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The Debate On The Structure Of Federal Regulation Of Banks

Federal Deposit Insurance Corporation
Federal Reserve System
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Department of the Treasury

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Contents

CHAPTER 1

INTRODUCTION

There has been much public debate by congressional committees, trade associations, Government advisory groups, academicians, and the regulators themselves on whether the current Federal structure for regulating commercial banks should be changed.

We have recently completed a study of the effectiveness of the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve System (FRS), and the Office of the Comptroller of the Currency (OCC) in supervising commercial banks. ("Federal Supervision of State and National Banks," OCG-77-1, and "Highlights of a Study of Federal Supervision of State and National Banks," OCG-77-1a, Jan. 31, 1977.)

The GAO study was undertaken at the request of several congressional committees. Primarily, we were asked to evaluate the agencies' efforts to (1) identify unsound conditions and violations of laws and regulations in banks, and (2) cause bank management to take corrective actions. We were not asked to determine whether the Federal bank regulatory agencies should be reorganized. Thus, we have not attempted to determine the "ideal" organizational structure for regulating banks. During the course of our study, however, we gained some perspective on the debate about the need to reform the present system. For example, our report pointed out several areas where the three agencies should be working together more closely.

As part of our study, we reviewed numerous studies, congressional hearing records and reports, and other documents pertaining to the Federal bank regulatory structure. The purpose of this paper is to briefly summarize these discussions and proposals for restructuring and to present our observations.

THE EXISTING REGULATORY STRUCTURE

The discussion in this paper is primarily limited to FDIC, FRS, and OCC--the three Federal agencies that regulate and supervise commercial banks. However, some proponents of change have also included other Federal regulatory agencies in their proposals:

--The Federal Home Loan Bank Board, which charters, regulates, and supervises savings and loan associations, and directs the operations of the Federal Savings and Loan Insurance Corporation and the Federal Home Loan Mortgage Corporation.

--The National Credit Union Administration, which charters, insures, and supervises Federal credit unions and may also insure State-chartered credit unions.

FDIC, FRS, and OCC have similar supervisory responsibilities. Their structure is also similar, but FRS is less centralized. The agencies receive no congressional appropriations but rely essentially on the banks they supervise and their investments in U.S. Government securities for operating funds.

OCC was established in 1863. The Comptroller of the Currency, who performs his duties under the general direction of the Secretary of the Treasury, is appointed by the President and confirmed by the Senate for a term of 5 years. To carry out its responsibilities, OCC has approximately 2,000 bank examiners, based in 14 regional offices and 143 subregional offices.

FRS was established in 1913 to carry out monetary policy and improve the supervision of banking in the United States, as well as provide various central banking services for banks and the U.S. Government. FRS bank supervision is carried on by the Board of Governors and the 12 Federal Reserve banks and their 25 branches. The Reserve banks operate as relatively autonomous units with their own staffs and budgets, and each has a supervision or examination department. FRS has about 700 bank examiners.

FDIC is an independent agency created in 1933 to insure small depositors against losses resulting from bank failures. Management of FDIC is vested in a Board of Directors consisting of three members, one of whom, by law, is the Comptroller f the Currency. It has 14 regional offices and about 150 sub-offices.

The three agencies have several functions in common with respect to banks for which they are the primary supervisor:

--Monitor and examine banks to determine whether they are being operated legally and soundly.

--Approve or deny applications for structural and other changes, such as branches, mergers, and relocation.

--Administer securities registration requirements (under the Securities Exchange Act of 1934).

In addition each agency has certain unique bank regulatory functions. As supervisor of national banks the Comptroller:

--Charters national banks.

--Issues rules and regulations governing the corporate structure of national banks and their lending and investment practices.

--Determines when national banks become insolvent and appoints FDIC to be the receiver for such banks.

The Federal Reserve:

--Admits State-chartered banks to membership in FRS.

--Determines margin requirements, that is, the amount of credit that may be extended to purchase or hold equity securities.

--Establishes maximum interest rates that member banks may pay on savings and time deposits.

--Regulates the foreign activities of all member banks.

--Regulates the activities of bank holding companies.

--Establishes rules for all banks to disclose interest rates and terms of repayment ("truth in lending").

FDIC is authorized to:

--Approve or deny applications from State-chartered banks for deposit insurance. National banks receive FDIC insurance with their charters as do State banks with FRS membership, and therefore, do not require FDIC approval.

--Act as receiver for all insured banks which close.

--Operate special deposit insurance national banks for up to 2 years to provide limited banking services to communities where banks have closed.

--Purchase assets from, make deposits in, or extend loans to any insured banks which have closed or are in danger of closing.

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As of December 31, 1975, 4,744 national banks and 9,640 State banks were insured by FDIC. All national banks and 1,046 State banks were members of FRS. FDIC has statutory authority to examine all insured banks, FRS has statutory authority to examine all member banks, and OCC has statutory authority to examine all national banks. As a matter of practice FDIC examines only insured State banks that are not members of FRS, FRS examines only State member banks, and OCC examines national banks.

CHAPTER 2

RESTRUCTURING PROPOSALS

Since the passage of the Federal Reserve Act in 1913, restructuring proposals have centered on the following possibilities:

1. Consolidate Federal bank supervision in the Federal Reserve System.

2. Consolidate supervision in the Federal Deposit Insurance Corporation since a principal purpose of bank examination is protecting the insurance fund.

3. Consolidate supervision in the Department of the Treasury as the "logical" center of financial policymaking in the Federal Government.

4. Consolidate supervision in a new agency such as a "Federal Bank Commission."

5. Consolidate supervision of all State banks in a new agency, retain the Office of the Comptroller as supervisor of national banks, and keep the Federal deposit insurance program separate from the two supervisory agencies, or establish an overall coordinating council.

There are also variations of the above restructuring possibilities which, for example, retain FDIC as a separate agency and consolidate OCC and FRS bank examination activities into a new agency. To consolidate bank supervision generally, and examination specifically, in one new or existing agency does not necessarily mean that the other agencies must be abolished. At least one proposal has called for consolidating examination in FDIC but retaining FRS and OCC by redefining their supervisory functions.

Finally, there are less drastic proposals which seek to improve coordination and cooperation between the agencies. One recent proposal was to create a Federal Bank Examination Council and leave unchanged the present Federal bank regulatory agencies. The Council would establish uniform Federal bank examination standards and procedures and recommend further improvements in bank supervision. (See ch. 4.)

The following chart summarizes many of the restructuring proposals which have been made over about the last 60 years. Following this chart each proposal is briefly described.

SUMMARY OF RESTRUCTURING PROPOSALS

Centralize All or Some Federal Bank Supervision or Policymaking in One of The Following Agencies

	FRS	FDIC	Treasury	Bank Commission	New Agencies
1. 1919-21--Legislative proposals, 66th and 67th Congresses	X				
2. 1937--Brownlow Committee report			X		
3. 1937--Brookings Institution report		X			
4. 1938--Legislative proposal, 75th Congress			X		
5. 1939--Legislative proposals, 76th Congress		X			
6. 1949--Hoover Commission report			X		
7. 1961--Commission on Money and Credit report	X				
8. 1962--OCC Advisory Committee on Banking report			X		
9. 1962--FDIC Chairman Cocke's plan		X			
10. 1963--Legislative proposal, 88th Congress				X	
11. 1965--Legislative proposal, 89th Congress			X		
12. 1965--Legislative proposal, 89th Congress				X	
13. 1965--Independent Bankers Association of America plan		X			
14. 1969--Legislative proposal, 91st Congress				X	
15. 1971--Hunt Commission report					X
16. 1974--FRS Governor Sheehan's plan	X				
17. 1975--FDIC Chairman Wille's plan					X
18. 1975--Financial Institutions and Nation's Economy recommendation				X	
19. 1975--Legislative proposal, 94th Congress				X	
20. 1976--Legislative proposal, 94th Congress				X	
21. 1976--Legislative proposal, 94th Congress					X
22. 1977--Legislative proposal, 95th Congress					X
23. 1977--Legislative proposal, 95th Congress				X	

PROPOSALS TO RESTRUCTURE FEDERAL BANK SUPERVISION

1. 1919-1921. Legislative proposals, 66th and 67th Congresses.

Under the Federal Reserve Act of 1913, national banks automatically became members of the new Federal Reserve System. Supervision of Reserve member banks was thus divided between two Federal agencies. Between 1919 and 1921 at least four bills were introduced in either the House or Senate to end this division of supervisory responsibility by abolishing OCC and transferring its examination and supervisory functions to FRS.

2. 1937. Brownlow Committee report.

The President's Committee on Administrative Management (Brownlow Committee) recommended that each Government corporation (such as FDIC) "should also be placed under a supervisory agency in the appropriate department." Presumably FDIC would have been placed in the Department of the Treasury. Since OCC was already a bureau within the Department of the Treasury, this recommendation would have partly centralized bank supervision in Treasury. FRS would have continued as a separate agency.

3. 1937. Brookings Institution report.

A Brookings Institution report, "Investigation of Executive Agencies of the Government," took the view that bank examination was more important to FDIC than to OCC or FRS because of the need to protect the insurance fund. It recommended abolishing OCC. All insured banks, including members of FRS, would have been examined by FDIC. FDIC would have chartered national banks subject to an FRS veto. FDIC would have had similar veto power over State banks wishing to join the Federal Reserve System. While the supervisory functions of FRS would have been transferred to FDIC, FRS would have had access to the examination reports of Reserve member banks, and would have been permitted to make special purpose examinations.

4. 1938. Legislative proposal, 75th Congress.

A Senate bill was introduced which would have transferred all the bank supervisory functions of FRS and FDIC to OCC, which would have been renamed the "Federal Bureau of Examination and Supervision" within the Treasury Department. The deposit insurance function of FDIC would have been vested in a "Federal Bureau of Insurance," also within the Treasury Department.

5. 1939. Legislative proposals, 76th Congress.

A House bill was introduced which would have abolished OCC and transferred its functions to FDIC. A Senate bill was introduced to give the examination functions of FRS and OCC to FDIC.

6. 1949. Hoover Commission report.

