Research Department
Federal Reserve
Bank of
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FRBSF Weekly Letter

Reorganization?

Following 14 months of deliberation, the Task Group on Deregulation of Financial Services headed by Vice President George Bush recently made its recommendations for changes in the federal bank supervisory and regulatory structure. Over the years a number of proposals for revamping this structure have been advanced, including several which found accommodation in formal legislative proposals. They invariably generated considerable controversy and, with one exception, failed of adoption. Nevertheless, in the view of the Bush Task Group, the requirements of a rapidly changing financial environment now justify a modification of the present bank supervisory and regulatory apparatus. This *Letter* will discuss the Task Group's recommendations, and some previous proposals for reorganization.

The current system

When the Task Group commenced its investigations early last year, it noted that the current system of Federal Regulation of financial institutions and services is highly complex and fragmented, the end-product of a series of piecemeal changes made in response to specific problems or perceived needs as they arose over the last 60 years.

Under the present system, three separate federal agencies regulate commercial banks —the Office of the Comptroller of the Currency (in the Treasury Department), which exercises primary supervisory and examination authority over some 4,600 national banks, the FDIC, with primary authority over some 8,900 state-chartered banks that are not members of the Federal Reserve System (plus some 330 mutual savings banks), and the Federal Reserve, which exercises primary authority over approximately 1,000 state-chartered member banks.

Under the Bank Holding Company Act the Fed also regulates all bank holding companies (about 5,000 in number), including those whose *banks* are regulated by the Comptroller and the FDIC. This includes exclusive authority to define what activities are so "closely related to banking" or an "appropriate incident thereto" as to be permissible for the holding companies' nonbank subsidiaries. Under Congressional mandate, the Fed also exercises authority over Edge Act and international banking activities, and has rule-writing authority for a host of consumer protection laws such as Truth in Lending and Equal Credit Opportunity.

Finally, the Federal Home Loan Bank Board and Credit Union National Association exercise federal authority over the nation's savings and loans and credit unions, respectively, while each of the fifty states has its own authority for supervising and regulating state-chartered banks and thrifts.

Bush proposals

The Bush Task Group's recommendations would, in its estimation, result in a substantial modification of the current *bank* regulatory system in a manner that would "significantly benefit the public" by reducing unnecessary overlap and duplication, waste and inefficiency. In conjunction with pending legislative proposals, which would permit a greater deregulation of financial services, the Task Group also believes that adoption of its recommendations also would encourage innovation and competition in the provision of financial services.

The Federal Banking Agency

The main recommendation of the Task Group is that a Federal Banking Agency (FBA) be created to replace and assume the responsibilities of the Comptroller within the Treasury Department. It would supervise, examine and regulate all federally chartered (national) banks and all but some

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35 of the largest or "international class" bank holding companies whose lead bank is a national bank. It also would assume, from the Board of Governors, authority to define those non-banking activities that are permissible for a holding company's non-bank subsidiaries.

For its part, the Fed would relinquish its present rule writing authority but would still be empowered to comment on the proposed "permissible activities" (and implementing regulations) *prior* to their publication by the FBA. And, by a vote of five of the seven members of the Board of Governors, it could veto the FBA's regulations if it determined that their adoption would (1) impair the stability of the U.S. banking system, or (2) have a seriously adverse effect on safe and sound financial practices.

The FDIC
The FDIC would be limited to activities related to its deposit insurance function, and would forego general supervisory authority over state-chartered banks. However, it would retain its authority to examine banks for insurance purposes, keeping the authority to deny or revoke insurance, and to set premium levels in relation to the riskiness of a bank's assets. In essence, this means that its examination activities would focus on troubled banks.

The Fed
The Fed would retain direct authority for supervising, examining and regulating some 50 so-called "international class" bank holding companies. These entities, which include the 35 whose lead bank is federally chartered and 15 whose lead bank is state-chartered, are defined by the Bush Task Group as those which (1) own or control U.S. banks with foreign branches or "material" foreign banking subsidiaries; (2) have assets which aggregate more than a half percent of the assets of all (domestic) bank holding companies; or (3) are a foreign bank or a foreign holding company which owns or controls either a U.S. bank *or* a foreign bank with branches, agencies or banking subsidiaries in the United States.

In addition, the Fed initially would continue to regulate bank holding companies whose lead bank is state-chartered, and initially would assume responsibility (from the FDIC) for the supervision, examination and regulation of approximately 8,900 state-chartered non-member banks (which together with state member banks hold 40 percent of the total assets of banks in the U.S.).

"Certification" program
The word "initially" is significant because the Task Group recommendations postulate that "to the maximum degree practical and prudent," the Fed, in conjunction with the FBA and FDIC, is to establish a "certification" program specifying the criteria and standards under which state authorities would assume the responsiblity for exercising current federal examination and supervision authority over state chartered banks *and* bank holding companies.

