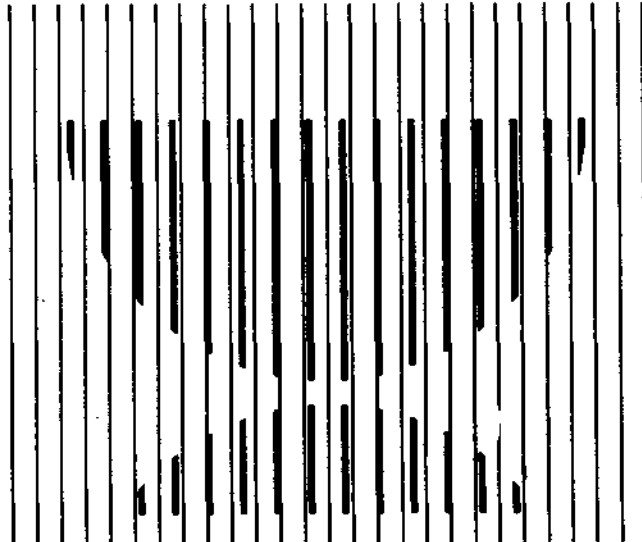


CBO STAFF MEMORANDUM

OPTIONS FOR REORGANIZING
FEDERAL BANKING AGENCIES

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CONGRESSIONAL BUDGET OFFICE
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WASHINGTON, D.C. 20515

This memorandum was prepared in response to a request by the Senate Committee on Banking, Housing, and Urban Affairs. The committee asked the Congressional Budget Office (CBO) to examine the current federal regulatory structure of banking and thrift institutions and to analyze options for improving the regulatory structure through reorganization.

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SUMMARY AND INTRODUCTION

Federal regulation of depository institutions is based primarily on the type of institution (bank or thrift) and on whether the institution is federally or state chartered. Early in 1991, the Department of the Treasury released a study containing the Bush Administration's proposals for reforming the regulation of depositories.¹ Among other recommendations, that study called for a reorganization of the federal agencies that regulate depositories. The Congress did not enact that proposal but has remained interested in reform ideas. Two bills have recently been introduced in the House of Representatives, and one or more bills are expected to be introduced in the Senate, to accomplish that reform.

The proposals for reform emanate from the widespread dissatisfaction with the current supervisory and regulatory structure. This dissatisfaction is based on concerns about unnecessary duplication of functions, interagency conflict over the interpretation of statutes governing banking, lack of uniformity in the administration of those statutes for different categories of financial institutions and the resulting competitive inequities, and, most recently, perceived shortcomings in the performance of some or all of the agencies in dealing with the liquidity and solvency problems faced by a large number of institutions.

This memorandum provides a brief overview of the current regulatory structure, describes past efforts to restructure the bank regulatory agencies, and discusses some of the key issues in the debate over restructuring. It concludes by examining some of the prominent ideas for changing the structure of the regulatory agencies.

The four main federal regulators of banks and thrifts are the Office of the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision. Critics have identified at least four major problems associated with the structure of the bank regulatory agencies. Many of these problems cannot be solved at the federal level alone--they involve state regulation and supervision of banking and its overlap with similar federal functions. This analysis, however, looks only at federal regulatory agencies.

One major criticism is that the division of responsibilities among the agencies is overly complex and inefficient from the point of view of the agencies and of the institutions that they regulate. Another criticism is that

1. Department of the Treasury, *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks* (1991). The term depository institution is used here to denote all federally insured banks, thrifts, and credit unions. Similarly, the term banking is used in this memorandum to encompass activities carried out by depositories.

differences in the agencies' functions too strongly influence the agencies' policy attitudes and their performance and that these policy differences often have to be worked out on a case-by-case basis. A third criticism pertains to competition among regulators in the form of policy decisions that are designed to maintain or expand the number of institutions under their regulatory jurisdiction. Although many observers believe that such competition leads to lax supervision and regulation, others point to circumstances that may prompt regulators to toughen their positions. Finally, critics have pointed to differences in the administrative structures of the agencies as an important factor in how they operate: the Office of the Comptroller of the Currency has a single administrator, who has generally been adaptable and open to change; the Federal Reserve System is governed by a seven-member Board of Governors and has been viewed by analysts as having more conservative policies.

Current proposals for regulatory reform are very similar to those that have been made before. Proposals that have been advanced since the end of World War II have recommended that regulation by charter type--the current basis for regulation--be replaced with regulation by function, that is, chartering, insuring, and central banking. Other aspects of proposed alternatives include the degree of independence from the executive branch and the organizational structure of the agency. For example, two bills introduced in the House of Representatives would merge the Office of Thrift Supervision and the Office of the Comptroller of the Currency into a new, independent Federal Banking Commission. The bills differ, however, with regard to the degree of independence and how the agency would be structured.