The various task forces of the Commission on Organization of the Executive Branch of the Government (Hoover Commission) made the following recommendations:

--The Task Force on Fiscal Budgeting and Accounting Activities suggested that OCC "more properly belongs under the Federal Reserve Board than in the Treasury Department."

--The Task Force on Lending Agencies suggested that FDIC functions be transferred to FRS. The task force did not study OCC, but its report stated that, if it had, it would have suggested transferring OCC functions also to FRS.

--The Task Force on Regulatory Commissions suggested that all Federal bank supervision be combined, preferably in FRS.

The Hoover Commission itself recommended that FDIC be transferred to the Treasury Department. The Commission also recommended creating a National Monetary and Credit Council to coordinate bank supervision by the Treasury Department and FRS.

7. 1961. Commission on Money and Credit report.

The Commission on Money and Credit, established by the Committee for Economic Development, a private study group, recommended that the supervisory functions of OCC and FDIC be transferred to FRS.

8. 1962. OCC Advisory Committee on Banking report.

The Comptroller of the Currency's Advisory Committee on Banking recommended that the sole Federal regulatory authority over insured State banks be vested in FDIC, which would be reorganized under a single administrator and transferred to the Treasury Department. Authority to approve branches of State banks would be vested in State authorities. The Committee's report did not discuss how FRS would obtain bank examination information which might be needed to discharge its monetary function.

9. 1962. FDIC Chairman Cocke's plan.

The Chairman of FDIC, Erle Cocke, suggested that FDIC be given overall responsibility for examining all federally insured banks. FDIC would have alternated with OCC for examining national banks and with State banking authorities for State insured banks. FRS would have made no examinations, but it would have received examination reports for all Reserve member banks.

10, 12, and 14. 1963, 1965, and 1969. Legislative proposals, 88th, 89th, and 91st Congresses.

Various House and Senate bills were considered which would have combined the examination and supervisory functions of FRS, FDIC, and OCC in a new agency called the Federal Banking Commission.

11. 1965. Legislative proposal, 89th Congress.

A House bill was introduced which would have transferred the bank examination and supervision function of FRS, FDIC, and OCC to the Secretary of the Treasury.

13. 1965. Independent Bankers Association of America plan.

The Independent Bankers Association of America recommended that FRS be relieved of its examination functions, which apparently would have been transferred to FDIC. FDIC would have alternated with OCC for examining national banks and with State banking authorities for State insured banks.

15. 1971. Hunt Commission report.

The Presidential Commission on Financial Structure and Regulation (Hunt Commission) recommended establishing

--an "Administrator of National Banks" incorporating OCC's supervisory responsibilities,

--an "Administrator of State Banks" incorporating FRS's and FDIC's supervisory responsibilities, and

--an "Federal Deposit Guarantee Administration" incorporating FDIC's insurance responsibilities.

Unlike various proposals to vest supervisory authority in a multi-member commission, the Hunt Commission was attracted to the single administrator idea.

16. 1974. FRS Governor Sheehan's plan.

A member of the FRS Board of Governors, John E. Sheehan, suggested that all Federal bank examination and supervision be centralized in the Federal Reserve System. Governor Sheehan cited the structure of FRS, "with its seven-man Board of Governors--with long terms" and its insulation from "short-run political pressures" as one reason for locating regulatory responsibility in FRS.

17. 1975. FDIC Chairman Wille's plan.

The Chairman of FDIC, Frank Wille, suggested that the examination and supervisory functions of FDIC and FRS be merged into a new agency under a single administrator. He also proposed a five-member Federal Banking Board with power to implement a "uniform national policy" for bank regulation.

18. 1975. FINE study report.

A study conducted by a subcommittee of the House Committee on Banking, Currency and Housing, entitled "Financial Institutions and the Nation's Economy" (FINE), recommended establishing a "Federal Depository Institutions Commission" which would have combined the supervisory and examination functions of FDIC, FRS, OCC, the Federal Home Loan Bank Board, and the National Credit Union Administration.

19. 1975. Legislative proposal, 94th Congress.

A Senate bill (S. 2298) was introduced which would have combined the examination and supervisory functions of FRS, FDIC, and OCC in a new agency called the Federal Bank Commission.

20. 1976. Legislative proposal, 94th Congress.

The Financial Reform Act of 1976, derived from hearings held on the 1975 FINE study, was introduced as a House Banking, Currency and Housing Committee print. The act would have established a Federal Banking Commission, merging OCC and FRS supervisory responsibilities, including those for bank holding companies. FDIC would have continued as an independent agency.

21. <u>1976. Legislative proposal, 94th Congress.</u>

A Senate bill (S. 3494) was introduced which would have established a Federal Bank Examination Council. The Council would have prescribed uniform standards and procedures for Federal bank examinations, conducted schools for bank examiners, developed uniform reporting systems, and made recommendations for uniformity in other supervisory matters.

22. <u>1977. Legislative proposal, 95th Congress.</u>

Resubmission of S. 3494 which would establish a Federal Bank Examination Council, as S. 711.

23. <u>1977. Legislative proposal, 95th Congress.</u>

A Senate bill substantially identical to S. 2298 was introduced to establish a Federal Bank Commission. This bill (S. 684) would, in the words of its sponsor, "*** preserve and strengthen *** the dual banking system ***" by accepting bank examinations made by State authorities in lieu of Commission examinations.

CHAPTER 3

ARGUMENTS FOR AND AGAINST A SINGLE AGENCY

Many proposals have been made to restructure the bank regulatory system, usually in one existing agency (for example, the Department of the Treasury) or a new agency, such as a "Federal Bank Commission."

This chapter discusses each principal argument made in recent years for and against consolidating the Federal bank regulatory agencies. For each argument, we have paraphrased or excerpted statements supporting and opposing the argument and, in some cases, added our own observations. In the interest of brevity we have not cited all who expressed views on the arguments but rather have selected a few to summarize the salient features of each argument.

We reviewed more than 100 statements and articles on this issue. Many of them are from the following volumes, which are referred to in the text as shown below:

> Senate Committee on Banking, Housing and Urban Affairs, "Compendium of Major Issues in Bank Regulation," Aug. 1975; cited as 1975 Compendium.
>
> __________. "Federal Bank Commission Act," hearings during Oct. and Dec. 1975; cited as 1975 hearings on Federal Bank Commission.
>
> __________. "Federal Bank Commission Act--1976," hearings during Feb. and Mar. 1976; cited as 1976 hearings on Federal Bank Commission.
>
> House Committee on Banking, Currency and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, "Financial Institutions and the Nation's Economy (FINE) Discussion Principles," hearings during Dec. 1975 and Jan. 1976; cited as 1975-76 hearings on FINE discussion principles.
>
> __________. "The Financial Reform Act of 1976," hearings during Mar. 1976; cited as 1976 hearings on Financial Reform Act.

We also reviewed other materials which are cited in full in the text. Our recent report on the agencies (OCG-77-1) is also cited.

Included are statements made by persons who, at the time of their testimony, were officials of one of the three Federal agencies or a State banking authority. We have identified them accordingly. Statements made by former supervisory officials are not so identified. Former FDIC Chairman Wille summarized arguments for and against consolidation. These arguments, however, did not necessarily represent his own views and are referred to as "cited by Wille."

The principal arguments for and against consolidation of the regulatory system are listed below and discussed in more detail in the remainder of this chapter.

ARGUMENTS FOR CONSOLIDATION

1. A consolidated agency would avoid the present system's problems in dealing with problem or failing banks. The problems commonly cited relate to (1) a need for the agencies to coordinate efforts, which may require considerable time and effort, (2) the different supervisory goals and tools of the three agencies, and (3) a reluctance on the part of the regulators to take effective action against banks with problems for fear that these banks will change supervisors.

2. A consolidated agency would avoid the division of supervisory responsibility where, in some cases, one agency is responsible for a bank holding company and another agency or agencies are responsible for the subsidiary banks.

3. A consolidated agency would be more economical and efficient because many of the existing forms of duplication would be eliminated.

4. A consolidated agency would be more accountable to the Congress and the public because congressional oversight would not be fragmented.

5. A consolidated agency would result in more uniform regulation of banks because all banks would be subject to only one, rather than three, regulators.

6. Bank supervision and monetary policy should be integrated because (1) knowledge about the banking industry, and ability to influence that industry, are essential to the formulation of monetary policy and (2) FRS has lender-of-last-resort responsibility for many banks it does not supervise.

ARGUMENTS AGAINST CONSOLIDATION

7. Problems in the banking industry are not caused by the tripartite regulatory system and could be resolved by better coordination, which would avoid needlessly disrupting the system.

8. Consolidation would result in excessive centralization of power in one agency, leading to overzealousness in protecting existing banks, adversely affecting competition among banks, and discouraging banks from being innovative.

9. The present system promotes innovativeness on the part of bank regulators to devise better administrative and examining techniques and avoids an organizational conservatism that could occur under a consolidated, non-competitive environment.

10. The present system preserves dual banking by allowing banks to chose their Federal regulator and thus providing protection against rigid or arbitrary regulation.

ARGUMENTS FOR CONSOLIDATION

1. Increased effectiveness in handling problem or failing banks

Supporting views

Even though each bank is primarily supervised by one agency, in certain instances all three Federal agencies may become involved in handling a problem or failing bank. This multiplicity can create several problems. These problems relate to (1) the considerable time and effort required to coordinate the agencies' efforts. (2) the different supervisory goals and tools of the three agencies and (3) a reluctance on the part of regulators to take effective action against banks with problems for fear that these banks will change regulators.

The agencies have different tools for coping with failing banks, which makes it difficult to consider all alternatives concurrently. OCC has more flexibility in arranging a national bank merger which requires no Federal assistance; FRS can provide loans to help maintain a bank's liquidity; and FDIC can provide other types of financial assistance. (Cited by FDIC Chairman Wille, 1975 Compendium, p. 1016.)