The criteria and standards to be established for "certifying" a state authority are to be adopted by majority vote of a committee consisting of the FBA, the FRB, and the FDIC. The Board of Governors, "in consultation" with the other two agencies, would act on specific applications for certification by a state authority, but the FDIC could veto certification applications as well as the Board's certification decisions, and also could recommend the revocation of certification decisions at any time. Subsequent to the certification, the Board would exercise oversight authority including, in the case of state regulation of bank holding companies, the right to review and disapprove state decisions which are considered to be inconsistent with federal law or regulation. In the event or to the extent that a state is not certified, the Fed would exercise responsibility for the federal supervision and regulation of that state's banks *and* state-chartered holding companies.

...and the thrifts
Finally, recognizing that in an era of rapidly progressing deregulation and homogenization of financial services the differences

MONETARY POLICY OBJECTIVES FOR 1984

Federal Reserve Chairman Paul Volcker presented a report to the Congress on the Federal Reserve's monetary policy objectives for 1984 on February 7. The report includes a summary of the Federal Reserve's monetary policy plans along with a review of economic and financial developments in 1983 and the economic outlook in 1984. Single or multiple copies of the report can be obtained upon request from the Public Information Department, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, CA 94120. Phone (415) 974-2246.

between commercial banks and thrifts rapidly is being obliterated, the Task Group recommends that the nation's savings and loan associations continue to be subject to supervision and regulation by the Federal Home Loan Bank Board only if they maintain a given proportion (not specified) of their assets in the financing of housing.

In summary, while none of the existing federal banking agencies would be *eliminated*, adoption of the Task Group's recommendations would result in a substantial reallocation of the three *banking* agencies' present functions, including a reduction from three to two in the number of agencies involved in day-to-day supervision.

Past efforts at reform

Recent history is littered with the bones of numerous proposals to revamp the supervisory and regulatory structure. Consolidation of bank supervisory and regulatory functions into the Fed was recommended in 1949 by the Hoover Commission and by the Commission on Money and Credit in 1961, except that the latter advocated a separate agency to supervise all federal thrift institutions. In 1962, President Kennedy's Advisory Committee on Banking (the "Saxon Committee") recommended that the Fed be divested of *all* supervisory and regulatory responsibilities except those pertaining to monetary policy. In the same year, Governor Robertson proposed the establishment of a single Federal Banking Commission to handle all supervisory and regulatory matters (on which the Fed would have one member), thereby limiting the Fed to the conduct of monetary policy.

In 1974, Chairman Burns of the Board of Governors called the bank supervisory system "a jurisdictional tangle that boggles the mind" but warned of the threat to innovation and flexibility that would result from the concentration of power in a *single* regulatory agency. The Financial Institutions Regulation Act, enacted late in 1978, established the inter-agency Federal Financial Institutions Examination Council to solve this problem. However, the Council recently was criticized by the General Accounting Office for not having achieved its objectives of bringing about greater uniformity in examination and supervisory procedures and reporting forms among its member agencies.

Initial response

The Task Group's recommendations by all counts will be drafted into legislative form for submission to the Congress fairly soon, and will have the endorsement of the Administration. Chairman Volcker has said that the recommendations "adequately reflect the concerns of the Federal Reserve" for maintaining an effective presence in the supervisory and regulatory process. This is essential, he noted, to the implementation of the System's other responsibilities, inasmuch as monetary policy and supervisory and regulatory policies all affect bank liquidity and the viability of the financial structure.

Nevertheless, the denouement of the Task Group's recommendations is uncertain, as the reception they have received in the Congress thus far has been less than overwhelmingly enthusiastic.

Senate Banking Chairman Jake Garn (R-UT) credits the proposals as a "heck of a good starting point," but questions the need for the Fed to be directly involved in regulatory matters in order to conduct monetary policy; he also argues that Congress should decide what services institutions should be allowed to offer "before we decide who regulates." The Senate Banking Committee's ranking minority member, William Proxmire (D-WI), has called the Task Group proposals "an ill-disguised power grab over bank regulation by the Reagan Administration." Others still ask "what consolidation?", while yet others appear inclined toward the traditional view, "if it isn't broken, don't fix it."

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding	Change from	Change from year ago Dollar	Percent
Loans, Leases and Investments[1 2]				
Loans and Leases[1 5]				
Commercial and Industrial				
Real estate				
Loans to Individuals				
Leases				
U.S. Treasury and Agency Securities[2]				
Other Securities[2]		Due to reporting delays table is not available this week.		
Total Deposits				
Demand Deposits				
Demand Deposits Adjusted[3]				
Other Transaction Balances[4]				
Total Non-Transaction Balances				
Money Market Deposit Accounts—Total				
Time Deposits in Amounts of $100,000 or more				
Other Liabilities for Borrowed Money[5]				

Weekly Averages of Daily Figures	Week ended	Week ended	Comparable year-ago period
Reserve Position, All Reporting Banks			
Excess Reserves (+)/Deficiency (−)			
Borrowings			
Net free reserves (+)/Net borrowed(−)			

1 Includes loss reserves, unearned income, excludes interbank loans
2 Excludes trading account securities
3 Excludes U.S. government and depository institution deposits and cash items
4 ATS, NOW, Super NOW and savings accounts with telephone transfers
5 Includes borrowing via FRB, TT&L notes, Fed Funds, RPs and other sources
6 Includes items not shown separately

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