111547

BY THE COMPTROLLER GENERAL

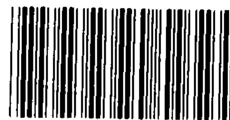
Report To The Congress

OF THE UNITED STATES

Federal Supervision Of Bank Holding Companies Needs Better, More Formalized Coordination

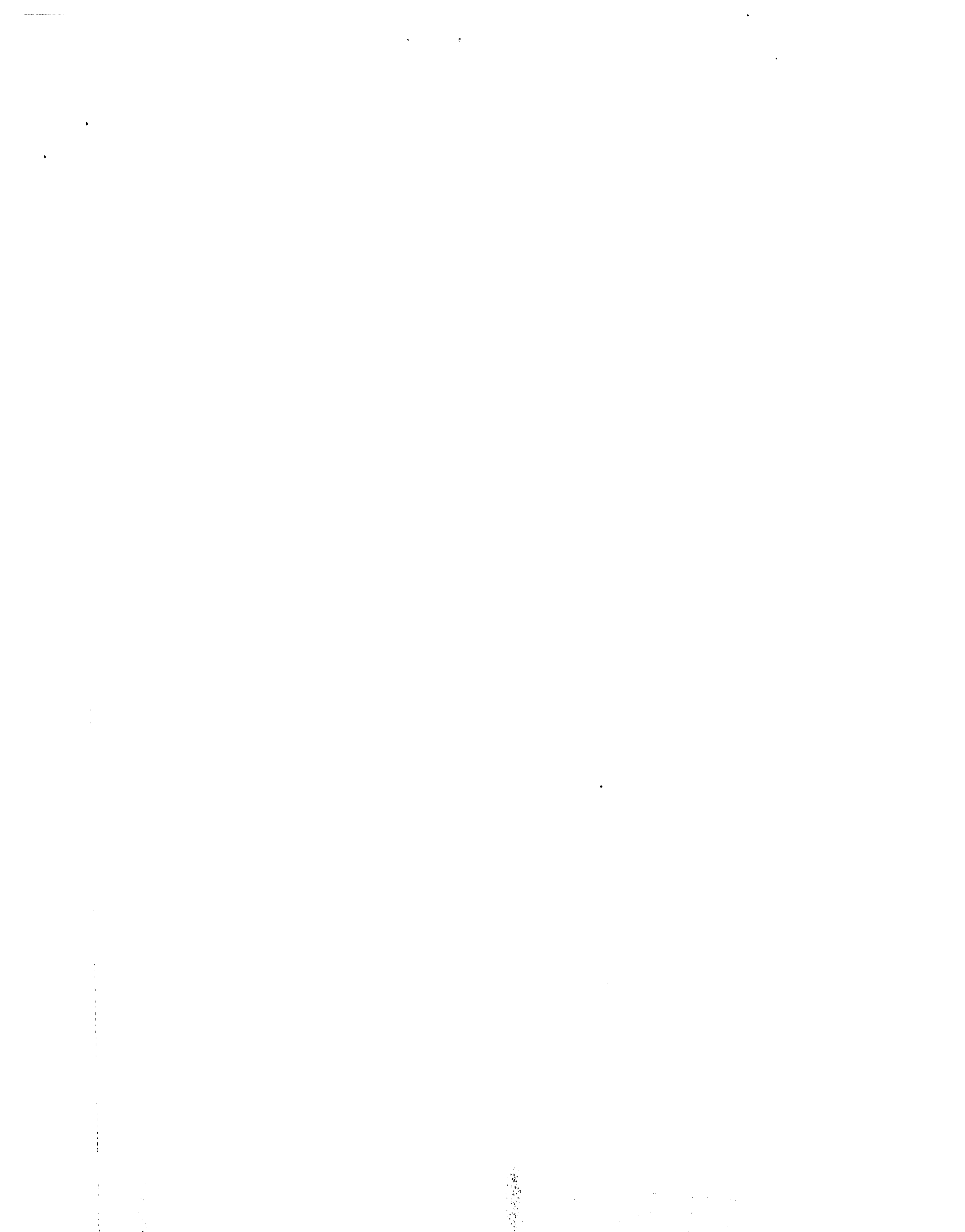
The three Federal banking regulatory agencies must better coordinate their efforts to supervise bank holding companies, which control almost three-fourths of all banking assets in the United States. Not supervising the companies as integrated units has led to problems in dealing with holding company banks in trouble.

GAO recommends that the Federal Financial Institutions Examination Council establish procedures to coordinate the examinations of holding companies and their bank subsidiaries and to coordinate any supervisory actions that must be taken to help solve problems that may exist.



008649

GGD-80-20
FEBRUARY 12, 1980



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-195515

To the President of the Senate and the
Speaker of the House of Representatives

This report describes how the Federal bank regulatory agencies are not adequately coordinating the supervision of bank holding companies and the problems that are caused by this situation. We recommend that the Federal Financial Institutions Examination Council develop procedures to improve coordination.

We undertook this review of bank holding company supervision because holding companies control banks with three-fourths of the Nation's banking assets, and because in the past holding company affiliations have contributed to some bank failures.

Copies of this report are being sent to the Chairman, Board of Governors of the Federal Reserve System; the Executive Secretary of the Federal Financial Institutions Examination Council; the Chairman, Board of Directors of the Federal Deposit Insurance Corporation; the Comptroller of the Currency; and the Secretary of the Treasury.

Elmer B. Staats
Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FEDERAL SUPERVISION OF BANK HOLDING COMPANIES NEEDS BETTER, MORE FORMALIZED COORDINATION

D I G E S T

Current Federal laws divide the authority for supervising bank holding companies and their subsidiary banks among three Federal agencies. This fragmented authority hinders the agencies' abilities to effectively supervise these financial institutions. More effective supervision of bank holding companies can be achieved through better coordination among the Federal agencies involved. The Federal Financial Institutions Examination Council, therefore, should formalize coordination procedures.

CURRENT STRUCTURE FRAGMENTS SUPERVISION

The Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve supervise different types of banks. About 4,600 national banks are supervised by the Comptroller. About 1,000 State banks which are members of the Federal Reserve System are supervised by the Federal Reserve. Other State banks with Federal insurance, over 8,700, are supervised by the Federal Deposit Insurance Corporation. Bank holding companies are supervised by the Federal Reserve under authority of the Bank Holding Company Act of 1956, as amended. But the Federal Deposit Insurance Corporation supervises 53 percent of all holding company bank subsidiaries, the Comptroller 39 percent, and the Federal Reserve only 8 percent. This means the supervision of most holding company organizations--that is, the authority to examine and initiate enforcement actions--is divided between at least two of the Federal bank regulatory agencies.

Banking experts agree that a holding company and its subsidiaries ought to be supervised as a single integrated entity (see p. 6.) because

--Holding companies are managed as a single entity.

--Within a given holding company, operations in one subsidiary affect the company's affiliated organizations.

--To spot potential problems, bank supervisors need complete and current information on the entire holding company and its operations.

The current legal structure for supervising bank holding companies inhibits the Federal banking agencies' attempts to treat holding companies as single entities. The very complexity of this structure requires a rigorous coordination effort which has not successfully operated on an informal basis. According to bank regulators, coordination is not good enough even in routine cases. Coordination is all the more crucial when Federal regulatory agencies have to deal with holding companies having problems.

COORDINATION OF HOLDING COMPANY SUPERVISION INADEQUATE

Evidence shows the need for better coordination among the Federal bank supervisors. Voluntary efforts at cooperation have been, in some cases, ineffective. GAO found that the agencies took uncoordinated actions against holding companies and their subsidiary banks that did not solve their problems. (See p. 8.)

For example, in one case GAO reviewed, the Federal Reserve required a holding company to increase its capital; the company chose a method for doing so that could have endangered a bank subsidiary supervised by the Federal Deposit Insurance Corporation. The latter agency, acting independently of the Federal Reserve, then issued an order protecting the bank that, in effect, prohibited the holding company from carrying out its plan to comply with the Federal Reserve's requirement. (See p. 11.)

The Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Conference of State Bank Supervisors have suggested that the supervisor of a holding company's lead bank be given responsibility to supervise the parent company and its nonbank subsidiaries. This suggestion has merit, and, in the long run, may be the best solution. However, such a solution would require significant changes in supervisory authority and agency relationships. (See p. 17.)

The Congress established the Federal Financial Institutions Examination Council in 1978 to promote better coordination among the Federal bank regulators. Formal procedures established under the auspices of the Council could improve bank holding company supervision without having to make more dramatic changes in the Federal supervisory structure.

CONCLUSIONS AND RECOMMENDATIONS

The current structure for supervising bank holding companies inhibits effective supervision, especially in cases requiring coordinated actions by regulators to solve a company's problems. Better coordination is needed in gathering information and in dealing with holding companies in trouble.

The Federal Financial Institutions Examination Council should develop procedures to improve the coordination of bank holding company supervision. The Congress established the Council to provide for better coordination among the Federal bank supervisory agencies. The Council should be given a chance to succeed in its mission before the Congress considers other legislative changes in the way holding companies are supervised.

Accordingly, GAO recommends that the Federal Financial Institutions Examination Council develop procedures to improve holding company supervision by coordinating examinations

and by structuring the process used to decide on appropriate supervisory actions to be taken when necessary. (See p. 21.)