An FRS Governor cited the 1974 failure of Franklin National Bank as a concrete example which illustrated one of the problems inherent in the current system. The agencies had different goals: OCC, the bank's primary regulator, was concerned about the financial soundness of the bank; FDIC was concerned about the threat of loss to the insurance fund; and FRS was concerned about the $1.7 billion it had lent the bank and possible effects on the Nation's economy. He concluded that the ultimate disposition of Franklin National Bank through merger was "an admirable piece of financial craftsmanship," although the process took too long. In his estimation, the "need to coordinate each step among three Federal regulators, each with its own separate law, was a primary culprit in the exasperating delay." (pp. 1026-28.) (FRS Governor Sheehan, 1975 Compendium).

In the opinion of some the basic cause of problems which they believe exist with the present system--such as ineffectiveness in handling problem or failing banks and the lack of uniformity in the treatment of all banks--is attributable to the subtle pressure that may be exerted by banks on their regulators to be lenient in their actions against banks. Since banks are able to switch from one regulator to another, it is believed by some that the Federal and State banking agencies would not want to lose their banks to the least restrictive regulator and, as a result, there is competition among the agencies to be lax in their supervision of banks. (This condition has been referred to as "competition in laxity" and is discussed in more detail on pages 27 to 30.)

As "competition in laxity" relates to the effectiveness of the Federal agencies in dealing with problem and failing banks, a former FRS Governor contended that a primary factor in recent failures was

> "an institutionalized reluctance on the part of regulators to pull the rug out from under their own banks. To do so causes unhappy tremors among the other banks in their sphere and puts the particular regulator at a psychological and political disadvantage with its fellow regulators, with the Congress and with the industry." (J.L. Robertson, 1975 hearings on Federal Bank Commission, p. 9.)

The Chairman of the Senate Committee on Banking, Housing and Urban Affairs stated:

> "I might say in the past 4 years we have had four of the largest bank failures in the history of the Nation. All of these have been national banks. There's evidence that these failures could have been avoided if the Comptroller had taken a tough early stand to prevent unsound banking practices in those institutions. This regulatory laxity on the part of the Office of the Comptroller has largely been responsible for what Chairman Burns of the Federal Reserve has referred to as a competition in laxity among the Federal bank regulators." (Sen. Proxmire, 1976 hearings on Federal Bank Commission, p. 61.)

Objecting views

The current system has worked well, not only since FDIC was established over four decades ago, but even during the most recent half-dozen years. For example,

--less than 120 banks have failed since 1944, a rate of failure far below that of businesses in general. (Haywood, 1976 hearings on Federal Bank Commission, p. 151.)

--Since 1933, depositors have lost less than $22 million from the closing of insured banks. (Comptroller of the Currency Smith, 1976 hearings on Federal Bank Commission, p. 112.)

--Depositors' losses since 1934 have been limited to less than 1 percent of total deposits in failed banks. (Haywood, ibid., p. 151.)

An FDIC group reviewing the restructuring issue concluded:

"*** 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." (Cited by FDIC Chairman Wille, 1975 Compendium, pp. 1012-13.)

Similarly, the American Bankers Association testified "a centralized super agency is unlikely to be more efficient or more effective than the current structure in preventing bank failure." (1976 hearings on Federal Bank Commission, p. 190.) The Conference of State Bank Supervisors testified:

"***the recent widely publicized bank failures have not been due to deficiencies inherent in our decentralized banking structure, nor is there reason to believe that such failures would not have happened within the framework of a centralized bank regulatory structure such as contemplated in S. 2298." (Ibid., p. 203.)

The Connecticut Bank Commissioner stated:

"I would not attribute the recent forced mergers of a number of large banks to a failure in the present federal regulation system. In fact, comparing the current experience to that of over ten years ago when the San Francisco National Bank failed, I would say that the federal regulatory agencies have come a long way in handling failing banks. The San Francisco National Bank was liquidated largely because the agencies could not find a merger partner. Today, banks, many times the size of San Francisco National, are merged into sound banks." (Connell, 1976 hearings on Federal Bank Commission, p. 116.)

(The "competition in laxity" theme has been rejected by some as lacking substance. Others claim that, to the extent that there is competition among the agencies, it encourages them to improve their operations. These views are discussed in detail on pages 41 to 43.)

Our observations

In our study of the three agencies, we reviewed in detail examination reports and related correspondence for 30 of the 42 banks that closed between January 1971 and June 30, 1976. (OCG-77-1, ch. 9.) We did not find direct evidence that the present regulatory structure had created problems in dealing with these banks. We did, however, note a tendency by each supervisory agency to delay formal action until a bank's problems had become so severe that they were difficult to correct.

Reasons given by the regulatory agencies for not being more aggressive in taking formal actions were:

--The public might learn of a formal action and this publicity could hurt the bank.

--Formal actions are cumbersome.

--Agency officials may have been too zealous in seeking to minimize governmental interference with management decisions.

--In prior years the legal powers were relatively new and unfamiliar to agency personnel.

There was no indication from the records we reviewed that the regulators were reluctant to take forceful action against banks for fear that they would switch regulators.

With respect to identifying problem banks, our report pointed out that the three agencies use different criteria to identify problems banks and thus they do not agree on which banks require special supervision. (OCG-77-1, ch. 8.) While OCC has the primary responsibility for dealing with a problem national bank, FRS may also have a material interest in its soundness, especially if FRS has made or is considering making a loan to the bank. FDIC likewise has an interest in the bank since it is an insured bank. We recommended that the three agencies develop uniform criteria for identifying problem banks. Obviously, consolidation of the three agencies would preclude this type of problem.

2. Increased effectiveness in dealing with bank holding companies

Background

Bank holding companies are those which own or control one or more banks. They are a major element in the American banking system, owning or controlling one-fourth of all commercial banks in America and controlling two-thirds of all banking assets and deposits.

One observer has warned that, because of the growing influence of holding companies, FRS may become "the super-agency that nobody planned." (Guttentag, 1975 Compendium, pp. 884-85.)

A holding company can strengthen a bank by providing financial support, diversification, the benefits of larger operations, or specialized management support. It can also weaken a bank by directing loans to be concentrated in one business or industry or by introducing less qualified managers. FRS has primary responsibility for examining bank holding companies, while subsidiary national banks are examined by OCC and State insured nonmember banks are examined by FDIC.

Supporting views

Under the existing system a holding company and its subsidiary banks may be subject to different agencies' supervision. A single agency would make it easier to obtain a "more complete picture of the entire operation and the assessment of the overall risk exposure of the bank(s) and the holding company." (Cited by FDIC Chairman Wille, 1975 Compendium, p. 1016.) Furthermore, the highly complex nature of holding company arrangements "may not be fully appreciated by agencies responsible for only parts of the operations." (Kaufman, 1975 hearings on Federal Bank Commission, p. 127.)

To illustrate the problem of divided responsibilities, the Massachusetts Commissioner of Banks presented the following case:

> "*** This case involved a small state-chartered bank (regulated by the FDIC since it was not a Federal Reserve member) which was a subsidiary of a one-bank holding company. The parent company was subject to Federal Reserve supervision, but not state regulation since the Massachusetts bank holding company law generally covers

only multi-bank concerns. Thus, the Federal Reserve had jurisdiction over the holding company but not the bank, and the state banking department and the FDIC had jurisdiction over the bank but not the holding company.

"The holding company raised over $600,000 in funds by selling notes locally, mostly to individuals in relatively small denominations. Most of the proceeds from the note issue were used to buy from the bank a large loan that had been classified by our examiners and the FDIC, thereby removing a problem from the books of the bank. Subsequently, the Federal Reserve actually conducted a special examination of the holding company, but for lack of communications with us or the FDIC, or investigation of the large loan, there was no followup or criticism of the holding company's financial position. When the notes became due, the holding company had no way of paying them off and an emergency acquisition of the bank had to be arranged in order to prevent failure of the holding company from leading to a run on the bank. At the Federal level, the problem was precipitated by the separation of responsibility for the one-bank holding company from responsibility for the bank subsidiary." (Greenwald, 1976 hearings on Federal Bank Commission, p. 128.)

Another example of the problems that can result from the divided supervision of banks and bank holding companies was cited by the Connecticut Bank Commissioner.

"*** Likewise, bank holding companies, where the national bank was the lead bank, with the approval of the Federal Reserve Board acquired mortgage banking companies or established REIT's. When these non bank affiliates found themselves in financial difficulty, they often sold assets to the lead bank. It was then that the examiners of the Comptroller of the Currency had to deal with the exposure that was previously authorized by another agency." (Connell, 1976 hearings on Federal Bank Commission, pp. 116-117.)

Objecting views

Others do not dispute that the split responsibility for regulating holding companies and subsidiary banks may cause difficulties. (Comptroller of the Currency Smith, 1976 hearings on Federal Bank Commission, pp. 83-84; New York Bank Commissioner Heimann, 1976 hearings on Financial Reform Act, p. 475.) A less drastic cure has been proposed: that each holding company be supervised by the agency responsible for the banks which control most of its assets. (Associate Deputy Comptroller of the Currency Homan, 1976 House "Oversight Hearings Into the Effectiveness of Federal Bank Regulation," Jan. 20, 1976, p. 41; a similar proposal was made by New York Bank Commissioner Heimann, 1976 hearings on Financial Reform Act, pp. 475-76.)

It may not be possible to correct the alleged problems of dealing with bank holding companies by consolidating the agencies. Holding company regulation itself may be the problem.

> "[The] risk of complicated financial arrangements within bank holding companies having a wide range of nonbanking activities would be difficult for even the best trained bank examiners to discern. Much more important would be a thorough reform of holding company regulation. ***
>
> "I am concerned that if nonbanking activity of bank holding companies is not prohibited, holding company activity and its regulation will become more and more complex and lead to losses of efficiency as well as increasingly immeasurable risk for the banking system." (Havrilesky, 1975 hearings on Federal Bank Commission, p. 88.)

Our observations

While our study did not include an overall review of FRS' supervision and regulation of bank holding companies, we did look at the problems in our sample banks which were related to holding companies. FRS needs to strengthen its oversight of bank holding companies. Furthermore, procedures for coordinating the three agencies' supervision of holding companies and their subsidiary banks are not fully effective. (OCG-77-1, pp. 4-51 and 11-7.)

In spite of our limited review of bank holding companies we recognize that the alleged supervisory difficulties associated with this form of bank organization constitute a strong argument for some realignment of responsibilities. This is a situation that demands close interagency cooperation and coordination. If the three agencies cannot jointly and meaningfully supervise holding companies, then a major element of the banking industry will elude them.

