulatory burden and particularly the efforts of the Federal Reserve and the other bank regulatory agencies to reduce burden administratively.

The issue of the appropriate level of regulation of banking organizations, although not new, recently has been a focus of concern. Banking institutions serve a vital role in determining the growth of the economy. Consequently, in an increasingly global and competitive financial market, the U.S. can ill afford to handicap its banking institutions -- and therefore the individuals and businesses they serve -- with stifling and constantly changing rules and regulations. The ever-increasing number and detail of regulatory requirements and restrictions have increased the costs and reduced the availability of service from banking institutions. Further, aggregate burden frustrates the purpose of stability and safety regulations by driving traditional banking functions toward alternative, less regulated providers.

In an effort to counter the trend toward costly over-regulation, the banking agencies have worked both individually and as a group to identify administratively imposed burden and, insofar as possible, to reduce it. These efforts are represented in initiatives such as the agencies' "Regulatory Uniformity Project," the Federal Financial Institutions Examination

Council's (FFIEC) "Study on Regulatory Burden," and, most recently, last week's announcement by the President of an interagency program designed to reduce the cost and burden of lending, particularly to small and medium-sized businesses.

The Interagency Policy Statement on Credit Availability

On March 10, the President announced that all of the banking regulatory agencies will, over the next few months, take actions in five areas to promote greater availability of credit to credit-worthy borrowers. The actions to be taken in each of the areas are as follows:

> Eliminate impediments to small and medium-sized business lending by permitting banks to make and carry a basket of loans to such borrowers with minimal documentation requirements. In addition, guidance will be issued to make it clear that banks and thrifts, in making loans to such borrowers, particularly those loans to be placed in the basket, are encouraged to give important consideration to character and general reputation in assessing a borrower's credit worthiness.
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> Reduce appraisal burden and improve the climate for real estate by altering existing rules so that institutions taking real estate as "additional" collateral for a business loan that is not to acquire or refinance real estate will not be required to have such property appraised by a certified or licensed appraiser. In addition, the agencies will be re-examining their existing rules to make sure that thresholds below which formal appraisals are not needed are at reasonable levels.
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> Enhance and streamline arrangements by which bankers can obtain a fair and speedy review of complaints about examiner decisions, while providing assurance that neither banker nor examiner will be subject to retribution as a result of an appeal.
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> All examination processes and procedures are to be improved by eliminating unneeded duplication of examinations and increasing coordination of examination activities, particularly centralizing and streamlining examinations of multibank organizations. The agencies have also agreed to

heighten emphasis in examinations on risks to the institution and to issues involving fair lending, as well as to reduce regulatory uncertainty by eliminating ambiguous language in regulations and interpretations -- and delays in publishing regulations and interpretations.

All regulations and interpretations are to be reviewed to find ways to minimize paper work and other regulatory burden.

We certainly expect that these changes will affect the willingness of the banking industry to lend to creditworthy borrowers, and we are working together to implement them fully.

The FFIEC Study on Regulatory Burden

I have been asked by the Subcommittee to describe the agencies' recently completed Study on Regulatory Burden. The study, mandated by Congress in Section 221 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), required the FFIEC to review the regulatory policies and procedures of the banking agencies and the Treasury Department to determine whether they impose "unnecessary" burden on banking institutions, and to identify any revisions that might reduce burden without endangering safety and soundness or diminishing compliance with or enforcement of consumer laws. The FFIEC was directed to report its findings by December 19, 1992.

During early 1992, the four federal banking agencies and the Department of the Treasury undertook extensive internal reviews of their policies, procedures, recordkeeping and documentation requirements. In addition, an interagency task force assembled and reviewed the public comments that the Federal

Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) had received in response to their Spring 1992 requests for comments on regulatory burden. The FFIEC also requested and received public comments specifically on ways that burden might be reduced and held public hearings on this topic in Kansas City, San Francisco, and Washington, D.C.

At the outset, the FFIEC stated its belief that the goal of this process was not to examine and develop proposed revisions to the overall statutory scheme governing financial institutions. Rather, it appeared to the Council that the Congressional intent was to accept the statutory scheme as a given and instead to examine the manner in which the federal banking agencies and the Treasury Department have implemented that scheme by means of regulations, policy statements, procedures and recordkeeping requirements.

Many commenters, as well as the agencies themselves, recommended changes which were within the jurisdiction of the agencies. During the year, the agencies acted on many of these suggestions for regulatory improvement, particularly those related to required reports, examination procedures, and application processes. The study included a summary of those actions.

Interagency working groups reviewed other specific recommendations for regulatory change and divided them into three categories. The first category included specific recommendations

from the public and areas of concern that the FFIEC agreed were worthy of further consideration. In many cases, the agencies agreed on the general approach and developed a consensus position which is described in the study. In some cases, an agency supported a recommendation in part or preferred an alternative approach to meet the goal of the recommendation, and in a few cases, the agencies felt that further consideration and possibly some compromise may be required to address the issues.