AGENCY COMMENTS

The Comptroller of the Currency and the Federal Deposit Insurance Corporation disagreed with GAO's conclusion that the problems GAO found could be solved through better, more formalized coordination. They believe that a legislative change is needed--designating the holding company's lead bank supervisor as the holding company's supervisor. (See app. I and III.)

The evidence reviewed by GAO does not support the need for a major legislative change. Rather, it indicates the need for closer cooperation among the agencies--cooperation that GAO believes should be effected through the Federal Financial Institutions Examination Council.

Both the Federal Reserve and the Council implicitly agreed with the thrust of GAO's recommendations, and the Council informed GAO that it has adopted policies similar to those which GAO recommends. (See app. IV.) GAO reviewed those policies and believes they could, if properly applied, significantly improve bank holding company supervision.

C O N T E N T S

		Page
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	What is a bank holding company?	1
	Evolution of bank holding company legislation and supervision	1
	Federal legal structure divides holding company supervision	3
2	FEDERAL BANK REGULATORS MUST COORDINATE THEIR EFFORTS TO SUPERVISE BANK HOLDING COMPANIES	5
	Holding companies are not supervised as single entities	7
	Uncoordinated supervision delays or hampers solutions to holding company problems	8
	Conclusion	16
3	ALTERNATIVE SOLUTIONS: RESTRUCTURE OR COORDINATE	17
	Holding company supervision is part of total consolidation question	17
	Lead bank supervisor could also supervise holding companies	17
	Formalized coordination could improve holding company supervision	19
	Federal Examination Council has not taken strong enough action to solve the basic problems	19
	Conclusion	20
	Recommendations to the Federal Financial Institutions Examination Council	21
	Agency comments	22
4	SCOPE OF REVIEW	25

APPENDIX		Page
I	Letter dated November 23, 1979, from the Comptroller of the Currency	26
II	Letter dated November 23, 1979, from the Board of Governors of the Federal Reserve System	29
III	Letter dated November 30, 1979, from the Federal Deposit Insurance Corporation	32
IV	Letter dated December 7, 1979, from the Federal Financial Institutions Examination Council	34

ABBREVIATIONS

FDIC Federal Deposit Insurance Corporation

GAO General Accounting Office

CHAPTER 1

INTRODUCTION

Throughout the history of commercial banking, bank owners have used several ways to expand their markets, both geographically and in the types of services they offered. Group banking--the formation of a bank holding company--is one of those ways, and the Congress has been creating and amending legislation to allow the Federal bank regulatory agencies to deal with it.

WHAT IS A BANK HOLDING COMPANY?

A bank holding company is a form of bank ownership in which individuals own a company which, in turn, owns stock in a bank. A bank holding company can be a corporation, partnership, trust, or similar organization that has control of a bank or another bank holding company. People may choose the holding company form rather than direct ownership of bank stock because holding companies:

--Enjoy certain tax advantages.

--Can often own more than one bank in States that prohibit branch banking.

--Can own nonbanking subsidiaries as well as banks and can extend these activities across State lines.

--Enjoy a wider market for obtaining capital than do individual banks.

As of December 1978, 2,113 bank holding companies (excluding multitiered companies) controlled 4,101 of the 14,602 commercial banks in the United States. But holding company banks held more than 73 percent of all banking assets. The vast majority of the holding companies--1,799--control only one bank. The rest control two or more banks. A few holding companies have dozens, even hundreds of nonbank subsidiaries including, but not limited to, such activities as insurance, mortgage lending, leasing, and personal finance companies. Some companies have no nonbank subsidiaries.

EVOLUTION OF BANK HOLDING COMPANY LEGISLATION AND SUPERVISION

Historically, both the Congress and the bank regulators have been concerned with maintaining competition in

the [illegible] by [illegible]ting concentration of financial [illegible] some banks failed in the early 197[illegible], [illegible] of holding company affiliation, the [illegible] concerned about protecting ban[illegible] companies. The Congress exhibited this concern by [illegible] legislation giving the regulatory agencies [illegible] to deal with holding companies in trouble. The Federal Reserve increased its bank holding company [illegible], 1/ which had not been significant before [illegible].

The basic [illegible] holding companies is the Bank Holding [illegible] (70 Stat. 133). This is the framework of [illegible] regulation and supervision, though it was [illegible] amended in 1966, 1970, and 1978.

The 1956 [illegible] companies, established the Federal [illegible] regulator and supervisor, and provided the framework for those functions. Most of the 1956 act [illegible] the formation of holding companies and the acquisition of subsidiaries. The act placed little emphasis [illegible] other than permitting the Federal Reserve [illegible].

The 1966 amendments [illegible] 236) again emphasized competition in the banking industry. They expanded the number of organizations cover[illegible] the act and applied limitations on transactions [illegible] affiliated organizations of a holding company. But most significantly, the amendment applied [illegible] of the Sherman and Clayton antitrust acts to the Federal Reserve's considerations for approving holding company [illegible]ations and acquisitions.

In response to the increasing number of one-bank holding companies in the 196[illegible], the Congress passed the 1970 amendments to the Bank Holding Company Act (84 Stat. 1760). Until then, the one-bank companies had not been covered by the act. But because some large one-bank companies were acquiring many nonbanking activities, the Congress became concerned about potential overconcentration of financial power. Thus, the 1970 amendments sought to circumscribe the kinds of nonbanking [illegible] all bank holding companies could own.

1/In this report, holding [illegible] supervision means the onsite examination [illegible] of the parent company and its subsidiaries and the authority to take formal enforcement action [illegible] holding company itself.

The early 1970s saw a great increase in the number of bank failures from 3 in 1972 to 16 in 1976. At least three of the banks that failed in 1976 had holding company affiliations that contributed to their problems. As a result, the Congress became more concerned about the supervision of individual companies. In November 1978, it passed the Financial Institutions Regulatory and Interest Rate Control Act (Public Law 95-630) which, among other things, gave the Federal Reserve more supervisory tools to use in dealing with recalcitrant holding company managements.

The Federal Reserve had not been very active in examining holding companies until the mid-1970s. In a 1977 report to the Congress, 1/ we pointed out that many Federal Reserve banks did not begin formal holding company inspection programs until 1974. In fact, in all of 1975, only 13 percent of the bank holding companies were inspected, and most of the inspections were made by only 3 of the 12 Federal Reserve banks.

In the last 2 years, the Federal Reserve has taken steps to improve its supervision of bank holding companies. In 1978, it began using a systemwide standard inspection report. In 1979, it completed a bank holding company inspection manual and it developed a more comprehensive computerized surveillance operation. Finally, it designed special training courses for individuals who actually inspect the holding companies.

Thus, the emphasis in bank holding company regulation has evolved from one of preserving industry competition to an added one of preserving the soundness of individual holding company banks.

FEDERAL LEGAL STRUCTURE DIVIDES HOLDING COMPANY SUPERVISION

Although the emphasis in bank holding company regulation evolved over the years, the regulatory structure for supervising the companies has not changed since 1956. Three Federal banking agencies share supervision of U.S. banks. The Federal Reserve supervises bank holding companies, but those companies' subsidiary banks may be supervised by any of the Federal bank regulatory agencies, depending on the category of the bank.

1/"Federal Supervision of State and National Banks" (OCG-77-1, Jan. 31, 1977).

Banks can be classified into four broad categories:

--National banks, which are chartered by the Comptroller of the Currency, belong to the Federal Reserve System, and are insured by the Federal Deposit Insurance Corporation (FDIC).

--State banks, which are chartered by a State bank regulator, belong to the Federal Reserve System, and are insured by FDIC.

--State-chartered banks insured by FDIC but not members of the Federal Reserve System.

--State-chartered banks not associated with any Federal bank regulatory agency.

Although a bank's charter, Federal Reserve membership, and FDIC insurance could entail overlapping Federal regulatory authority, in practice the Federal bank regulators divide supervisory responsibilities. The Comptroller of the Currency directly supervises national banks, the Federal Reserve supervises its member State banks, and FDIC supervises federally insured State banks that are not members of the Federal Reserve.

A bank holding company can own one or more banks that fall in the first three categories listed above. Therefore, even though the Federal Reserve supervises the holding company, the subsidiary bank(s) may be supervised by the other Federal agencies. The latest figures available (June 1978) show that the FDIC supervises about 53 percent of all holding company bank subsidiaries, the Comptroller supervises 39 percent, and the Federal Reserve 8 percent. 1/ Normally the Comptroller and FDIC do not examine the parent companies of banks they supervise. However, both Federal agencies have the authority to examine the affiliates of banks they supervise.

1/By comparison, of all insured banks, FDIC supervised about 61 percent (over 8,700), the Comptroller supervised 37 percent (about 4,600), and the Federal Reserve 7 percent (about 1,000).

CHAPTER 2

FEDERAL BANK REGULATORS MUST COORDINATE THEIR EFFORTS

T^ SUPERVISE BANK HOLDING COMPANIES

Effective supervision of bank holding companies has been inhibited by a lack of coordination among Federal regulatory agencies. Without formalized coordination procedures, the agencies cannot ensure that their supervisory actions will be complementary. To prevent the problems of one member in a holding company from adversely affecting the soundness of its affiliates, bank regulators should treat a holding company and its subsidiaries as an integrated entity.

Such treatment, however, requires a level of interagency coordination that does not exist among the three Federal agencies whose responsibility is divided for supervising bank holding companies and their subsidiary banks. Because agencies have not sufficiently cooperated in their supervision of bank holding companies, they have taken different actions which could ultimately undermine the effectiveness of those actions.