3. <u>More efficient operation</u>

<u>Supporting views</u>

Consolidating the bank regulatory agencies could produce savings in a number of areas:

--Reduce overhead by more efficient use of regional and headquarters staff. (Connecticut Bank Commissioner Connell, 1976 hearings on Federal Bank Commission, p. 116.)

--Develop a single, comprehensive early warning system, rather than the three exclusive systems being developed concurrently by the three Federal agencies. (Massachusetts Commissioner of Banks Greenwald, 1976 hearings on Federal Bank Commission, p. 128.)

--Reduce legal and research staffs. (Cited by FDIC Chairman Wille, 1975 Compendium, p. 1014.)

--Reduce senior staff time spent communicating and keeping current with the activities of the other agencies. (Ibid.)

--Increase the use of experts in such areas as complicated credits, trust activities, international departments and foreign offices of insured banks, data processing and other areas of automated activity, and compliance with Federal and State consumer protection statutes. (Ibid., pp. 1014-15.)

--Eliminate duplicate training and ease the development of more advanced and specialized training. (Ibid., p. 1015, and FRS Governor Sheehan, ibid., p. 1024)

--Reduce duplicate computer facilities. (Former FRS Governor J.L. Robertson, 1975 hearings on Federal Bank Commission, p. 74.)

--Reduce reporting requirements placed on banks, including costs for administering, processing, and publishing such reports. (Cited by FDIC Chairman Wille, 1975 Compendium, p. 1015.)

--Eliminate the requirement that each of the three agencies prepare recommendations on proposed mergers. (Former FRS Governor J.L. Robertson, 1975 hearings on Federal Bank Commission, p. 74.)

Objecting views

Potential savings are (1) not proven, (2) slight in relation to overall budgets, and (3) less than the costs of consolidation.

The American Bankers Association suggested that the potential for savings is "conjectural" because the current system already "permits a division of labor and a degree of specialization." (Chisholm, 1976 hearings on Federal Bank Commission, p. 186.)

A professor has argued that the consolidated agency would be more efficient only if given proper incentives, including congressional oversight. (Kaufman, 1975 hearings on Federal Bank Commission, p. 114.)

Due to consolidation, there "might even be a few economies of scale, though any savings would be peanuts to a government that now spends $1 billion a day." (R.M. Robertson, 1976 hearings on Federal Bank Commission, p. 160.)

Another professor said: "Some waste is worth suffering to preserve flexibility and competition." (Friedman, 1975-76 hearings on FINE discussion principles, p. 2166.) Moreover, efficiency is not synonymous with ease of administration. An all-powerful agency "may seem efficient simply because conflicting points of view have been suppressed" within the consolidated agency rather than debated publicly among equals. (Haywood, 1976 hearings on Federal Bank Commission, pp. 149-50.)

Our observations

One of the most prevalent comments of those who favor some form of consolidation of the present regulatory system is that reform is needed to promote economy and efficiency in operating the system. However, we have not found any study which concludes on the basis of empirical data that savings would result from consolidation of the Federal regulatory agencies.

The principal cost incurred by the three agencies for regulating banks is attributable to bank examinations. The three agencies have mutually agreed not to exercise their overlapping statutory authority so that only one agency will examine each bank, that is, OCC examines all national banks, FRS examines all State member banks, and FDIC examines all insured banks that are not examined by either OCC or FRS.

While the three agencies do not duplicate each others' bank examinations, in several areas they are carrying out similar activities differently and are thus operating inefficiently. (OCG-77-1, ch. 11.) In many of the areas of potential savings cited above and in our report, much could be accomplished through effective interagency cooperation, as well as through consolidation.

Also, in our report to the Senate Committee on Banking, Housing and Urban Affairs, "Information On Consolidation Of Bank Regulatory Agencies" (Dec. 5, 1975, GGD-76-42), we discussed areas where certain costs could be affected by consolidation of the three agencies, but we did not attempt to estimate whether consolidation would result in overall cost savings or increases.

4. <u>Increased accountability to the Congress and the public</u>

<u>Supporting views</u>

In the context of restructuring the Federal bank regulatory system, increased "accountability" refers to making a single officer responsible for certain activities, rather than several officials.

Senator Proxmire raised the issue of accountable officers when he said

> "I think it's far easier for this committee which has oversight on all of these agencies to act if we have a single agency on which to concentrate rather than if we have three disparate agencies with different people to be confirmed and all doing things at different times in different ways. So our oversight would be improved, too." (1975 hearings on Federal Bank Commission, p. 133.)

A State banking commissioner stated that, if the agencies were consolidated, "Congress could place responsibility squarely with one agency should anything go wrong." (Heimann, 1976 hearings on Federal Bank Commission, p. 134.)

Finally, a consolidated agency "would provide a single focal point for Congressional and *** public inquiries on matters of banking and bank regulation." (Cited by FDIC Chairman Wille, 1975 Compendium, p. 1013; also Heimann, ibid.)

<u>Objecting views</u>

A Treasury Department spokesman has stated that "while the accountability of bank regulatory authorities to the Congress would be increased [with consolidation], I seriously question whether the accountability to the public would improve." (Deputy Secretary of the Treasury Gardner, 1975-76 hearings on FINE discussion principles, p. 610.)

Senator Packwood said: " *** I don't think Congress has ever really lacked for information." (1976 hearings on Federal Bank Commission, p. 83.)

5. More uniform treatment of all banks

Supporting views

It is inherently inequitable for some commercial banks to suffer competitive disadvantages relative to others in the same market solely because of differences among regulators.

Writing in the mid-1960s, the FRS General Counsel said that the "existence of conflicts among the banking agencies *** produced competitive inequities among the different classes of federally-regulated banks." He noted numerous conflicts, including (1) the rule by former Comptroller Saxon that national banks could accept savings accounts of profit-making business corporations, despite a contrary ruling by the Federal Reserve Board and (2) the dispute between the Comptroller and the Board over the authority of member banks to underwrite obligations of States and municipal subdivisions. (Hackley, Virginia Law Review, Vol. 52, pp. 598, 605, and 618.)

In 1975 a former FRS Governor cited four interagency differences, including how to calculate a bank's capital and whether a bank can underwrite revenue bonds. (J.L. Robertson, 1975 hearings on Federal Bank Commission, p. 5.)

A State superintendent of banks detailed several conflicts in the early 1960s between the bank merger decisions of the Comptroller and the Federal Reserve. (Root, 1963 House hearings on "Proposed Federal Banking Commission and Federal Deposit and Savings Insurance Board," pp. 250 ff.) Commenting on past attempts at interagency coordination with respect to the Bank Merger Act of 1960, a member of the Federal Reserve Board noted in 1963 that the act had failed to generate "uniform standards" in spite of "streams of documents" flowing between the three agencies. (J. L. Robertson, ibid., p. 175.)

Speaking on the Bank Merger Act of 1966, a professor recently noted:

> "While it is now clear that the same law applies to all banks ***, it is also clear that uniformity in application has not resulted. Recent studies have shown that different standards are applied by the agencies." (Shull, 1975 hearings on Federal Bank Commission, p. 111.)

This point was supported by the Massachusetts Commissioner of Banks, who stated:

> "*** As is now widely recognized, the present system has been plagued by marked differences among the federal agencies in their policies on bank structure decisions. The Comptroller of the Currency has been the most likely agency to approve bank mergers and permit bank expansion into nonbanking activities. Bankers have been quite cognizant of the difference and have strategically structured their applications to take advantage of the Comptroller's permissive attitude. A bank merger application can be filed with the Comptroller to gain a virtually guaranteed approval. A case in point was the proposed merger of Connecticut Bank and Trust (largest in the state) and the Connecticut National Bank (number five in the state) in 1969, filed under the charter of the smaller national bank and approved by the Comptroller. The only plausible reason for use of the smaller bank's charter was to obtain federal regulatory approval of the merger, which would not have been forthcoming from the Federal Reserve. Similarly, recognizing the difference in bank structure policy between the Comptroller and the Federal Reserve, holding companies have acquired banks by merging them into national bank subsidiaries in circumstances where the Federal Reserve would probably have denied a direct holding company acquisition. Bankers have consciously taken advantage of the Comptroller's relative disregard for anticompetitive effects in bank acquisitions. (Greenwald, 1976 hearings on Federal Bank Commission, p. 129.)

Objecting views

While conceding that a number of interagency disputes have, in the words of one supporter of the existing regulatory system, "produced bothersome confusion or serious competitive inequities between state and national banks *** it must be noted that they were not of such consequence as to affect banking drastically." (Golembe, Virginia Law Review, Vol. 53, 1967, p. 1103.)

While deploring on one occasion a "jurisdictional tangle that boggles the mind," the Chairman of the Federal Reserve Board of Governors elsewhere noted: "Absolute consistency in bank regulation is not necessarily a virtue." (Burns, 1975

Compendium, p. 1008, and 1976 hearings on Financial Reform Act, p. 909.)

> "On the contrary, some diversity of viewpoint among the banking agencies can be healthy for the banking system. ***[B]anking has benefitted from some of the provocative and innovative policies" of former Comptroller Saxon, who figured in much of the jurisdictional conflict in the early 1960s. (1976 hearings on Financial Reform Act, pp. 909-10.)

Saxon's philosophy and policies have also been characterized as a "serious attempt *** to eliminate anachronistic restrictions and to encourage a more competitive and aggressive banking system." (Golembe, Virginia Law Review, Vol. 53, 1967, p. 1104.)

A Treasury Department spokesman noted that a Federal Bank Commission would provide more uniform application of the provisions of the Bank Merger Act, but he was "not sure that is a total blessing." At any rate, since the ruling of the Antitrust Division of the Justice Department "takes precedent in all cases," there is "what is equivalent to a single agency uniform procedure." (Gardner, 1975 hearings on Federal Bank Commission, p. 263.)