CURRENT REGULATORY STRUCTURE

The two primary organizing principles behind the current structure of regulatory agencies are related to the type of depository--bank or thrift--and whether the depository is federally or state chartered. Responsibility for regulating and supervising federally insured depositories in the United States is divided among the banking departments of the states and four federal agencies--the Office of the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.²

2. The National Credit Union Administration (NCUA) should also be counted in this group. The NCUA is the primary regulator of federally chartered credit unions and state-chartered credit unions whose shares (deposits) are insured by the National Credit Union Share Insurance Fund. Because of the small role that credit unions play in the overall financial system and their unique role as cooperative organizations, most analyses, including this one, exclude credit unions and the NCUA.

The Office of the Comptroller of the Currency (OCC) charters and serves as the primary regulator of banks with a federal charter (national banks). In 1992, it was the primary federal regulator of 3,607 of the nation's 11,465 commercial banks. Its budget was \$316 million, and it reported 3,615 full-time-equivalent employees (see Table 1). It is the oldest federal bank supervisory agency, established in 1863 by the National Currency Act (reenacted with revisions the following year as the National Banking Act), which also provided for a uniform national currency secured by holdings of U.S. securities.

The second oldest federal banking agency is the Federal Reserve System, established by the Federal Reserve Act of 1913 as the nation's first full-fledged central bank. The Federal Reserve shares responsibility with the OCC for regulating national banks, which are required by law to be members of the Federal Reserve System. It is the primary federal regulator for state-chartered banks that choose to become members of the Federal Reserve System, and the primary regulator for bank holding companies and their nonbank subsidiaries and for foreign banks operating in the United States.³ In 1992, the Federal Reserve regulated 958 commercial banks, employing nearly 3,000 people in both the supervisory and regulatory activities of its Board of Governors and 12 regional banks. The combined budget for these activities was \$327 million (see Table 1).

Although the day-to-day administration of federal laws governing national banks rests with the OCC, the Federal Reserve has the sole power to regulate the margin, or down payment, required on loans that are made by any insured bank for the purchase of stocks and that are also secured by stocks. Other, nonregulatory responsibilities of the Federal Reserve System include conducting monetary policy, serving as lender of last resort, overseeing the payments system, and preserving the integrity of the currency (by achieving and sustaining a low rate of inflation).

The Federal Deposit Insurance Corporation (FDIC), established during the depths of the Great Depression by the Banking Act of 1933 to insure bank deposits, is the primary federal regulator for state-chartered commercial banks that are not members of the Federal Reserve System (known as nonmember banks) and for state and federal mutual savings banks whose deposits are federally insured. In 1992, it was the primary federal regulator of 7,448 insured institutions, including 518 savings banks or thrifts. Its estimated budget for supervision and regulation was about \$300 million, and

3. The Bank Holding Company Act of 1956 entrusted the Federal Reserve with the regulation of all registered bank holding companies. A bank holding company is a company that owns or controls one or more banks.

TABLE 1. DATA ON FEDERAL AGENCIES THAT REGULATE BANKS AND THRIFTS, CLASSIFIED BY PRIMARY REGULATOR, 1992

	Office of the Comptroller of the Currency	Federal Reserve System ^a	Federal Deposit Insurance Corporation	Office of Thrift Supervision
Number of Institutions	3,607	958	7,448	1,907
Assets (Billions of dollars)	2,004	655	1,062	807
Annual Budget (Millions of dollars)	316	327	290	223
Employees (Full-time equivalents)	3,615	2,994	3,900	2,451
Charges Fees for Exams	Yes ^b	No	No	Yes

SOURCE: Congressional Budget Office using data on number of institutions from the Federal Deposit Insurance Corporation, *A Statistical Profile of the United States Banking Industry, 1992 (1993)*; and personal communication with the Office of Management and Budget and each of the regulatory agencies to convert data from fiscal to calendar years.

NOTE: Data for annual budgets and employees are based on reported budgets and personnel related to supervision or regulation. All data stated on a calendar year basis.

- a. Data for budget and employees include activities associated with the examination of bank holding companies and foreign-owned banks.
- b. Banks are charged a yearly assessment that pays for all services provided by the Comptroller's office, including examinations.

it employed about 3,900 personnel (see Table 1). The FDIC operates two separate deposit insurance funds: the Bank Insurance Fund (BIF) for commercial and savings banks, and the Savings Association Insurance Fund (SAIF) for savings and loan institutions.