Researchers' limited studies conclude that most holding companies try to manage their organizations as integrated entities. Holding company management may not always get involved in all operational areas, but they often set management philosophies and operating policies.

For example, a Federal Reserve staff study concluded that, "While the evidence is limited, it nevertheless suggests that most BHCs [bank holding companies] are trying to manage their organizations as integrated entities, at least to some degree." 1/

Sometimes a holding company's attempt to maximize its operations as a whole works to the detriment of specific subsidiaries. In extreme cases, holding companies have used subsidiary banks' funds to cover problems in the operations of other subsidiaries in the same companies. For example, in one instance often cited by bank regulators, the management of Hamilton Bancshares, Inc., a large holding

---

1/"The Bank Holding Company Movement to 1978: A Compendium," study by the staff of the Board of Governors of the Federal Reserve System, September 1978, p. 89.

company, required a subsidiary bank to purchase poor loans made by a mortgage company subsidiary. Ultimately, the bad loans placed such a drain on the bank's funds that the bank failed.

Such cases have convinced both bank examiners and holding company inspectors that they need as much data as possible on the operations of an entire holding company in order to carry out their supervisory activities effectively. The condition of the subsidiary banks, especially lead banks, is the key to the condition of the holding companies. Therefore, the holding company inspectors need as much information as possible on the banks, and the bank examiners need to know the current condition of the holding company and the nonbank subsidiaries in order to determine what effect they might have on the banks. As a former FDIC chairman pointed out, "It is simply a form of self-deception to think that the lead bank in a holding company, or any other holding company banking affiliate for that matter, is in a safe and sound condition just because its last examination was satisfactory, unless other bank holding activities have undergone rigorous scrutiny." 1/

Other banking experts also agree that holding companies must be supervised as integrated entities. The current FDIC Chairman testified before Senate committees in February 1979 that, "We have now had the benefit of experience since the 1970 amendments to the Bank Holding Company Act, and this experience has clearly demonstrated that each holding company system must be regarded as an integrated unit." 2/ Testifying before the same committees, the Deputy Secretary of the Treasury stated, "Most regulators agree that holding companies and their bank and nonbank affiliates should be examined in a process that recognizes that they are a single entity and that transgressions in one part of a system will inevitably affect other portions." 3/

1/Former Chairman George A. LeMaistre, in an address before the Association of Bank Holding Companies, Boca Raton, Florida (Nov. 3, 1977).

2/Statement on S. 332, Consolidated Banking Regulation Act of 1979, presented to the Senate Committees on Governmental Affairs and on Banking, Housing and Urban Affairs, by Irvine H. Sprague, on February 28, 1979, p. 6.

3/Statement by the Honorable Robert Carswell on S. 332 on February 28, 1979, p. 1.

HOLDING COMPANIES ARE NOT SUPERVISED AS SINGLE ENTITIES

Although bank holding companies should be supervised as integrated entities, fragmented supervisory authority inhibits the various agencies from closely coordinating their actions with regard to holding companies and bank subsidiaries. The inhibition is manifested in two ways. First, the agencies have not coordinated their holding company inspections and bank examinations on a regular basis. Second, they do not have an orderly process by which to coordinate complementary supervisory actions taken against holding companies and their bank subsidiaries.

The Federal Reserve's approach to supervising holding companies involves the periodic onsite examination (inspection) of a holding company by Federal Reserve inspectors, supplemented by monitoring data gathered from reports filed by the companies and reports of subsidiary bank examinations. The Federal Reserve inspectors also review records of nonbanking subsidiaries. The inspectors normally do not, however, examine the bank subsidiaries of a holding company. Rather, they review reports of examination prepared by Comptroller, FDIC, and Federal Reserve bank examiners.

Limited statistics show that supervisors can best spot problems in holding companies when they put together data from the primary bank examiner and the holding company supervisor. In 1978 one Federal Reserve district we reviewed carried 36 bank holding companies on its so-called "problem list." Federal Reserve examiners ascertained that the problems existed in 17 of those companies from a combination of holding company inspection reports, bank examination reports, and holding company annual reports. They detected problems in 14 companies from the Comptroller's and FDIC's bank examination reports. In only five cases were problems uncovered just from the Federal Reserve's holding company inspections.

Although the Federal bank regulators have agreed to exchange bank examination and holding company inspection reports, the information being exchanged can be outdated since examinations and inspections are not coordinated. In the Atlanta District, Federal Reserve officials said that too often the bank examination reports they receive to evaluate holding company soundness are not current. In the Kansas City District, last year an average of about 3 months elapsed between the time the Comptroller and FDIC completed their bank examinations and the time the Federal Reserve received them. This could delay the perception of a problem in a subsidiary bank by the Federal Reserve.

Bank regulatory officials believe that the best way to get a complete picture of the condition of a holding company and its subsidiaries is to coordinate their examinations. To this end, the Comptroller's office used to make its own holding company examinations in some regions in the days before the Federal Reserve had increased its own holding company inspection efforts. Both FDIC and the Comptroller have, on occasion, examined simultaneously all the subsidiary banks of a holding company. All three Federal agencies have tried on occasion to conduct joint or coordinated examinations of the holding company and its subsidiaries, especially in companies having supervisory problems.

Examinations are not regularly coordinated. Although agency officials in the New York Federal Reserve District felt their arrangements work well, Atlanta district Federal Reserve officials told us that because of frequent mutual scheduling problems, they cannot always conduct regular coordinated lead bank examinations and holding company inspections in spite of attempts to do so with the Comptroller's regional office. They did not coordinate examinations at all with FDIC. In the Kansas City district, the Federal Reserve bank had conducted only four joint holding company/bank examinations in 1977 and 1978, and those were in special problem cases. The Federal banking agencies in that district told us their present coordination procedures could be improved. According to a Deputy Comptroller of the Currency, scheduling problems among the three Federal agencies inherently limit their ability to conduct coordinated examinations.

Although Comptroller and FDIC field staff are pleased at the higher quality of the Federal Reserve's new holding company inspections, the current regulatory structure requires more interagency coordination than now occurs. As our next section discusses, coordination is all the more crucial when agencies take actions to deal with banks having problems.

UNCOORDINATED SUPERVISION DELAYS OR HAMPERS SOLUTION OF HOLDING COMPANY PROBLEMS

Because holding company affiliates are supervised as discrete entities, Federal regulators have sometimes been unable to detect holding company-related problems in time to effect solutions. Even when regulators detect problems, however, their lack of coordinated efforts has led to incompatible supervisory actions that do not solve the problems.

Each Federal bank regulatory agency is empowered to take specific formal actions to influence banks and holding

companies to solve problems. 1/ In general, the Comptroller can take action against national banks, the Federal Reserve against State-chartered banks that are members of the Federal Reserve System, and the FDIC against State nonmember insured banks. The Federal Reserve is the only Federal bank regulator that can take formal actions against a bank holding company.

Federal agencies sometimes take different supervisory actions against affiliates within a holding company having problems. While taking different actions is not always inappropriate, it can undermine the effectiveness of the actions, thus perpetuating the problems.

In studying this problem we had to determine

--if a lack of coordination has occurred in a significant number of cases and

--whether the uncoordinated effort actually harmed financial institutions.

To do this we reviewed cases in which one or more of the Federal bank regulators took a formal action against a bank holding company or one of its bank subsidiaries for unsafe, unsound practices. The cases we reviewed--48 that occurred in the last 4 years--included those in which Washington Federal bank regulators told us they had trouble coordinating supervisory actions.

From these 48 cases we found 16 that showed a significant lack of coordination. Four of them are summarized below to illustrate the problems we found.

Case I

This first case illustrates the best example of coordinated examinations and inspections by the three Federal bank supervisors. Still, they took different supervisory actions because the cooperation was not the result of a formal orderly process. In the end, the agencies simply went in different directions.

> The case involves a multibank holding company with bank subsidiaries supervised by all three Federal bank regulators. The company also had some small nonbank subsidiaries, one of which was a mortgage loan company.

1/These actions are specified in 12 U.S.C. 1818 and 12 U.S.C. 1844.

In mid-1975, the three bank regulators held joint examinations of the holding company and the banking and nonbanking subsidiaries. The examinations disclosed serious problems in some of the banks caused by the holding company. According to the Federal Reserve, principals of the holding company used the banks as a captive source of funds by forcing them to make improper loans to insiders. The holding company also arranged credit through its banks and charged the banks excessive fees for this service.

The Federal Reserve issued a cease and desist order against the holding company and the bank subsidiaries it supervised in February 1976. Although it informed the Comptroller and FDIC of the action, it could only suggest that these agencies take similar action against the banks they supervised in order to protect them. The Comptroller agreed with the suggestion and took action against the national bank he supervised. FDIC took no action against the banks it supervised.

During 1977, earnings from bank operations were still well below what the Federal Reserve felt they should have been. According to the Federal Reserve, four of the subsidiary banks continued to have some difficulties, and two were FDIC-supervised banks. Finally, in June 1978, the holding company sold its lowest rated FDIC subsidiary bank to generate cash. As a result, the condition of the remaining banks improved, and the cease and desist orders were terminated.

The fact that the Federal agencies chose different supervisory actions is not detrimental, per se. However, the differences were not the result of an orderly, coordinated decisionmaking process. No matter how good the informal coordination was, the agencies appeared in the end to go their own separate ways.