In responding to a FINE study questionnaire, the Office of the Comptroller of the Currency stated that:

> "*** Although serious differences of statutory interpretation and regulatory approach arise infrequently, when divergence does occur it adds the kind of innovation all too lacking in many regulatory environments. Rather than having stultified its constituency, the present system has produced a dynamic and healthy industry. Consistency in regulation is a goal which increasingly is coming under examination." ("Compendium of Papers Prepared for the FINE Study," June 1976, p. 450.)

According to the previous Chairman of FDIC, "a top-level staff group" at FDIC attempted in the first half of 1975 to find "*** points of friction within the present Federal bank regulatory structure which might justify recommendations for major Congressional reform." The group "identified only two significant and demonstrable points of friction within the present structure": one relating to different agency attitudes toward bank acquisitions, the other relating to the overlap due to FRS' authority over one-bank holding companies in which the only bank subsidiary is either a national bank, supervised by OCC, or a State nonmember bank, supervised by FDIC and a State agency. (Wille, 1975 Compendium, p. 1012.)

Our observations

During our study of the Federal supervision of banks, agency officials told us that in the 1960s different classes of banks were frequently treated unequally under identical conditions, due to the conflicting views of bank regulators.

The general philosophy of Comptroller Saxon differed markedly from that of the Federal Reserve Board or the Chairman, FDIC, and his decisions on many regulatory or supervisory matters were often at odds with theirs. (FRS General Counsel Hackley, Virginia Law Review, Vol. 52, 1966, pp. 598-632.) The courts later reversed some of Saxon's interpretations. In some cases, the other two agencies changed their policies to agree with those of OCC. Finally, Comptroller Camp, who succeeded Saxon, apparently reversed some of Saxon's rulings in an effort to bring the three agencies in accord. Agency officials told us that the inconsistencies of the 1960s have generally been resolved.

If classes of banks receive different treatment in identical situations, it may be done in a very subtle way. In many of the areas where examiners attempt to influence the activities of banks, they do so not through specific policy statements, but rather through comments in examination reports. In many cases these conclusions are based on the examiners' professional judgment rather than on specific financial ratios or standards. For example, an examination report may criticize a bank for inadequate capital. There are no hard and fast rules for determining whether a bank's capital is adequate; rather, each bank's position is judged by the agency officials.

During our study we found examples of banks receiving different treatment under similar circumstances solely because of differences among regulators. For example, the regulators inconsistently evaluated loans to foreign governments and businesses. (OGC-77-1, p. 4-31.) Similarly, shared loans to large domestic corporations were evaluated differently. (Ibid., p. 7-13).

6. Integrated bank supervision and monetary policy

Background

Not only is FRS one of three bank regulatory agencies, it is also the Nation's central bank and its monetary policy maker. As the central bank, FRS manages the U.S. money supply by influencing the lending activity of commercial banks, which in turn affects the level of spending and production in the economy. This is called monetary policy.

Over the years the Congress has given FRS three major tools for accomplishing these objectives. Each tool has a distinct impact on the cost and availability of member bank reserves and, thus, on credit and monetary growth. FRS increases or decreases reserves in the banking system through buying or selling U.S. Government and Federal agency securities in the open market. FRS can also change the percentage of deposits that member banks must hold in reserve--immediately increasing or decreasing commercial banks' capacity to extend credit. And FRS can change the "discount rate," the interest rate charged to member banks that borrow from Reserve banks to beef up their reserves.

Supporting views

Bank supervision and monetary policy should be integrated because: (1) knowledge about the banking industry, and ability to influence that industry, are essential to the formulation of monetary policy and (2) FRS has lender-of-last-resort responsibility for many banks it does not supervise.

One Governor stated:

> "Any decision on monetary po 'cy must be grounded on good knowledge of the state c the banking industry as well as of the economy in general. And the monetary authorities must be able to readily effect changes in the regulatory policy and the supervisory apparatus and action which they believe to be necessary to carry out their responsibilities.
>
> "Furthermore, there is an inextricable link between the Federal Reserve System's lending function and banking supervision and regulation. The function of lending to commercial banks which are faced with either temporary liquidity difficulties or longer-term problems necessarily lies with the monetary authorities ***.

"The same people who are carrying out the monetary policy must have firm control over the regulation and supervision of the banking industry." (Sheehan, 1975 Compendium, pp. 1029-30.)

FRS responsibility for conducting monetary policy, "extends beyond the banking system to the entire economy, both as the nation's monetary authority and its lender of last resort." In the case of Franklin National Bank, the Governor said the bank's liquidity problems [and possible failure] created a threat to FRS: either lend money to the bank "or risk a possible trauma in national and international money markets with the potential effects on the nation's and world's economies." He was concerned that FRS has "lender-of-last-resort responsibility for some 13,000 banks whose operations [it does] not examine." (Sheehan, ibid., pp. 1025-26.)

Objecting views

Monetary policy and bank regulation should not be integrated because: (1) information about the banking industry need not come from direct supervision; (2) bank supervision takes too much of the FRS Governors' time; (3) there may be goal conflicts between bank supervision and other FRS activities; and (4) FRS need not act as lender of last resort.

Information on banks may be germane to formulation of monetary policy, but the appropriate source of such information is not from direct supervision of banks.

Thus, one Governor stated:

"Separating the Federal Reserve from bank supervision would not, in my opinion, diminish its ability to keep abreast of banking developments. Information about banking practices would be just as available to the Board if supervision were unified in the 'Federal Banking Commission.'" (Bucher, 1975 Compendium, p. 927.)

The previous Chairman of the Federal Reserve Board testified: "I personally do not pay too much attention" to bank examination reports in formulating monetary policy, although some of his associates had "different views." (Martin, 1963 House hearings on "Proposed Federal Banking Commission and Federal Deposit and Savings Insurance Board," p. 195.)

A former Governor said:

> " *** the supervisory work of the Federal Reserve has nothing whatsoever to do with the formulation of monetary policy.
>
> "I have never seen a single individual in the Federal Reserve System who formulated monetary policy on the basis of his knowledge of banks gained through examinations only by the Federal Reserve." (J.L. Robertson, 1976 hearings on Financial Reform Act, p. 500.)

A former official of the Federal Reserve Bank of Boston said that her

> " *** experience of seven years as a member of the monetary policy group *** was that there was no input from the examination department in advising on monetary policy. Results from bank examinations played no role in the discussions with the President of the Bank to determine the appropriate monetary policy goals he would vote on at the Federal Open Market Committee ***." (Massachusetts Bank Commissioner Greenwald, 1976 hearings on Federal Bank Commission, p. 130.)

FRS examines relatively few banks, but if it lost its bank supervision function it should have "clear and unquestioned access" to reports of the agency or agencies that do examine banks. (New York Bank Commissioner Heimann, 1976 hearings on Financial Reform Act, pp. 494 and 500.)

FRS should be removed from direct supervision of banks because too much of the Board of Governors' time is diverted from monetary policy, without enough of it being spent on bank supervision. One Governor said:

> "Supervision is too important a function in itself to be the Federal Reserve's part-time job. For example, during 1974, the Board issued 434 orders on bank holding company applications alone, not to mention numerous deliberations on other regulatory matters ***." (Bucher, 1975 Compendium, pp. 925-26.)

Another stated that the Board of Governors

> "should be permitted to devote all of its time and effort to the task [of monetary policy], without diverting

attention to bank supervisory matters that demand concentrated full-time attention by people especially qualified for the job." (J.L. Robertson, 1975 hearings on Federal Bank Commission, p. 31.)

Others have echoed these sentiments, saying that bank supervision is "really a terrible diversion and waste of talent for which the governors do not necessarily have comparative advantage" (Tobin, 1975-76 hearings on FINE discussion principles, p. 2371) and that bank supervision is a "poor step child" at FRS. (Lee Richardson, ibid., p. 2475.)

Data on the governors' participation in votes on bank regulation upholds this view. According to one study, during 1975 all seven members of the Board were present for only 10 percent of the votes and only four members were present for more than one-fourth of the 283 decisions. (Cong. Reuss, 1976 hearings on Financial Reform Act, p. 495.)

FRS's dual roles under the current system may force it to sacrifice one goal for the other. A Governor said:

> "***conflicts of objectives may rise that result in contradictory claims upon the agency. ***[B]ank examiners should be always allowed to function in an environment where their decisions are based entirely upon their perception of *** the banks for which they have examination responsibility and are not influenced by considerations of a broader scope." (Bucher, 1975 Compendium, p. 926.)

Similarly, it has been argued that FRS's "regulatory functions bring it into close contact with banks, and this may give it an unbalanced view of national priorities." (T. Mayer, 1975-76 hearings on FINE discussion principles, p. 76; Massachusetts Bank Commissioner Greenwald, 1976 hearings on Federal Bank Commission, p. 130.)

Likewise, in enforcing consumer protection laws, FRS's "primary responsibility to the supervision of monetary policy has significantly interfered with its ability to focus on the very real needs of consumers." (O'Reilly, 1976 hearings on Financial Reform Act, p. 872.)

That FRS has, or sees itself as having, lender-of-last-resort responsibility for all insured banks is unclear. A critic of this view asserted that the

"Federal Reserve indicated that it did not have that responsibility in the case of a failing non-member bank in South Carolina, whereupon the FDIC utilized its own powers of last-resort-lending in order to lay the ground work for a deposit assumption transaction." (Golembe, 1975 Compendium, p. 1045.)

Our observations

Although we did not review FRS monetary policymaking, we question whether FRS needs to directly examine banks to decide monetary policy.

The principal data derived from examinations apparently is communicated to those who formulate monetary policy through the examination reports, because

-- the FRS staff that formulates monetary policy does not examine banks, and

-- FRS examines only a small percentage (about 7 percent) of the insured commercial banks in this country and receives examination reports from FDIC and OCC on the others that it does not examine. We saw no recent complaints from FRS about access to other agencies' reports.

If FRS were to be removed completely from bank examinations, it could continue to receive examination reports from the agency or agencies that examine banks. To insure that FRS access to such reports is complete and prompt, and not subject to the changeable policies of another agency or agencies, such access might well be legislated.

In addition to relatively sporadic examination reports (not much more frequent than once a year), FRS gets a wealth of current information on member banks (that is, OCC- and FRS-examined banks) from a variety of weekly, monthly, and other reports. These reports are not part of the examination process. They are designed to assist in formulating monetary policy and would presumably be continued even if FRS no longer examined banks.