The Office of Thrift Supervision (OTS) is the primary regulator of federally and state-chartered thrifts whose deposits are insured by the SAIF. In 1992, it was the primary federal regulator of 1,907 savings institutions, with a budget of \$223 million and a staff of 2,451 people. OTS was created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 to replace the Federal Home Loan Bank Board.

PROBLEMS OF THE CURRENT STRUCTURE

Competitive pressures--from mutual funds and other nonbank providers of financial services--and deregulation have eroded many of the differences between depositories and other financial institutions. Many observers believe that the federal regulatory structure, by failing to keep pace with these changes, has become ineffective or inefficient in supervising and regulating the banking industry. Critics have identified at least four problem areas associated with the current regulatory structure:

- o Complexity and overlapping jurisdiction;
- o Functional differences between agencies;
- o Regulatory competition; and
- o Differences in administrative structure.

Many of these problems are intertwined with issues associated with maintaining a dual banking system--that is, essentially parallel systems established at the federal and state levels of government. In the current economic environment, many of the problems of the financial services industry are being addressed simultaneously at both levels. Moreover, the states are actively pursuing changes in the powers that banks have and in how banks are regulated that are reverberating at the federal level. In particular, competition among the states for financial providers to locate within their borders is forcing federal regulators to confront these issues. This memorandum does not address issues related to the dual banking system, although it does analyze the federal role in regulating state-chartered depositories.

Complexity and Overlapping Jurisdiction

The division of responsibility for supervising and regulating banks in the United States is complex (see Table 2). In principle, the FDIC retains the authority to examine all insured banks and thrifts (including national banks and state member banks, both of which are required to be insured) as well as state nonmember banks that are insured. The Federal Reserve has similar authority to examine all member banks, including national banks.

Such duplication of function would appear to be inefficient and conducive to conflict in cases in which two or more of the federal regulatory agencies disagreed in their evaluations of a given bank's condition. In practice, this potential source of conflict has been largely eliminated by an interagency agreement concluded in 1938 under which, except in unusual circumstances, examinations of national banks are conducted only by the OCC, examinations of state member banks only by the Federal Reserve, and examinations of state nonmember insured banks by the FDIC. The agreement requires that information from each agency's examinations be shared with the other two agencies.

More recently, the Federal Reserve and the FDIC, which had long shared responsibility with states for examining the banks under their respective jurisdictions, have worked out cooperative arrangements with the states under which the federal agencies accept examinations by qualified state banking departments. More important, the Federal Financial Institutions Examination Council (FFIEC), created by the Financial Institutions Regulatory and Interest Rate Control Act of 1978, has done much to standardize the examination procedures used by the banking agencies and to eliminate overlap in their supervisory activities.⁴

Although these measures have reduced the inefficiency resulting from the overlapping authority for examining banks, the same cannot be said of the examinations of thrifts. Some thrifts have complained of having to submit reports to the FDIC after already having been examined by state and OTS examiners.

The remaining overlap in jurisdiction and the fact that national banks, state member banks, state nonmember banks that are insured, and thrifts are in direct competition with one another are recurring sources of friction among the agencies. The OCC and the Federal Reserve, in particular, have often disagreed on the interpretation of laws governing the permissible activities of

4. For an excellent overview of the council's activities and accomplishments, see Robert J. Lawrence, *A History of the Examination Council* (Washington, D.C.: Federal Financial Institutions Examination Council, 1991).

TABLE 2. THE COMPLEX REGULATION OF BANKING

	Charter	Examiner	Supervisor	Insurer	Submit Reports to	Authorizations		
						Mergers ^a	Branches	Closure and Resolution
Banks								
National Banks	OCC	OCC	OCC	FDIC/BIF	OCC/Fed. Res./FDIC	OCC	OCC	OCC/FDIC
State Banks Member	State	State/Fed. Res.	State/Fed. Res.	FDIC/BIF	State/Fed. Res./FDIC	Fed. Res./State	State	State/Fed. Res./FDIC ^b
Nonmember	State	State/FDIC	State	FDIC/BIF	State/FDIC	State	State	State/Fed. Res./FDIC ^b
Bank Holding Companies	State Corporate Authority	State/Fed. Res.	Fed. Res.	n.a.	Fed. Res.	Fed. Res.	n.a.	Fed. Res./State Corporate Authority
Savings Banks State chartered, BIF insured	State	FDIC/State	FDIC/State	FDIC/BIF	FDIC/State	State	State	State/FDIC
Federally chartered, SAIF insured	OTS	OTS	OTS	FDIC/SAIF	FDIC/OTS	OTS	OTS	OTS/FDIC
Savings and Loan Institutions								
Federally Chartered	OTS	OTS	OTS	FDIC/SAIF	OTS/FDIC/SAIF	OTS	OTS	OTS/FDIC/SAIF
State Chartered	State	State/OTS	State/OTS	FDIC/SAIF	OTS/FDIC/SAIF	State	State	State/FDIC/SAIF
S&L Holding Companies	State Corporate Authority	State/OTS	OTS	n.a.	OTS	State/OTS	n.a.	State/OTS