Case II

The next case illustrates that each Federal bank regulatory agency, following its statutory responsibilities, must concern itself primarily with the segment of a holding company under its jurisdiction. This traditional parochial concern leads to uncoordinated and perhaps noncomplementary supervisory actions.

In this case the bank holding company had two commercial bank subsidiaries and a mortgage banking

subsidiary. One of the commercial banks was a national bank supervised by the Comptroller, and the other a State member bank supervised by the Federal Reserve.

Loan losses in the mortgage bank placed a heavy drain on the holding company, and the subsidiary commercial banks were used to cover those losses. After several years of declining earnings, the holding company posted a sizable consolidated loss.

The Comptroller found in his examinations that the national bank was in such unsatisfactory condition that his staff requested the bank's board of directors to restrict dividends paid to the holding company. This agreement, in effect, shifted a greater funding burden to the Federal Reserve's bank subsidiary. While the national bank's dividends to the holding company declined to zero, the Federal Reserve bank subsidiary nearly doubled its payments.

The condition of the Federal Reserve's bank and the holding company began to improve, but the Comptroller was not satisfied with the condition of the national bank. He entered into a written understanding with its board to take steps to improve it. After making an examination in November 1978, the Comptroller felt that the holding company would have to inject capital into the national bank and pressed it to do so.

The Federal Reserve, however, believed that the holding company was in no position to inject the capital needed by the national bank and so did not encourage it.

This case illustrates the anomaly of the Federal supervisory structure. Although the holding company was definitely functioning as an integrated entity, the supervisors were not treating it as one. The nonbank subsidiary was a drain on the parent company and consequently on the subsidiary banks, but the regulators could address only the conditions of organizations within their own jurisdictions.

In extreme situations, when the Federal agencies do not take coordinated supervisory actions, holding-company-related problems may become more serious. Some bank regulators have stated that this possibility justifies reorganizing supervisory responsibilities. The next two cases illustrate.

Case III

In the following case the bank supervisor, who is supposed to determine the bank's safety and soundness, felt

that the Federal Reserve's approach with the holding company would have been detrimental to the bank. The Federal Reserve, however, disagreed and felt it could deal adequately with the holding company. Consequently, uncoordinated approaches led to different supervisory actions. The bank supervisor felt that the holding company's reaction to the Federal Reserve's supervisory efforts could have endangered the bank.

> The holding company owned one bank and three non-bank subsidiaries. The bank was an insured State non-member bank supervised by FDIC. The parent company was dominated by its board chairman, who was also its president and owned over half of the holding company's outstanding stock. The Federal Reserve had criticized the holding company management for failing to correct a variety of serious problems.
>
> During an inspection of the holding company, the Federal Reserve found that it was in unsatisfactory condition. Because the holding company used a lot of debt financing, the Federal Reserve entered into a memorandum of understanding with the company's management to have them increase the company's capital.
>
> The holding company tried to accomplish this by forming a trust plan, with the subsidiary bank as trustee. The trust borrowed from the holding company so that the trust could buy the holding company's stock. The plan called for the holding company and its subsidiaries to service the trust's debt.
>
> In its review of the trust plan, FDIC decided that if the plan were permitted to continue as originally designed, the result would be an additional drain on the bank. FDIC issued an emergency cease and desist order against the bank, prohibiting it from disbursing any funds to the holding company and/or to any other party that would be for the benefit of the holding company. Later, the plan was allowed to continue under stricter supervision by FDIC.

Although the appropriateness of each agency's actions is not at issue here, this case clearly demonstrates the lack of a coordinated approach to solving this company's problems. Each agency addressed its own constituent institution's problems. Had the bank regulator and the holding company regulator coordinated more closely between themselves and with the holding company management, FDIC emergency action might not have been necessary.

Case IV

This case illustrates several points. First, the chief executive of this multibank holding company exercised a great deal of control over the subsidiary banks and caused problems for them. Second, bank examiners had to make their own examination of the holding company to get a unified view of it. Third, even though the three banking agencies tried to cooperate in their treatment of the holding company as a unit, the results were not satisfactory to all parties. Fourth, the bank supervisor was limited in his ability to deal with the problem because of the split supervisory authority. Finally, corrective actions by the agencies were delayed because of divided supervisory responsibilities.

> This holding company owned a State-wide network of commercial banks, made up of national banks, State member banks and State nonmember banks. Regulators had cited most of the subsidiary banks for different problems at various times. All three Federal regulatory agencies had criticized the holding company's president for self-serving practices which he imposed on the subsidiary banks. These practices included placing insider loans at subsidiary banks, forcing the banks to purchase low quality loans from affiliated banks, and forcing them to provide an excessive amount of funds to the holding company.
>
> The Comptroller's office noted deteriorating conditions in the national banks as early as June 1976. After examining one national bank, the Comptroller's examiners requested and received assurances from the bank's board of directors that holding-company-mandated actions would be reviewed more closely in the future. Subsequent examinations convinced the Comptroller that the holding company was still taking actions detrimental to the bank and that the bank's condition was deteriorating.
>
> The Comptroller exercised his authority to examine the holding company in April 1977 in order to get more in-depth information about the relationship between the parent company and its subsidiary banks. From this examination, the Comptroller found that the holding company was deeply in debt and noted problems in the method by which the company assessed fees against subsidiary banks.
>
> The Comptroller's examination of the national banks in June 1978 noted still further increases in previously criticized payments to the holding company. In July

1978, the Comptroller, Federal Reserve, and FDIC regional officials met to coordinate Federal enforcement actions against the holding company and to discuss results of the Federal Reserve's recent inspection of the company. The Federal Reserve examiners had also found that the company was deeply in debt and involved in various insider transactions. This confirmed the findings of the earlier holding company examination by the Comptroller.

Some officials of the Comptroller's office considered taking formal action against the national bank subsidiaries in mid-1978. They delayed action pending the Federal Reserve's review of the situation. The Federal Reserve decided to require the holding company to submit a written plan designed to prevent further abuses of the bank subsidiaries and to limit the level of funds upstreamed to the parent.

The Comptroller went along with the Federal Reserve's less formal action for several reasons. First, the Comptroller's staff felt that, on the basis of the holding company's past history, even if they had taken formal action against the bank subsidiary the parent holding company probably would have devised some means to circumvent it. In addition, the Federal Reserve had supervisory authority over the holding company and therefore had more control over transactions initiated by it. For these reasons, and to cooperate with the Federal Reserve, the Comptroller took no formal action against the national banks, even though it was considered.

In June 1979 the Federal Reserve again inspected the holding company. The regulators found that the company had failed to follow the agreed upon plan. In fact, the Federal Reserve found that the bank subsidiaries were not even familiar with the plan. The company was in such bad condition that the Federal Reserve Bank's director of inspections recommended that formal action be taken, a year after the Comptroller's staff had considered it.

It is not our purpose to conclude which agency was right. What concerns us in this case is that no formal process existed that might have resulted in more timely action being taken.

Banking experts often cite other cases in which holding companies caused serious problems for their banks, but in which the Federal agencies could not adequately perceive those problems due to their individual points of view.

Testifying in 1976 before the Senate Committee on Banking, Housing and Urban Affairs, the then Commissioner of Banks for the Commonwealth of Massachusetts gave the following example from her State:

> "With divided responsibilities, problems do slip by regulators. An example from a recent experience in Massachusetts provides a case in point. 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 communication 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."

In the February 1979 testimony mentioned on page 6, both the Comptroller of the Currency and the Chairman of the FDIC cited the case of the Hamilton National Bank in Chattanooga, Tennessee, as another example of a situation that eluded the Federal regulators until it was too late to take effective

action. In this case, bad loans from the holding company's mortgage subsidiary were transferred to the lead bank, ultimately causing the bank to fail.

Our own review of the Hamilton case confirmed that the Comptroller and the Federal Reserve had not organized their efforts to treat the holding company as an entity. The Federal Reserve made a special investigation of the holding company only after it noticed a large increase in the holding company's short term borrowing. This investigation disclosed the fact that problems existed in the mortgage subsidiary that would affect the bank. After that disclosure, the Comptroller reexamined the bank. (A previous examination, which was independent of the Federal Reserve, had been made 8 months earlier.) Until that time, neither agency had obtained the complete picture of the holding company as an entity.

While it would be speculative to say a different supervisory approach could have saved the bank, banking experts point to this case to illustrate the supervisory structure problem. Had the agencies taken a more comprehensive view of what was happening, severe bank problems might have been averted by more timely action by the Federal regulators.

CONCLUSION

The divided legal structure for supervising bank holding companies and their subsidiaries requires that the Federal regulators carefully coordinate their actions. While there is not an overwhelming number of cases in which poor coordination has harmed banks, evidence clearly indicates the potential for serious problems to develop because the Federal agencies have not treated bank holding companies as integrated business entities. Since their past efforts to coordinate were ad hoc and voluntary, a more formalized procedure is needed.

CHAPTER 3

ALTERNATIVE SOLUTIONS: RESTRUCTURE OR COORDINATE

Several alternatives exist that could improve the effectiveness of bank holding company supervision. They can be grouped into three categories: restructure the way the Federal Government supervises banks, restructure the way it supervises bank holding companies, or improve coordination among the Federal agencies. Although suggestions for restructuring have merit, the Federal Financial Institutions Examination Council, recently created by Congress to improve interagency coordination, should be given a chance to solve the problems before the more drastic step is considered.