As for FRS' alleged responsibility as lender of last resort to all commercial banks, FDIC apparently has the authority and financial resources to play this role. Under section 13(c) of the 1950 Federal Deposit Insurance Act, FDIC was given authority, under certain circumstances, to assist insured banks in danger of failing. This power was first used to help an operating bank in 1971, and it had been used three times by the end of 1975. (FDIC Annual Report for 1975, p. 3.) In addition to its $6.7 billion trust fund (as of December 31, 1975), FDIC has authority to borrow $3 billion from the U.S. Treasury.

ARGUMENTS AGAINST CONSOLIDATION

7. Removing a system that works well

Supporting views

Although the regulatory agencies have various inter-agency disputes, there is no inherent reason why these disputes cannot be minimized by better interagency coordination. (R.M. Robertson, 1976 hearings on Federal Bank Commission, p. 59.) Speaking of the 1961-66 period of policy conflict between the agencies, one individual has noted that "neither the banks nor the regulatory agencies, aside from some members of the Board of Governors of the Federal Reserve, has indicated that the present system is unworkable." (Golembe, Virginia Law Review, Vol. 53, 1967, p. 1106.)

The recent problems of the banking industry (for example, real estate investment trusts, international loans, and loan default in general) cannot be laid at the door of any single regulatory agency or of the current regulatory structure. Banking industry problems "have been due largely to the adverse economic climate of the past several years during which we have experienced an accelerating inflation and the most severe recession since the 1930's." (Faris, p. 518; Duwe, p. 765; Deputy Secretary of the Treasury Dixon, p. 338; and New York Bank Commissioner Heimann, p. 446, all in 1976 hearings on Financial Reform Act.)

Objecting views

While conceding that the present regulatory system "works," those who favor consolidation deny that it "works well." The FRS General Counsel said in 1966 that the Federal bank regulatory structure was on the "verge of chaos," involving "gross inequities among different classes of banks." (Hackley, Virginia Law Review, Vol. 52, 1966, p. 823.)

The Chairman of the Federal Reserve Board described the present regulatory system as a "jurisdictional tangle that boggles the mind, *** conducive to subtle competition among regulatory authorities, sometimes to relax constraints, sometimes to delay corrective measures, *** competition in laxity." (Burns, 1975 Compendium, p. 1008.) However, the Federal Reserve Board, as a whole, did not favor consolidating the three agencies into one. Indeed, the Chairman also stated: "Absolute consistency in bank regulation is not necessarily a virtue." (Burns, 1976 hearings on Financial Reform Act, pp. 909 and 916.)

Our observations

By its very nature this argument must take into account all other arguments that have been made for and against consolidation of the existing agencies. While problems have occurred under the present system, the questions which should be considered are:

-- Were the problems a direct result of the regulatory structure? If so,

-- Would the advantages of consolidation more than offset any disadvantages?

While we did not attempt to directly answer these questions, our review did not sustain the charge that the regulatory system is on the "verge of chaos," if by that one means a nearly total inability to function. The agencies did not work well together in sharing experiences about innovations in bank supervision or undertake certain activities jointly or on a reciprocal basis. These problems, however, could be resolved by better interagency coordination. (OCG-77-1, ch. 11.)

8. <u>Excessive centralization of power.</u>

<u>Supporting views</u>

Citing the experience of a single regulatory agency in another industry, a Department of Justice official observed in 1973:

"The dual banking system has contributed a great deal to the more efficient operation of financial markets. It has permitted an element of competition among supervisory authorities which has been conducive to innovation and experimentation by financial institutions. In addition, it has restrained supervisory authorities from overzealously protecting existing firms by restricting entry to the field.

"The banking experience in this respect might be contrasted to the surface transportation experience, where all modes of transportation are under a single regulator--the Interstate Commerce Commission. That Commission has restricted entry and applied a variety of extremely detailed measures which frequently raise ultimate costs. Moreover, it has generally tried to prevent one mode from using advantages--even advantages based on lower cost--as a way of undercutting the competitive position of other modes. It is for this reason that the Administration recommended in 1972 substantial deregulation of the surface transportation industry.

"Therefore, we think that it is particularly important that the Congress not 'reform' financial regulatory structure in such a way as may replicate our experience in surface transportation. Having a number of regulators who can supervise various types of institutions may look 'inefficient', and yet be much less inefficient in ultimate cost than an industry subject to a regulatory straitjacket imposed by an 'efficient' agency. The Hunt Commission expressed very much the same concern when it said that a single agency 'may become overzealous in protecting existing firms, with the result that entry by new firms is effectively foreclosed.'" (Baker, 1973 House hearings on "The Credit Crunch and Reform of Financial Institutions," pp. 533-34.)

Former Comptroller of the Currency James E. Smith stated:

"It should also be noted that consolidation would be centralizing some rather significant functions in one almost omnipotent agency. Bank regulation is simply too important to leave to a single regulator from whom, for all practical purposes, there is no appeal. The now famous phrase of 'competition in laxity' may be no more than a description of the healthy flexibility which presently exists. It would be ironic, given the recent discussion of the non-banking agencies' ability to stultify their industries, for us to now move to similar control of banking." (1975 House hearings on H.R. 8024, "Bank Failures, Regulatory Reform, Financial Privacy," p. 878.)

An OCC staff paper on regulatory structure asserted:

"There are many examples in our economy of industries regulated by a single monolithic federal agency becoming moribund and unresponsive to a changing environment (i.e. railroads, pipelines). There is a tendency for a monolithic agency to be captured by its industry and to turn its attention toward protection of the members of that industry. Usually such protection is inconsistent with competition and innovation. But our society is premised upon competition as the most efficient way of allocating resources."

At a broader level, it has been argued that combining regulatory agencies would affect the structure of the banking industry. Consolidation of the industry into a few large banks would inevitably follow consolidation at the Government level. (Golembe, Virginia Law Review, Vol. 53, 1967, pp. 1113-14.)

Objecting views

The Congress can deal directly with any problems of excessive power without recourse to several regulatory agencies. (Greenbaum, 1975 hearings on Federal Bank Commission p. 90.) Furthermore, an analogy between the present system and the constitutional principle of separation of powers is false because the three agencies perform the same functions. One agency does not "check" or veto the actions of another. (FRS General Counsel Hackley, Virginia Law Review, Vol. 52, 1966, pp. 819-20; former FRS Governor J.L. Robertson, 1975 hearings on Federal Bank Commission, p. 6.)

9. Restricting innovativeness

Background

The banking industry is undergoing rapid and pervasive transformation in response to forces both within and outside the industry. Changes include the expansion of bank holding companies, the advent of asset-liability management, an increase in international operations, economic fluctuations, and innovations in electronic funds transfer and other payments mechanisms. This section discusses whether, under the current system, there is competition among the regulators which may create an atmosphere conducive to experimentation and innovation on the part of the banking community as well as on the part of the regulators.

Supporting views

Competition between State and Federal regulatory agencies is conducive to experimentation and innovation among bank regulators. "All too often single-bodied regulators are too conservative and short-sighted to facilitate or even to allow their industries to adopt new technology." (Ferguson, 1975 hearings on Federal Bank Commission, p. 218.) A State banking supervisor has noted that multiple regulation has prevented one regulator from blocking innovations in bank regulation. Under the dual State-Federal system, State authorities have "taken the lead" in authorizing NOW accounts and fostering experiments in electronic funds transfer. (Heimann, 1976 hearings on Financial Reform Act, p. 447.)

According to the American Bankers Association:

> "'Competition' among bank regulatory agencies has often led to better administrative and examining techniques, improved financial services for the public, and a more competitive banking system. An excellent example of this is some of the recent efforts that have been undertaken by the Comptroller of the Currency." (Chisholm, 1976 hearings on Federal Bank Commission, p. 189.)

Similarly, the previous Comptroller of the Currency stated:

> "There is right now a vital competition among the agencies: a competition in creativity to devise the best and most effective mode of examination and follow-up procedures. To consolidate the agencies now into one commission would destroy this healthy competition." (Smith, 1976 hearings on Federal Bank Commission, p. 111.)

Objecting views

Those who concede that banking and regulatory innovation have taken place deny that such innovation is the logical consequence of the current regulatory structure. Regulatory "divisiveness" does not necessarily breed innovation. (Havrilesky, 1975 hearings on Federal Bank Commission, p. 90.)

As one individual noted, "The rush into new banking activities was strongly motivated by market forces; and it would have found a way around antiquated bank regulations***." He described the one-bank holding company as a device to get around "adverse court decisions when they developed into a barrier." (Shull, 1975 hearings on Federal Bank Commission, pp. 112-13.)

Some who support consolidation of the system point to other situations where a single regulator of an industry did not stifle innovation. For example, a State bank commissioner said:

> "Some have argued that a single federal bank regulator would have a stultifying influence on banking that innovation and progressive regulations would be inhibited under the heavy hand of a single agency. Yet, within the financial sector, the existence of consolidated federal regulation of the savings and loan and credit union systems should logically demonstrate the viability of a dual state and federal system with a single federal agency." (Greenwald, 1976 hearings on Federal Bank Commission, p. 130.)

According to the FRS General Counsel:

> "*** if the three agencies construe the same *** law in different ways *** the end result may not be progress but *** a 'race in laxity' that could threaten the soundness of the banking system." (Hackley, Virginia Law Review, p. 821.)

A representative of a public interest group, in supporting legislation to consolidate the three agencies, stated:

> "The most significant impact of the bill is that it will eliminate or tend to eliminate unhealthy competition among the existing regulators; in particular, competition between the Federal Reserve and the Comptroller over allowing banks within their spheres of influence to move into new permissible banking

activities or those deemed to be closer related to banking. This competition between regulators is widely held to lead to an unhealthy overextension of banking activities. Given that the regulatory agencies will in general attempt to enlarge their spheres of influence, one would expect the bank regulators would seek to attract more banks into their fold generating the natural competition between the two regulatory agencies. Over time, these two bodies have slowly but steadily enlarged the list of permissible activities which they allow to the banks under their control. Perhaps as a consequence of this competition between them some questionable extensions of bank activities have been permitted." (Ferguson, 1975 hearings on Federal Bank Commission, pp. 223-24.)