Other suggestions from the public which, after careful consideration, were found not to meet fully the standards set forth in Section 221 are discussed in the study while those that concerned non-Council member agencies are simply listed. In addition, an analysis of the public recommendations concerning the rules implementing the Bank Secrecy Act (BSA) was contributed by the Department of the Treasury.

During the course of the study, the FFIEC also reviewed the small number of existing studies of the costs of regulation. Despite methodological and coverage differences, their findings are reasonably consistent that regulatory costs might be in the range of 6 to 14 percent of non-interest expenses. This estimate includes the cost of deposit insurance premiums, but does not include any measurement of the opportunity cost of reserve requirements or prohibited activities. This range applied to the actual 1991 non-interest expenses for commercial banks of \$124.6 billion suggests that regulatory costs could have been between \$7.5 and \$17 billion in that year.

In the weeks since the study was submitted to the Congress, the agencies have continued to consider the suggestions, and I anticipate that further action will be taken in the near term. However, many of the public recommendations as well as the actions taken by the regulatory agencies address problems which are technical in nature and not highly significant in terms of their impact on total regulatory burden. Indeed, significant relief from regulatory burden will require more substantial changes. Because legislation is often very detailed in its requirements and the regulations must track the statutory provisions, the agencies are limited in their ability to address many provisions which impose substantial burdens.

Accordingly, the Council's member agencies have agreed to continue meeting to identify and recommend possible statutory changes to reduce regulatory burden further. The Council hopes to provide a separate report to Congress on those issues by late spring.

Recommendations for the Future

Banking institutions are regulated because of important public policy considerations, and much of the regulation arises ultimately from four fundamental public policy concerns: bank safety and soundness, banking market structure and competition, systemic stability, and consumer protection. The safety and stability of the banking system is vital to the economy. Further, it is difficult to quarrel with the purposes of

individual consumer protections. Nevertheless, the aggregate effect of the implementation of a substantial number of desirable policies may result in burdening individual banking transactions to an unacceptable degree.

In the aggregate, this burden has become substantial, raising the costs of banking services and thus encouraging bank customers to seek less costly loans and services or higher-yielding investments from other financial intermediaries that are not subject to the same regulatory requirements and restrictions. The movement of business from banking institutions to other intermediaries and directly to money and capital markets may frustrate the purposes for which banking regulations were adopted. I believe this burden has already begun to threaten the competitiveness of the banking industry itself.

What is needed is fundamental review of approaches to regulation in search of mechanisms that will achieve the same goals but with less burden and without the problems which accompany the current approach. New approaches to regulation which are more sensitive to cost/benefit tradeoffs must be sought and considered. In particular, existing market forces and incentives should be harnessed as much as possible to achieve regulatory goals, rather than relying on micro-level regulations that eliminate the flexibility that is important in a dynamic industry. We should consider, as well, changes that can reduce burden by reducing regulatory prohibitions on banking activities. As you know, the Federal Reserve Board has long supported

nationwide interstate banking, insurance sales and full investment banking powers to provide the public the benefits of wider competition, and it supports the payment of interest on required reserves to reduce the costs imposed on banking institutions as regulated entities.

To the greatest extent possible, banking regulation should provide flexibility by tailoring requirements to specific facts and circumstances and by distinguishing among institutions according to meaningful criteria such as condition, size, and management competence. Regulations that provide insufficient flexibility can cause unnecessary regulatory burden and create inefficiencies by preventing depository institutions from finding the most cost-effective means of complying with the law or regulation and by impairing the ability of banking institutions to react to changing market conditions.

These approaches must be applied not only to future regulatory actions, but to existing regulations as well. Efforts to reduce regulatory burden substantially will undoubtedly raise difficult questions about the tradeoffs to be made between competing public policies, much like the on-going discussion of the federal budget. Because achieving political consensus for change may be difficult, in my judgement, an independent nonpolitical commission charged with exploring possibilities for legislative change would be useful. Such a commission could address a broad range of banking issues, such as regulatory burden and the competitive position of U.S. banking

organizations, offer suggestions and guidance for legislative and regulatory changes, and assist Congress in developing a specific legislative agenda.

Conclusion

The regulatory burden on banking institutions is large and growing. The **cumulative** regulatory burden on the banking industry may well be more than the sum of its parts. This burden has grown slowly but relentlessly over the years, layer by layer by layer, and the pace of additional regulation has increased sharply in recent years. While there may be genuine public policy benefits from any single regulatory proposal, it is important to recognize that the banking regulations and prohibitions, taken together, create a burden that is substantial, if not approaching unmanageable, for many institutions. When aggregated, these burdens affect the economy by reducing the efficiency and competitiveness of the banking industry.

Recent actions by the regulatory agencies and the plan announced by the President represent important steps in an ongoing process to address the problem of regulatory burden on the banking industry, and I look forward to working with this Subcommittee and others in considering additional proposals. Perhaps regulatory relief, like regulatory burden, can be cumulative.