HOLDING COMPANY SUPERVISION IS PART OF TOTAL CONSOLIDATION QUESTION

Problems resulting from the fragmented supervision of bank holding companies have been cited as one reason for consolidating the Federal bank regulatory agencies. Consolidating the Federal bank regulatory agencies would be one way to solve the problems we cited in chapter 2.

The question of whether to consolidate the Federal bank regulatory agencies, however, involves many more issues than just holding company supervision. We cannot justify recommending a total restructuring of Federal supervision solely on the basis of problems in holding company supervision found in this review. Furthermore, we pointed out in our 1977 issue paper entitled "The Debate on the Structure of Federal Regulation of Banks," 1/ that from our limited work, "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."

LEAD BANK SUPERVISOR COULD ALSO SUPERVISE HOLDING COMPANIES

As an alternative to total consolidation, bank regulators have suggested that the supervisor of a holding company's lead bank should also supervise the parent company and its nonbank subsidiaries. This suggestion has merit for several reasons, but still involves a considerable restructuring of legislative authority.

1/OCG-77-2 (Apr. 14, 1977, pp. 20 to 22).

In early 1979, representatives of Federal and State bank supervisory agencies testified before the Senate Committee on Banking, Housing and Urban Affairs on the question of consolidating the Federal banking agencies. The Comptroller of the Currency, the Chairman of the FDIC, and a spokesman for the Conference of State Bank Supervisors all acknowledged that the fragmented supervision of holding companies was a problem. They recommended that instead of total consolidation, the Federal agency supervising a holding company's lead bank, typically the company's largest bank, also supervise the holding company itself. More specifically, in testimony and in interviews with us, the regulators recommended that the lead bank's supervisor:

--Have the authority to examine the parent holding company and its nonbank subsidiaries.

--Have the authority to take legal action directly against a holding company and its management.

--Coordinate the examinations of the other bank subsidiaries by their respective supervisors.

The suggestion to give the lead bank supervisors responsibility to supervise holding companies has great merit. The reasons for making this suggestion, discussed below, are persuasive.

The lead bank's supervisor is in the best position to supervise the holding company because:

--The condition of the lead bank is usually the key to the condition of the holding company.

--Most holding companies have only one bank, and in the majority of those, the bank holds most of the company's assets.

--Senior officials at a lead bank may serve in management positions in its holding company.

Even this limited restructuring of supervisory responsibilities, though, would require major legislative changes. The Federal agencies would have to reapportion their resources, and the Comptroller and FDIC probably would need more staff. The most significant change would be in the relationships among the agencies. With regard to each holding company, this alternative amounts to a consolidation of authority, because the lead bank supervisor would have to be

given the power to make the final decision on examination scheduling and on any necessary legal supervisory action taken. This, in effect, subordinates the other Federal agencies to the lead bank supervisor.

Furthermore, since three different Federal agencies would be supervising holding companies, the need for coordination would still exist because of the requirement to enforce uniform regulations relating to bank holding companies. To treat holding companies consistently, the Federal agencies would have to develop standards for their supervision, much as is required now for bank supervision.

FORMALIZED COORDINATION COULD IMPROVE HOLDING COMPANY SUPERVISION

By formalizing coordination procedures, Federal bank regulatory agencies could improve the supervision of bank holding companies. The Federal Financial Institutions Examination Council should become more actively involved in the regulators' coordination efforts.

The case studies in chapter 2 evidence a lack of coordination among the Federal bank regulatory agencies in two areas: in the gathering of information about holding companies and their subsidiaries and in the actions taken to influence bank and holding company managers to solve problems. Coordination was weak in these cases because cooperative efforts were ad hoc and totally voluntary. No formal agreements existed on coordinating examination schedules or deciding on legal actions. As a result, each agency concerned itself primarily with its own constituent institution.

FEDERAL EXAMINATION COUNCIL HAS NOT TAKEN STRONG ENOUGH ACTION TO SOLVE THE BASIC PROBLEMS

The Federal Financial Institutions Examination Council was created by Title X of Public Law 95-630, dated November 10, 1978. Its purpose was to prescribe uniform principles and standards for the Federal examination of financial institutions. Section 1006 (b) (1) provides that the Council "shall make recommendations regarding the adequacy of supervisory tools for determining the impact of holding company operations on the financial institutions within the holding company..."

The Council has addressed the problem of divided Federal authority for holding company supervision. It established a subcommittee on "integrating bank holding company

supervision." The subcommittee discussed and recommended policies to improve the coordination of holding company examinations and to improve interagency "communication and participation in preparing formal corrective supervisory actions."

The actions originally envisioned by the Council subcommittee, however, were not strong enough. They still relied on the voluntary cooperation of the Federal agencies. Furthermore, they had no mechanism to resolve disagreements on supervisory actions needed to correct financial institutions' problems. As we concluded in chapter 2, voluntary efforts to cooperate have not been able to overcome the basic division of supervisory authority in the cases we reviewed.

On December 7, 1979, after our review had been completed, the Council informed us of the coordination procedures it had just adopted. (See app. IV.) Influenced in part by our draft report, the Council's final procedures are stronger and more specific than the subcommittee's original recommendation.

In fact, the Council's final policies are identical to those we recommend, with one exception. The Council proposes to coordinate lead bank and holding company examinations and inspections if either the company or the lead bank is rated composite 4 or 5 on the Bank Holding Company Rating System or the Uniform Rating System for banks. 1/ We believe that if any bank in a holding company is rated that low, the agencies should consider coordinating the bank's examination with the holding company inspection. In some of the cases we reviewed, the lead banks were in better condition than other subsidiary banks, and the other subsidiary banks' problems were caused by the holding companies.

CONCLUSION

The potential exists for serious holding company and bank problems to remain unsolved because of inadequate interagency coordination. The likelihood for persistent problems requires that changes be made in bank holding company supervision. There are two possible approaches: changing the supervisory authority for holding companies or increasing

---

1/Both rating systems are designed as a "shorthand" to describe the condition of a bank or holding company. In both systems, institutions are rated on a scale from "1" to "5", "1" being the best rating and "5" the worst.

interagency coordination through formal procedures under the auspices of the Federal Financial Institutions Examination Council. Either action should solve the coordination problems we found, but establishing procedures through the Council is the less drastic of the two.

While a good logical case can be made supporting the lead bank supervisor approach discussed on page 17, the empirical evidence is not strong enough to support the significant legislative changes required.

In addressing the question of whether to consolidate the Federal banking agencies, the Congress decided instead to try formalizing interagency coordination by creating the Federal Financial Institutions Examination Council. Since the Council is relatively new, it should be given a chance to succeed before more drastic changes are made. Since the Council's purpose is to promote interagency cooperation, the formal cooperative procedures necessary to improve bank holding company supervision ought to be established through the Council. The cases we reviewed revealed the need for coordination in two areas: gathering information (inspections/examinations) and taking supervisory actions to solve problems. Obtaining complete information is most crucial for institutions that are large or have recognized supervisory problems.

There is some concern that even if the Council establishes formal procedures, compromises made during deliberations among the Federal bank regulators could result in accommodations that reduce the effectiveness of supervisory actions. This possibility makes it necessary to closely assess the results of actions taken by the Council. If these actions are not effective, then the restructuring alternatives must be reconsidered.

RECOMMENDATIONS TO THE FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

We recommend that the Federal Financial Institutions Examination Council develop procedures that require coordinated holding company inspections and bank examinations:

--Between a holding company and any subsidiary bank rated a composite 4 or 5 on the uniform holding company or bank rating systems.

--Where a holding company or its lead bank is rated a composite 3, but either the company's or the bank's financial condition is known to be deteriorating.

--For large holding companies. (The Council has suggested ones with consolidated assets of at least $10 billion. This appears reasonable.)

The inspections and examinations need not be simultaneous but should be coordinated to provide optimum timing. At a minimum, the lead bank examination must be coordinated with the holding company inspection. Other bank subsidiaries should be similarly coordinated as necessary (for example, if they are rated 4 or 5).

We recommend that the Council establish procedures to coordinate and document supervisory actions, if the agencies find it necessary to take such actions to influence a holding company or bank subsidiary to solve problems.

We recommend that the Council establish a committee of senior bank agency officials to ensure that coordinated supervisory actions are taken in a timely basis, since disagreements could occur that could delay needed actions. The committee need not participate in every case but should monitor pending actions to resolve disagreements that may arise.

AGENCY COMMENTS

Both the Comptroller of the Currency and the FDIC disagreed with our conclusion that the problems we found can be solved through better, more formal coordination. Without citing further evidence or cases, they call for a legislative change in supervisory structure--designating the lead bank supervisor as the holding company supervisor. (See apps. I and III.)

As we discuss on pages 17 to 19, the lead bank supervisor approach has merit. However, the evidence we found does not support the need for a significant change in legislative authority. Such a change would have to be justified by demonstrating some significant harm to banks caused by the current structure. While we found problems requiring better interagency coordination, we did not find any current cases of banks which failed or which were threatened with failure because of poor coordination.