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 such change. (Cited by FDIC Chairman Wille, 1975 Compendium, pp. 1017-18.)

Our observations

We do not know, of course, whether a single agency would be more creative than the existing agencies in developing new methods and tools for supervising banks. We note, however, that many executive departments have an office for program evaluation, development, or experimentation. Such an office can determine weaknesses in existing programs, design strategies to remedy such problems, and implement pilot projects and experimental designs to test these strategies on a limited basis before implementing them system-wide.

Assertions that competition among the agencies to enlarge their constituencies by increasing the range of permissible activities are related to the "competition in laxity" issue discussed on pages 27 to 30.

10. Weakening the dual banking system

Background

The term "dual banking" has been used to refer to two aspects of the current system of bank regulation:

--choice of one of three Federal agencies, each of which supervises a different group of banks, and

--choice of either Federal or State chartering of banks.

Although States can charter banks, they cannot grant Federal deposit insurance, which virtually has become necessary to operate a commercial bank.

Federal involvement in banking has increased over time. From 1863 until 1913, there were, in essence, two parallel bank systems--one national, one State--for chartering and supervising banks. In 1913 Federal supervision was extended to State banks which were accepted into the Federal Reserve System. In 1933 Federal supervision was extended to virtually all commercial banks with the establishment of FDIC. At the end of 1976, only 286 State-chartered banks did not have Federal deposit insurance, in contrast to over 14,000 banks with national or State charters which did have such insurance.

Supporting views

Consolidation would destroy the dual banking system. (Golembe. Virginia Law Review, Vol. 53, 1967, p. 1109.) Dual banking is important because it functions as a "safety valve," affording "protection against a rigid or arbitrary regulatory policy." (New York Bank Commissioner Heimann, 1976 hearings on Federal Bank Commission. p. 134.)

This protection, to some, comes from having more than one Federal agency. As a State bank regulator said:

> "It is difficult to imagine, for example, that a centralized Commission, which had looked at and rejected a federal charter application, would look favorably upon a request for federal insurance when the same applicant sought it under a state-charter approved by state authorities. This second look is preserved under the present tripartite system, and banks have come into existence over the years because of this feature and have played useful roles as viable financial outlets." (Faris, 1975-76 hearings on FINE discussion principles, p. 1234.

Another State bank commissioner said that "At the heart of the dual banking system is the fact that no single Federal agency holds veto power over an applicant for a new state bank charter." (Greenwald, 1976 hearings on Federal Bank Commission, p. 132.)

(These arguments relate to the question of "excessive centralization of power" discussed on pp. 39 and 40.)

To preserve the States' ability to effectively regulate banks, it has been proposed that, if the present Federal agencies are consolidated, there be:

> "a provision requiring automatic Federal insurance for State-chartered banks. ***The FDIC should really not object to that very much because over the last 10 years they have only disapproved 3 percent of all State applications. However, if the committee is reluctant to make the insurance automatic, then I think it should be structured in such a way that the burden of proof of disapproval would be on the Federal agency; that it would be very clear that disapproval was an exception to a general rule and that even in that case its disapproval was not absolute, that there would be some administrative or legal recourse to test the reasonableness of the Federal agency's decision." (Massachusetts Bank Commissioner Greenwald, ibid., p. 127.)

Another State bank commissioner said:

> "What I would most like to see is dual chartering as a genuine simple choice between state charter and federal charter.***
>
> "It is critical that the machinery be established for qualifying state banking departments to take over to the maximum extent possible the supervisory roles of the FDIC *** with respect to State-chartered institutions. One of the most important elements in that regard is the granting to the qualified state banking departments the right to certify newly chartered institutions for deposit insurance by the Federal insurance agency.
>
> "A healthy viable duality depends critically on the availability of genuine options for entering banking. The granting of insurance is so necessary to a new entrant in banking that, absent a grant of certification power by state banking departments, the FDIC in

effect could control entry into banking. Indeed the duality which exists today with respect to entry is grounded significantly in the requirements that the FDIC grant insurance to any bank chartered by the Comptroller of the Currency or any bank admitted to membership by the Federal Reserve. For an effective duality to continue to exist, the same authority should be granted to qualified state banking departments." (Heimann, ibid., p. 135.)

Objecting views

Consolidation would not destroy dual banking in the sense of having both Federal and State regulation but would eliminate choice among Federal regulators, according to a State bank commissioner, because "it is simply bad government to have three different agencies interpreting the same laws three different ways." (This line of reasoning relates to the issue of uniformity discussed on pp. 27 to 30.)

She continued:

"Some commercial bankers have opposed consolidation of the federal bank supervisors as a threat to the dual banking system. The dual banking system in this context is defined as the existence of alternative entry routes into banking, and a corresponding choice of supervisors. However, since every bank with federal deposit insurance is subject to supervision by at least one of the federal banking agencies, the concept, in practice, implies a choice among different federal supervisors. For this choice to be meaningful, the dual banking system concept must rely on different federal regulators administering identical statutes in unequal manner. In other words, some effective competition in laxity is required on the part of the federal bank supervisors for choice to be meaningful. The Federal Bank Commission is not a threat to the dual banking system from a state regulator's point of view. The main change is that it eliminates the opportunity for banks to play one federal regulator off against another." (Greenwald, ibid., p. 130.)

A recent discussion between Senator Proxmire and the previous Comptroller of the Currency illustrates the alleged lack of uniformity among the Federal agencies.

The Chairman. *** Don't these figures confirm that your office is more lenient as far as capital adequacy is concerned?

Mr. Smith. Our office has never established a flat percentage number on capital and the fact is that the 8 percent number that you quote from the Federal Reserve is not applied as an inflexible standard by the Federal Reserve. Indeed, one of the finest banking institutions in the United States, probably the pride of the Federal Reserve System, has a ratio below that 8 percent level.

The Chairman. Isn't it true that your policies on capital give national banks a competitive advantage with respect to other banks?

Mr. Smith. No, I don't believe so.

The Chairman. Do they have more leverage?

Mr. Smith. I don't believe so.

Mr. Chairman. Of course, they do.

Mr. Smith. Leverage is a matter of competent management. Every banking institution is going to try and leverage its capital and long-term debt to the highest reasonable degree. I think it is probably true that as a group national banks tend to be more aggressive banks in their communities than is typical of the generality of other banks.

The Chairman. And they have that advantage in aggressiveness because you have followed a policy of permissiveness in capital adequacy.

Mr. Smith. And that aggressiveness has also produced some very significant community results in terms of banks that are willing to lend and willing to accept risks. (Ibid., p. 72.)

With respect to the argument that multiple regulators are needed to provide a "safety valve," a Congressman asked:

"Why have only three agencies of Government, why not have six agencies and let the group or the individual or the bank go to six different agencies and present his application each time until he finally gets one of the six who will grant his application?" (Cong. Multer, 1963 House hearings on "Proposed Federal Banking Commission and Federal Deposit and Savings Insurance Board," p. 275.)

Finally, a former FRS Governor suggested, and sponsors of several bills claim, that consolidation would, in fact, strengthen the dual banking system since State supervisors would have to deal with only one Federal agency, not two--FRS and FDIC. The Governor envisioned that examining State banks could in time become the responsibility of State banking department subject to oversight by a new Federal agency. (J.L. Robertson, 1975 hearings on Federal Bank Commission, p. 75.)

Our observations

The argument in favor of dual banking--in either sense--rests upon the assumption that two or more agencies will not, in all cases, reach the same conclusion from the same set of facts and the same critieria.

Such disparity is said to exist in the three Federal agencies' merger decisions and may exist in other areas as well. Whether this disparity is a strength or a weakness of the current system depends upon individual perspective: some view it as a "safety valve," while others believe it leads to "competition in laxity."

Given the critical importance of Federal deposit insurance, meaningful choice among regulators would exist under a consolidated Federal agency if States had authority to grant Federal deposit insurance to banks they charter and to be the sole supervisor of those banks.

CHAPTER 4

A FEDERAL BANK EXAMINATION COUNCIL

A bill to establish a Federal Bank Examination Council (S. 3494) was introduced to the 94th Congress by Senator Adlai Stevenson--according to the Federal Reserve, on its behalf. The bill was reintroduced to the 95th Congress as S. 711. This bill would establish a Council composed of one representative from each of the three bank regulatory agencies and chaired by the FRS representative. The expenses of the Council would be shared equally by the agencies.

The Council would establish uniform bank examination standards and procedures; make recommendations for standardizing other supervisory matters; conduct schools for Federal and State bank examiners; and develop uniform reporting systems for banks, bank holding companies, and nonbank subsidiaries.

Its sponsor said such a Council is needed because the three Federal regulatory agencies' bank examination forms and procedures lack uniformity and, thus:

-- complicate the collection of data on the banking system and add to the reporting burden on banks, especially those which are subsidiaries of multibank holding companies and one Federal agency is not responsible for regulating all of the subsidiaries, and

-- produce discrepancies in identifying and supervising problem or failing banks.

To correct these problems, the proposed Council is to:

-- establish uniform Federal bank examination standards and procedures;

-- work out a cooperative arrangement between the agencies for identifying and supervising problem and failing banks;

-- better articulate the relationship between State and Federal bank supervision; and

-- standardize examination forms and procedures, jointly train bank examiners, and certify State bank supervisory agencies to examine banks instead of Federal examiners.

While the proposed legislation does not discuss the present interagency Coordinating Committee on Bank Regulation, Governor Holland of the Federal Reserve had previously stated that an interagency council:

> "*** would not supplant the present Interagency Coordinating Committee, which ought to continue to provide a forum for consultation on regulatory and policy questions affecting not only banks but nonbank thrift institutions as well. The distinctive features of a new Examination Council would be that its members would be assigned responsibility for particular areas of bank examination procedures, given decision-making power in those areas, and held accountable by their agencies for the development of suitable standards and practices in such areas."

The following section presents some of the principal arguments given by Senator Stevenson for a Federal Bank Examination Council and our comments on these arguments.