Although the Federal Reserve and the Council implicitly agreed with the thrust of our recommendations (see apps. II and IV), the Council and the bank regulators made some

suggestions for modifying the recommendations. In our original draft, we recommended that all banks in a holding company be examined concurrently and that all holding companies and their nonbank subsidiaries be examined concurrently with their lead banks. The Council and the three banking agencies pointed out that this would be impractical because of resource limitations and suggested instead that coordinated examinations should be required only if holding companies or their lead bank subsidiaries are rated 4 or 5 on the uniform rating system or if the companies are very large. We agree that resource limitations must be considered, and we have modified our recommendations.

However, whereas the Council and the regulators want to consider only the ratings of the company and lead bank, we believe that if any bank in the holding company is rated 4 or 5, its examination should be coordinated with those of the lead bank and the company. This is because our review disclosed cases in which bank subsidiaries other than lead banks had been jeopardized by holding company practices. Therefore, we have changed our recommendation to coordinate examinations/inspections for large companies and for those in which any bank is rated 4 or 5, not just lead banks.

Both the Federal Reserve and the Comptroller emphasized that the committee of senior officials we recommend to coordinate complementary supervisory actions become involved only in cases in which lower level staff can not agree on such actions. We also believe that the senior officials need not become actively involved unless disagreements arise.

The Council informed us of new procedures that it has adopted to coordinate supervisory actions. (See app. IV.) These procedures include establishing the committee of senior officials as well as requiring

--written notification of formal actions proposed by any agency as a first step,

--referral to the Council of matters not resolved by the committee members, and

--notification of State supervisory authorities when appropriate.

The procedures as outlined should provide adequate coordination. However, whatever actions are taken must be timely. We therefore recommended on page 22 that the committee of senior officials monitor actions to ensure their timeliness.

Also, the process used to reach agreements, or any disagreements that result in noncomplementary actions, should be adequately documented.

The Comptroller noted that he is developing a "conceptual approach" to examine a holding company with the Federal Reserve as a step in gathering data to use to evaluate the need to visit national bank subsidiaries. Because this concept was only in its earliest development stage when we did our review, we were not able to evaluate it. A Federal Reserve official told us that the Comptroller has not yet officially presented this concept to the Federal Reserve for its concurrence.

CHAPTER 4

SCOPE OF REVIEW

We conducted our review at the Washington, D.C., headquarters offices and at selected field offices of the Federal Reserve, FDIC, and Office of the Comptroller of the Currency. We selected the New York, Atlanta, Kansas City, and Richmond Federal Reserve Districts for our field work because collectively they enabled us to study the supervision of various kinds of bank holding companies: that is, large companies with one money-center bank and many nonbank subsidiaries, multibank companies, and small one-bank holding companies.

At both the headquarters and field locations, we studied the policies and procedures for bank holding company inspections, both agencywide and local. At each field office except Richmond, we attended, either in part or in entirety, a bank holding company inspection. We also reviewed other procedures used to monitor the condition of holding companies, including agencywide and local computerized surveillance systems. We interviewed both management and operating personnel, including holding company inspectors, review examiners, analysts, and organizational managers and administrators.

In studying the cases in which legal actions were taken against holding companies (see p. 9), we used a multitiered approach. We began by reading synopses of legal actions taken in 1976, 1977, 1978, and 1979, focusing on those that involved bank holding companies or their subsidiary banks. From this preliminary review, and from cases the agencies told us were examples involving inconsistent supervisory actions, we selected examples for further review. For those cases we reviewed pertinent bank examination reports, holding company inspection reports, and correspondence files. We also interviewed personnel at the Federal Reserve Board's Division of Banking Supervision and Regulation, the FDIC Problem Bank Section, and the Comptroller's Special Studies Division.

In our study of the Federal Financial Institutions Examination Council, we interviewed the chairman of its Task Force on Bank Supervision and the chairman of that group's Subcommittee on Integrating Bank Holding Company Supervision. We also reviewed minutes of the Subcommittee's meetings.

Comptroller of the Currency
Administrator of National Banks

Washington, D C 20219

November 23, 1979

Mr. Allan R. Voss
Director
General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Voss:

We have reviewed your October 26, 1979, draft of a proposed GAO report entitled "Federal Supervision of Bank Holding Companies Needs Better, More Formalized Coordination". We wish to compliment the GAO staff who participated in this significant review which we believe will result ultimately in changing the structure of financial institution supervision.

It should be noted that the bank regulatory agencies have greatly increased their coordinated efforts in supervising bank holding companies (BHC), despite the existing statutes which tend to inhibit such efforts.

On February 28, 1979, in a statement before the Committee on Banking Housing and Urban Affairs of the United States Senate, I testified on this office's position regarding the issue of bank holding company supervision. I stated:

> "In the past, special attention has been paid to frictions and inefficiencies involving the supervision of bank holding companies. Coordination and communication has improved significantly in this area. I am hopeful that the Federal Financial Institutions Examination Council will be an effective vehicle for further improvement until Congress can get to remedy what I consider to be a serious flaw in the present regulatory structure . . . . First and foremost, we should move quickly to address the problem resulting from regulation of various parts of a bank holding company by different agencies. It has been pointed out time and again that this facet of the regulatory structure significantly interferes with our effectiveness in supervising either these systems or the banks within them . . . . Both the FDIC and the OCC are on record as favoring resolution of this problem by transferring primary authority over the entire system to one

> agency. I would hope . . . that Congress will see fit to act upon this proposal expeditiously."

We strongly believe that while coordination is desirable and achievable, to some degree, the issue will not be resolved until structural issues are modified legislatively. Noted as a conclusion by GAO in the proposed report, we feel the following paragraph also closely reflects this office's position:

> "Changing the holding company supervisory structure by giving holding company supervisory authority to the lead bank supervisor, may, in the long run, be the best solution. This approach would eliminate the need for interagency coordination for one bank and some multi-bank holding companies. In other multi-bank holding companies, the Federal agency most familiar with the key segment of the holding company would supervise the entire organization."

This conclusion represents our position. We believe the GAO report substantiates this position, even though it failed to recommend it as the most effective and efficient way of dealing with this longstanding bank regulatory structure issue.

Regarding GAO's recommendations to the Federal Financial Institutions Examination Council (FFIEC), we offer the following comments in the context of our previously stated position. First, although coordination to the extent recommended by the GAO to the FFIEC is virtually impossible from an administrative, logistical, budgetary and supervisory perspective, the OCC believes that interagency agreements should be developed where possible and within each agency's available resource allocations. We believe realistic coordinated effort should be compatible with the supervisory and examination priorities of the respective agencies. This is the direction being pursued by the FFIEC's task force on supervision. In this regard, we are prepared to support a policy which requires:

- a coordinated bank holding company inspections/bank examinations for BHCs or lead banks with composite ratings of 4 or 5
- a coordinated inspection/examination of all BHCs with consolidated assets in excess of $10 billion
- a coordinated inspection/examination of any BHC or BHC subsidiary lead bank with a composite rating of 3 whose financial condition had worsened significantly since the last inspection/examination.

Second, the GAO recommended that all bank subsidiaries and bank holding companies be examined concurrently with the lead bank and the holding company. Although this office believes that this objective appears desirable on the surface, it may represent a misallocation of resources because, in many multibank holding systems, small subsidiary banks may not require an examination. Therefore, as an alternative, the OCC is developing a conceptual approach for the examination of bank subsidiaries and a coordinated simultaneous

examination of bank holding companies. We view this as a major evolution of our regulatory/supervisory philosophy. Our goal is to examine the parent holding company (with the Federal Reserve) and the subsidiary banks from the holding company/lead bank level using the holding companies' plans, policies and internal monitoring mechanisms, including management information systems as source material. We believe that in sophisticated centrally planned multibank holding companies we may eliminate the need to visit, or significantly reduce the time spent at individual national bank subsidiaries. Our approach is substantiated by the trend toward centralization in multibank holding companies; (e.g. objectives, strategy, budgets, plans, policies, procedures, internal controls, accounting and reporting systems are formulated and implemented from the BHC/lead bank level). We are hopeful that the Federal Reserve will join us in this endeavor since we feel it would be mutually beneficial in terms of quality supervision and effective allocation of resources.

Third, the GAO has also recommended the establishment of a committee of highly placed banking agency officials to decide on coordination of formal corrective administrative supervisory actions and that time parameters be set for decision-making and implementation to prevent delays. While we agree with the overall objective, we disagree with the recommendations because early notification (by one agency to another) of the intent to take a formal action is the key to assessing the need for a complimentary action and ultimate coordination. We are prepared to support written interagency notification of the intent to take formal and informal corrective administrative actions. In those cases where a complimentary action is appropriate by two or more Federal bank regulatory agencies, we are prepared to coordinate preparation, implementation and follow-up action required. Should differences arise between the Federal agency staffs about an individual agency's proposed action, then and only then should the case be reviewed on a timely basis by a committee consisting of the directors of supervision for each of the federal agencies. We expect the FFIEC's task force on supervision to reach agreement along these lines in the near future.

In conclusion, we are concerned that the GAO apparently was not convinced of the need to definitely solve the issue raised in the report through appropriate legislative change. Regardless of the degree of coordination and our commitment to it internally and through the FFIEC, instances can and will occur that may be analogous to the report's cases, absent legislative change along the lines that we have suggested now and in the past. Therefore, we strongly suggest that the GAO reassess its conclusion and recommendations.

Very truly yours,

John G. Heimann
Comptroller of the Currency

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

November 23, 1979

Mr. Allen R. Voss, Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

We appreciate the opportunity to review and respond to the draft of the General Accounting Office's recent report on the Federal supervision of bank holding companies. It is our understanding that the intent of the study was to focus on the structure of holding company supervision and that a follow-up report will describe the important steps taken by the Federal Reserve within the last several years to strengthen its program for supervising and inspecting bank holding companies. These steps include the development of a uniform report format for holding company inspections, the completion of a comprehensive holding company supervision and inspection manual, the implementation of a supervisory rating system for assessing financial condition, the design of an automated holding company profile report of key financial ratios and peer group comparisons, the development of formal monitoring and screening techniques and the adoption of a comprehensive body of supervisory policies and inspection procedures. The combined effect of these steps has been to extend significantly the on-site inspection coverage of bank holding companies and their nonbanking affiliates, and to ensure that the Federal Reserve has appropriate policies and supervisory tools in place to respond to any holding company action that could have a potentially adverse impact on a bank subsidiary. We are quite pleased that, as a result of these steps, in 1978 the Federal Reserve conducted on-site inspections of holding companies comprising 72 per cent of the aggregate of all domestic bank holding company assets. We expect that the System's program for supervising holding companies will show even greater progress in the near future.

In general, the Federal Reserve agrees that coordination and consistency in the supervision of banking institutions are clearly desirable and contribute much to the safety and soundness of the nation's banking system. Indeed, a number of actions have already been taken by the Federal Reserve and the other banking agencies to enhance communication and coordination in the supervision of the various components of bank holding companies. The following represent some of the more notable areas in which steps to strengthen coordination have been implemented:

1. The Federal Reserve solicited and incorporated specific comments and suggestions of the FDIC and OCC into its standardized holding company inspection report.

Mr. Allen R. Voss

2. As a matter of policy, Federal Reserve examiners review the most recent examination of the lead bank and other significant bank subsidiaries before commencing an on-site holding company inspection and integrate important information on the banking subsidiaries into the analysis set forth in the holding company inspection report.

3. Coordinated bank-holding company examinations are successfully scheduled in a large number of instances throughout the System in the case of problem banks or bank holding companies and for virtually all large money center institutions located in the New York Federal Reserve District.

4. The Federal Reserve provides both the regional and head offices of the FDIC and OCC with inspection reports of holding companies controlling banks under the latter agencies' respective supervisory jurisdictions.

5. The Federal Reserve provides the head offices of both the FDIC and OCC with the analytical memoranda prepared by its Washington staff on problem holding companies controlling banks under the other agencies' supervisory jurisdictions.

6. The Federal banking agencies periodically exchange lists and memoranda concerning banks and holding companies subject to special supervisory attention.

7. Bank holding company profile reports covering important financial and operating ratios, peer group comparisons and historical trend information will be provided to the FDIC and OCC.

8. Financial information and data from the annual report of bank holding companies and the quarterly report of intercompany transactions are available to all Federal banking agencies.

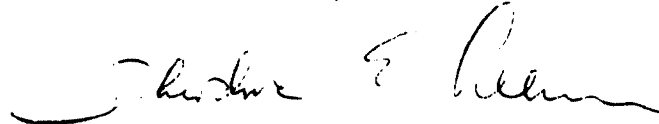
9. Under current Federal Reserve policy, all formal holding company enforcement actions are discussed with the relevant banking agency (or agencies) to explain proposed corrective provisions, coordinate joint corrective measures, if necessary, and resolve potential inconsistencies in agency actions. The Federal Reserve also forwards to the relevant banking agency for comment drafts of all proposed enforcement actions against holding companies owning banks supervised by that agency.

Mr. Allen R. Voss

Notwithstanding these significant steps, a number of other important initiatives are currently being pursued under the auspices of the Examination Council to address the general concerns expressed by the GAO with respect to the interagency coordination of examinations and formal corrective actions. Specifically, efforts are presently under way to formalize interagency procedures for requiring concurrent lead bank-holding company examinations in the case of all holding companies and/or lead banks requiring special supervisory attention and for certain other large money center or regional bank holding companies. In addition, procedures are also being explored on an interagency basis to improve coordination and the exchange of views concerning the use of formal enforcement actions. In particular, the Federal Reserve would support the establishment of a group consisting of a senior official from each banking agency that would enhance the interagency coordination and review of enforcement actions and provide a forum for the discussion of any differences in supervisory approach that could not be resolved at the staff level. If adopted by the Examination Council, both of these initiatives will enhance the coordination of holding company supervision and ensure consistent and equitable supervisory treatment of parent holding companies and their commercial bank and nonbank subsidiaries.

On behalf of the Federal Reserve, I want to thank you for the opportunity to comment on the GAO report and for the professional manner in which your entire staff conducted itself during the study.

Sincerely,



Theodore E. Allison
Secretary of the Board

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

November 30, 1979

Mr. Allen R. Voss, Director
General Government Division
U. S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

On November 26, 1979 members of our respective staffs met and discussed the recent draft of a GAO report entitled: "Federal Supervision of Bank Holding Companies Needs Better, More Formalized Coordination." Our respective staff members discussed in detail our differences with portions of the draft report and agreed to certain changes. We trust that all of our suggested changes agreed upon will be incorporated in the final report and, for that reason, will not detail them here. However, we do wish to comment on the recommendations.

The stated objective of the recommendations is to "insure the most effective supervision of holding companies and their banks." The recommended method of accomplishing this objective is that the Federal Financial Institutions Examination Council ("FFIEC") develop interagency agreements and procedures to coordinate examinations and to structure "the process used to decide on appropriate supervisory actions to be taken when necessary." As we read the draft report, your position is that amending legislation designed to restructure the supervision of bank holding companies is not needed at this time. We agree that increased coordination and agreement among the Federal bank regulatory agencies is desirable. However, we believe that, in addition to increased coordination and agreement among the Federal bank regulatory agencies, restructuring of the supervision of bank holding companies through appropriate amending legislation is both warranted and necessary. We note in passing that the recommendation to "require that all bank subsidiaries in a holding company be examined concurrently with the lead bank in holding company examinations" seems to mandate concurrent examinations of the entire bank holding company structure each time the lead bank is examined. If so, while the recommendation may be theoretically and conceptually valid, it is, in our judgment, impractical. Manpower and other resource constraints impose limitations on the number of concurrent examinations of an entire bank holding company structure that can as a practical matter be conducted within an appropriate time frame. Given those constraints, we would prefer a procedure for conducting concurrent examinations of an entire bank holding company structure based upon a framework of defined priorities which are centered on concepts of financial risk and supervisory concern.

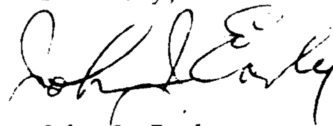
Support for Federal legislation to restructure the supervision of bank holding companies is premised on the argument that, from a supervisory standpoint, bank holding companies should be treated as a single, integrated unit, because the activity of one of its parts can impact significantly on the whole or other parts. All three Federal bank regulatory agencies support that concept, in whole or part. The present fragmented or multiple Federal structure, in which supervision of a multi-bank holding company may be divided among three separate Federal bank regulatory agencies, does not at times lend itself to a single, integrated unit approach to bank holding company supervision. Clearly, the Federal bank regulatory agencies have in recent years improved their coordination, communication and exchange of information and the FFIEC, with its statutory guide regarding bank holding company supervision, is an available and appropriate vehicle for increased efforts in that regard. Indeed, under the guidance of the FFIEC's Task Force on Supervision, efforts are going forward to develop guidelines for increased cooperation and coordination in conducting examinations of and in taking enforcement action against bank holding companies and their subsidiary banks. Nevertheless, largely because we are not confident that the major infirmities that currently exist lend themselves to correction with reasonable speed by voluntary agreement among the Federal bank regulators, we believe that there is a critical need for legislation to change the present fragmented structure of Federal supervision of bank holding companies.

In our view the most reasonable and practical legislative proposal is that which gives to the supervisor of the lead bank the statutory authority to supervise the holding company and its nonbank affiliates as well as to coordinate the examination of non-lead bank affiliates by their respective supervisors. By such an arrangement the entire system could be examined and monitored as a single, integrated unit, while at the same time each bank within the holding company family would be examined and monitored by its primary Federal regulator. Thus, it would have the least disruptive impact on the dual banking system.

Even with the enactment of legislation, there will continue to be need for coordination and cooperation among the agencies of the kind now being fostered by the FFIEC. These efforts would concern such aspects as uniformity in the approach to and coordination of formal enforcement actions, especially where there may be disagreement among two or more of the Federal bank regulators. To this extent, we agree with your recommendation that the FFIEC represents an ideal vehicle for such coordination and agreement. Through the medium of the FFIEC, it should be possible for the Federal bank regulatory agencies to develop and agree upon, among other things, basic guidelines as to when and how formal enforcement action against bank holding companies and their related entities should be undertaken. This process, as previously mentioned, has already begun through the Task Force on Supervision of the FFIEC.

We appreciate the opportunity to review and discuss the draft report with members of your staff and to provide written comments.

Sincerely,



John J. Early

Federal Financial Institutions **Examination Council** Washington, D.C. 20219

December 7, 1979

Mr. Allen R. Voss
Director
General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Voss:

The Examination Council has reviewed the GAO draft report of October 26, 1979, entitled "Federal Supervision of Bank Holding Companies Needs Better, More Formalized Coordination." Because each of the Federal bank regulatory agencies is responding to the draft report, the Council will comment only on those recommendations that have been addressed to the Council.