Sen. Stevenson's arguments	GAO observations
Uniform standards and procedures would produce more consistent bank supervision by standardizing information available to regulators.	Our report confirms the weaknesses implied by Sen. Stevenson. The three bank regulatory agencies' primary influence on bank operations is not through detailed rules and regulations but through the examiners' comments in the examination reports. Until recently few objective criteria had been established to assist examiners in reaching an overall concusion and criticizing the condition of the bank and the quality of its management. The new OCC handbook and pro forma working papers should provide more uniformity in collecting, assembling, and evaluating data during the examinations. (See OCG-77-1, pp. 4-4, 7-7, 7-8, and 7-24.)

Sen. Stevenson's arguments	GAO observations
A "***standing mechanism for joint supervisory followup***" of problem or failing banks might be more effective than the current fragmented arrangement. Because a bank's condition can change rapidly, the agencies must be able to act jointly and speedily.	Our report contains some support for Sen. Stevenson's argument. The agencies have not used their formal enforcement tools frequently enough to force banks to correct their problems. Further, the agencies lack common criteria for determining which banks have severe problems requiring close supervision. Thus, their lists of "problem banks"--those requiring close supervision --are different, even though all three agencies have an interest in the soundness of many of the same banks. (See OCG-77-1, pp. 8-18 and 8-48.)
Once uniform Federal standards are established, State agencies could be certified to examine banks and duplicate examinations could be reduced or eliminated.	Uniform Federal standards are not a necessary condition to this approach, but such standards could help States in upgrading their capabilities as well as assist FDIC and FRS in evaluating the reliability of State agencies' examinations, which could be substituted for Federal examinations. (See OCG-77-1, pp. 4-13 and 4-14.)
The Council could effect cost savings by standardizing forms and procedures, jointly training examiners, and certifying State examiners.	Standardizing forms and procedures, by itself, may save slightly on printing costs, but such an amount is negligible in relation to total costs. In our report we recommended that, where feasible, OCC, FRS, and FDIC combine their examiner schools and standardize their curriculums. (See OCG-77-1, p. 10-6.)

AGENCY VIEWS

Federal Reserve System

Former Governor Holland, testifying on behalf of the Board of Governors in July 1975, endorsed establishment of a Federal Bank Examination Council as "***an experimental and evolutionary idea***." Each of the three agencies would "***delegate some specific decision-making authority in the field of examination procedures***" to a representative on the Council. The members of the Council:

> " *** would be assigned responsibility for particular areas of bank examination procedures, given decision-making power in those areas, and held accountable by their agencies for the development of suitable standards and practices in such areas."

This Council would:

> " *** foster greater uniformity and consistency in the modernization of numerous bank examination and enforcement activities without most of the disadvantages feared from complete consolidation. In addition, it would permit undertaking a limited and circumscribed consolidation effort promptly, on an experimental basis, with flexibility to allow for revisions that prove desireable."

Office of the Comptroller of the Currency

Former Comptroller Smith "***approved in general the concept of a Federal Bank Examination Council to coordinate matters of policy***." However, he objected to giving the Council binding authority, rather than an advisory role, because "***policy questions should be finally decided according to the principles of the agencies involved" and because the "***possibility to innovate, which is the genius of the American bank regulatory system, would thus be seriously impeded." He also objected to vesting permanent chairmanship in FRS, preferring to have a rotating chairmanship. He suggested a more direct role for State agencies, including representation on the Council. (Letter to Sen. Proxmire, July 29, 1976.)

Federal Deposit Insurance Corporation

Chairman Barnett said: "While we heartily endorse the bill's objective *** we have serious reservations as to the need for nationally uniform examination standards and procedures."

The current diversity of responsibility--three Federal agencies and the States--leads to a greater "***possibility of useful innovation and improvement***." Such changes as those being implemented by OCC, "should not, however, require the approval and commitment of each of the other Federal bank regulatory agencies." (Speech, Nov. 11, 1976, to Missouri Bankers Association.)

OUR OBSERVATIONS

The extent of interagency cooperation and coordination is discussed in our recent report (OCG-77-1, ch. 11.). The only formal mechanism for coordination is the Coordinating Committee on Bank Regulation which was established in 1965. Other less formal exchanges of information also occur, but the full extent of coordination between the agencies was not determinable because it was not well documented.

We noted several areas where closer cooperation was needed among the three Federal bank regulatory agencies. We recommended that, to achieve such cooperation, the agencies or the Congress establish a committee of agency representatives to identify areas where interagency cooperation would be beneficial.

In March 1977 the Chairman of FDIC testified about the establishment of

> "a top level staff subcommittee made up of the senior examination staff officials of the FDIC, the Comptroller's Office, the Federal Reserve, and the Federal Home Loan Bank Board to coordinate matters relating to bank examination and supervision. The function of this Committee, which will meet on a continuing, periodic basis, is to provide a clearinghouse for ideas, policies and procedures in the area of examination and supervision."

Another means of furthering cooperation would be to establish an independent council or commission such as envisioned by S. 711. If the Congress decides to establish a Council we believe the following revisions to S. 711 should be considered.

--Expand the membership of the Council to include representatives from other regulators of financial institutions such as the Federal Home Loan Bank Board, National Credit Union Administration, Farm Credit Administration, and State bank supervisory agencies.

--Finance the operations of the Council through appropriations rather than from contributions from its members to allow the Congress to provide adequate resources for this activity as well as congressional oversight.

--Authorize the Council to hire its own staff so that it will not be dependent on the member agencies.

--Rotate chairmanship of the Council periodically among the Council members.

--Broaden the scope of the Council's authority. S. 711 provides that the Council (1) establish uniform Federal bank examination standards and procedures, and (2) may make recommendations for uniformity in other supervisory matters. In addition, the Council would conduct schools for Federal and State bank examiners and develop uniform reporting systems for banks, bank holding companies, and non-bank subsidiaries.

With respect to the requirement that the Council conduct schools for bank examiners, the Council might better serve as a vehicle for seeing that an adequate training program is provided and assuring effective cooperation and coordination between the various bank regulatory agencies and leave the actual training to the agencies.

The wording of S. 711 that the Council "may make recommendations for uniformity in other supervisory matters" leaves much to the discretion of the Council. Thus, there is no assurance that the Council would look into such areas as the supervision of bank holding companies, Edge Act and "agreement" corporations; or the handling of applications for structural changes in the banking system such as applications for new branches or to merge existing banks. The Congress may wish to specify the areas of bank supervision that the Council should deal with.

Also, it is not clear whether the standards, procedures, and recommendations of the Council would be binding on the agencies. If they are not intended to be binding, the Congress may wish to consider adopting one of the following alternatives.

Choice Number One

When a recommendation of the Council is found unacceptable by a Federal banking agency, the agency shall submit to the Council, within a time period specified by the Council, a written statement of the reasons that the recommendation is unacceptable.

Choice Number Two

When a recommendation of the Council is found unacceptable by a Federal banking agency, the agency shall submit to the Council and to both Houses of Congress, within a time period specified by the Council, a written statement of the reasons that the recommendation is unacceptable.

Choice Number Three

When a recommendation of the Council is found unacceptable by a Federal banking agency, the agency shall submit to the Council, within a time period specified by the Council, a written statement of the reasons that the recommendation is unacceptable. The Council shall reconsider such recommendations in light of agency objections. All such recommendations that are not withdrawn by the Council in light of agency objections shall be applied by the banking agencies.

CHAPTER 5

HOW BANKERS VIEW REGULATORY STRUCTURE

Part of our recent study (OCG-77-1) was a survey of commercial bankers. We asked senior bank managers whether they supported or opposed the current regulatory structure consisting of 3 Federal and 50 State regulatory agencies.

OVERALL RESULTS

While a majority of the bankers (58 percent) indicated they supported the current structure, this endorsement is not as overwhelming as one might expect, considering their responses to questions about bank examiners and examination. For example, senior Federal bank examiners' knowledge in 10 areas of bank operations covered by an examination was rated adequate or better by a much higher percentage--often as high as 90 percent. (See OCG-77-1, p. IV-4.)

Bankers were also asked to give their opinion on three possible alternatives to the present system. Two of the alternatives would have abolished the dual banking system by retaining only Federal regulatory involvement. These two alternatives were overwhelmingly rejected by the bankers. The third, and most favored, alternative would have consolidated Federal involvement in one agency while retaining State supervision. About an equal percentage of bankers opposed (44 percent) as supported (42 percent) the alternative. The remaining 14 percent were undecided.

GROUP RESULTS

We also grouped the bankers in several ways, such as by their Federal regulator, their bank's deposit size, their bank's management rating, and their status with their Federal regulator as a "problem" or "nonproblem" bank. In terms of these groupings, sources of support for the current system can be summarized as follows:

Retain the present system

-- State nonmember banks were the least supportive of the present system (48 percent indicated support).

-- Support for the present system increased as deposit size increased.

-- Problem banks were less supportive of the present system than nonproblem banks.

-- Support for the present system declined as a bank's management rating declined. This trend is congruent with the responses from problem banks.

No group of bankers supported either of the two alternatives which would eliminate the dual banking system.

Consolidated Federal supervision in one agency and retain State involvement

The responses to the alternative of one Federal agency together with State involvement can be summarized as follows:

-- State nonmember bankers were more supportive of this choice in comparison with the other two types of bankers.

-- Support for this alternative declined as deposit size increased.

-- Problem banks were slightly more supportive of this alternative than nonproblem banks.

-- Banks with the poorest management rating gave this alternative the greatest support.

CONCLUSIONS

The present system was endorsed by a majority of bankers, regardless of how they are grouped, with two exceptions. Less than half (48 percent) of State nonmember bankers (FDIC-examined) and bankers from "problem banks" (49 percent) supported the present system. We did not attempt to further isolate this group in terms of some other category such as deposit size or management rating.

In highlighting our study we concluded that:

"Our data revealed a seemingly contradictory pattern. While bankers from small banks tended to be more supportive of Federal bank examiners and the examination process than bankers from large banks, these same small bankers were less inclined to support the present structure of bank supervision. Bankers from small banks appear to strongly support what is being done, but they are somewhat ambivalent about who does it so long as the dual Federal-State involvement is preserved." (OCG-77-1a, p. 55)