The Examination Council has established several interagency staff groups to undertake projects in the various examination and supervisory areas of concern to the Council. At the outset, the importance of ensuring effective bank holding company supervision was recognized, and the Council's Staff Task Force on Supervision was asked to review current practices at the three Federal bank regulatory agencies and make recommendations to the Council for improved coordination on bank holding company supervision.

The work of the Task Force has been completed, and the Examination Council at its meeting on December 6, 1979, approved inspection, examination, supervision, and corrective-action procedures that are designed to ensure effective coordination among the agencies with respect to their bank holding company and subsidiary bank oversight activities. The two policy statements that the Council has approved as recommendations to the three Federal bank regulatory agencies are enclosed.

In the area of bank holding company inspections and subsidiary bank examinations the policy requires coordinated inspections and examinations for:

(1) any bank holding company with consolidated assets in excess of $10 billion;

Board of Governors of the Federal Reserve System. Federal Deposit Insurance Corporation. Federal Home Loan Bank Board. National Credit Union Administration. Office of the Comptroller of the Currency

Page 2 - Mr. Allen R. Voss December 7, 1979

(2) any bank holding company or bank holding company subsidiary lead bank rated composite 4 or 5 under the Bank Holding Company Rating System or the Uniform Rating System for banks; and

(3) any bank holding company or bank holding company subsidiary lead bank rated composite 3 whose financial condition appears to have worsened significantly since the last inspection/examination.

In addition, the agencies will, to the extent permitted by resource availability, coordinate examinations and inspections for all other bank holding companies with priority given to those holding companies and/or subsidiary banks where circumstances indicate that such coordination is particularly desirable.

For corrective actions, the principal features of the policy are listed below.

(1) Any Federal bank regulatory agency initiating a formal enforcement action against a bank holding company or a commercial bank will notify the other two agencies.

(2) A committee composed of the directors of bank supervision of the three agencies will review on a timely basis any differences of view among the agencies on actions to be taken. If the committee is unable to resolve the differences, the matter will be referred to the Council Members from the agencies involved.

(3) Notification by the Federal Reserve and Federal Deposit Insurance Corporation to the appropriate State supervisory authority of intent to institute a formal corrective action against a bank holding company or State-chartered bank.

In the GAO draft report, several specific recommendations are made regarding supervision of bank holding companies and their banks. These recommendations and the Council's views are set forth below.

(1) designate the lead bank supervisor for each holding company as having the predominate role for scheduling coordinated examinations and inspections.

The Council believes that scheduling and coordination problems would not be lessened by placing scheduling responsibility in the lead bank supervisor. The agencies' coordination efforts will be focused primarily on large holding companies and holding companies and lead banks that are problem or near-problem institutions. Scheduling of examinations involving these institutions will be accomplished at the periodic planning sessions called for in the Policy Statement.

Page 3 - Mr. Allen R. Voss December 7, 1979

(2) require that the Federal Reserve System schedule its inspections of the holding company and its nonbank subsidiaries to coincide with the examination of the lead bank.

The Council believes that the agencies do not have the resources to accomplish coordinated inspections and examinations of all holding company systems. For this reason, the Council believes the emphasis should be on the larger and problem institutions. Moreover, coincident examinations of the holding company and its lead bank may not necessarily be desirable. Rather, staggered starting dates may be desirable if the bank examination is likely to take much longer than the holding company inspection. The Council believes that such scheduling decisions can be made most effectively on a case by case basis.

(3) require that all bank subsidiaries in a holding company be examined concurrently with the lead bank and holding company examination.

While it would be desirable to examine all subsidiary banks concurrently with holding company inspections, the resource constraints of the agencies preclude achieving such an objective. The Council believes that emphasis should be placed on the holding company and its lead bank. Generally, if these institutions' problems are dealt with effectively, difficulties in the smaller subsidiary banks will remain manageable.

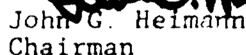
(4) Other recommendations:

- -- establish a committee of highly placed banking agency officials to decide on supervisory actions to be taken.
- -- set time parameters for decision-making and implementation to prevent delays.

The Council has essentially adopted these recommendations with respect to formal corrective actions by providing for timely review by senior officials of the agencies of any differences of opinion on actions to be taken. Joint discussions of examination findings with bank management will also take place as needed as part of the overall programs to coordinate bank holding company inspections and bank examinations.

The Council compliments the GAO staff for the thorough job it has done in reviewing the issues and problems associated with bank holding company supervision. The Report was very helpful to the Council and the agency staffs in the development of the Council's policies.

Sincerely,



John G. Heimann
Chairman

INTERAGENCY COORDINATION OF FORMAL CORRECTIVE ACTION BY THE FEDERAL BANK REGULATORY AGENCIES[1/]

Any federal banking regulatory agency that initiates formal enforcement action against a bank holding company or a commercial bank shall notify the other two federal banking regulatory agencies that such action is being taken. All such notifications shall be in writing and shall take place at both the regional and head offices of the banking agencies. In the event "complementary" action (e.g., action involving a bank(s) and the parent holding company) is considered appropriate by two or more federal agencies, the preparation, processing, and follow-up of the corrective action shall be coordinated by the agencies directly involved. In the event differences of opinion arise between the federal agencies' staffs concerning such matters as the appropriateness of a specific action, the need for complementary action, or the severity or content of such actions, the circumstances shall be reviewed on a timely basis by a committee consisting of the directors of bank supervision, and legal counsel as appropriate, for each of the federal agencies. If the committee is unable to resolve the differences, the matter will be referred to the Council Members from the agencies involved.

With respect to Federal-State agency coordination, the Federal Reserve provides the appropriate State supervisory authority with notice of its intent to institute a formal corrective action against a bank holding company. Pursuant to 12 U.S.C. 1818(m), the federal regulatory agencies are required to provide the appropriate State supervisory authority with notice of their intent to institute a formal corrective action against a State chartered bank. This requirement is made applicable to bank holding companies by 12 U.S.C. 1818(b)(3).

These procedures are not intended to preclude or forestall any federal agency from initiating a formal corrective action alone and on a timely basis against an institution for which it has primary supervisory jurisdiction.

1/ This policy pertains to formal administrative actions taken by the Federal banking agencies pursuant to the Financial Institutions Supervisory Act of 1966 as amended.

INTERAGENCY COORDINATION OF BANK HOLDING COMPANY INSPECTIONS AND SUBSIDIARY BANK EXAMINATIONS

Bank supervisory officials at each of the federal agencies' Regions or Districts shall hold periodic planning sessions in order to prioritize and schedule the coordination of bank holding company inspections and subsidiary bank examinations. These planning sessions shall be held at least semiannually or more frequently as necessary in order to provide for a coordinated schedule that will maximize the efficient use of examination resources and enhance the integration of bank and holding company examinations.

Coordination of inspections and examinations should focus on the use of common financial statement dates where possible and allow for joint discussions of examination findings with management. It need not always involve absolute concurrency, common "as of" dates or simultaneous starting dates. Staggered starting dates may be called for in cases where the bank examination is likely to take significantly longer than the bank holding company inspections, and for other reasons.

The agencies shall be required to conduct coordinated bank holding company inspections/bank examinations for:

(1) any bank holding company with consolidated assets in excess of $10 billion;

(2) any bank holding company or bank holding company subisidary lead bank rated composite 4 or 5 under the Bank Holding Company Rating System or the Uniform Rating System for banks; and

(3) any bank holding company or bank holding company subsidiary lead bank rated composite 3 whose financial condition appears to have worsened significantly since the last inspection/ examination.

The agencies will attempt, to the extent possible and where resources permit, to coordinate examinations and inspections for all other bank holding companies with priority given to those holding companies and/or subsidiary banks where circumstances indicate that such coordination is particularly desirable.

Bank examinations for additional subsidiary banks within a multibank holding company covered above should be coordinated with the parent inspection to the extent practicable and where resources will permit. In those multibank companies without a designated lead bank, the largest bank based on total assets shall be considered the lead bank for purposes of this policy statement.

In order to keep the State bank regulators aware of coordinated efforts by the federal banking agencies and to encourage participation by the State regulators, the Federal Reserve or FDIC, respectively, should inform the appropriate State bank regulator of coordinated federal efforts affecting either a bank holding company or State bank under the jurisdiction of the State bank regulator.

Although this statement of policy is intended to enhance interagency efforts at coordinating supervision of bank holding companies, including their bank and nonbank subsidiaries, it is not intended to preclude or prohibit any federal agency from using its authority to examine organizations "affiliated" with financial institutions for which it has primary federal supervisory responsibility.

(232010)

Single copies of GAO reports are available free of charge. Requests (except by Members of Congress) for additional quantities should be accompanied by payment of $1.00 per copy.

Requests for single copies (without charge) should be sent to:

U.S. General Accounting Office
Distribution Section, Room 1518
441 G Street, NW.
Washington, DC 20548

Requests for multiple copies should be sent with checks or money orders to:

U.S. General Accounting Office
Distribution Section
P.O. Box 1020
Washington, DC 20013

Checks or money orders should be made payable to the U.S. General Accounting Office. NOTE: Stamps or Superintendent of Documents coupons will not be accepted.

PLEASE DO NOT SEND CASH

To expedite filling your order, use the report number and date in the lower right corner of the front cover.

GAO reports are now available on microfiche. If such copies will meet your needs, be sure to specify that you want microfiche copies.

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, $300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

THIRD CLASS