SOURCE: Congressional Budget Office.

NOTE: OCC = Office of the Comptroller of the Currency; FDIC = Federal Deposit Insurance Corporation; BIF = Bank Insurance Fund; Fed. Res. = Federal Reserve; SAIF = Savings Association Insurance Fund; OTS = Office of Thrift Supervision; n.a. = not applicable.

a. Authorization of a merger is based on the type of institution in which the merger results. Other regulatory agencies must be consulted if they are affected. For example, if the merger is between a state bank and a national bank and results in a national bank, the OCC would be the authorizing agency, but it would consult with the affected state chartering agency. In addition, the authorizing agency must consult with the Department of Justice about the competitive effects of the merger.

b. Only the chartering authority can close an institution. The Federal Reserve may be involved in the resolution only if the institution has loans outstanding from the discount window.

national banks. The Federal Reserve has recently tried to assert authority over the activities of subsidiaries of state banks that are themselves subsidiaries of bank holding companies. For example, the Federal Reserve attempted to prevent Citicorp from underwriting and selling insurance through a subsidiary of its Delaware-chartered bank.⁵

Even in cases in which there is no overlapping jurisdiction, however, differences between the agencies can cause problems. For example, responsibility for administering the Bank Merger Act of 1960 is divided among the OCC, the Federal Reserve, and the FDIC depending on whether the bank resulting from the merger is a national bank, a state member bank, or a state nonmember bank that is insured. In the 1960s and 1970s, banking analysts often asserted that the OCC administered the act in a more liberal manner than the Federal Reserve or the FDIC, creating competitive inequities between national and state banks and encouraging mergers in which the surviving bank was a national bank.⁶ More recently, differences in regulation between the OCC and OTS with regard to interstate branching have created some competitive differences between banks and thrifts. Even with FFIEC coordination, each agency has its own vision of how regulation should be interpreted and enforced. Differences in the cost of regulation and examination (as shown in Table 1) also occur and create competitive inequalities.

A related criticism is that the complexity of the current structure creates confusion among the depositories and the public about responsibilities.⁷ Although the current system designates primary authority, overlapping jurisdiction means that responsibility is shared and accountability is diminished. Critics have pointed out that having fewer regulators would provide a focal point, now absent, for public concerns about bank regulatory policy.

5. A U.S. Court of Appeals ruled that the Federal Reserve lacked jurisdiction over the subsidiaries of banks. See Linda Corman, "Court Rules Citicorp Can Offer Insurance," *American Banker*, June 11, 1991, pp. 1, 6.

6. See George R. Hall and Charles F. Phillips, Jr., *Bank Mergers and the Regulatory Agencies: Application of the Bank Merger Act of 1960* (Board of Governors of the Federal Reserve System, 1964); Neil B. Murphy and Steven J. Weiss, "Restructuring Federal Regulation of Depository Financial Institutions," *Bankers Magazine*, vol. 155 (Winter 1972), pp. 71-77; and Robert A. Eisenbeis, "Differences in Federal Regulatory Agencies' Bank Merger Policies," in Federal Reserve Bank of Chicago, *Proceedings of a Conference on Bank Structure and Competition* (1972), pp. 118-131.

7. Bernard Shull, "How Should Bank Regulatory Agencies Be Organized?" *Contemporary Policy Issues*, vol. 11 (January 1993).

Functional Differences Between the Agencies

Analysts attribute differences in the regulatory stance and performance of the agencies to differences in their assigned functions. In general, the agencies' functions may affect their regulatory performance as a result of the type and quality of information available to them, the demands various functions place on agency personnel and resources, and the incentives agencies face in performing their mission. For example, many analysts have asserted that the Federal Reserve's regulatory responsibilities either enhance or detract from the performance of its primary function, the conduct of monetary policy.⁸ Similarly, the FDIC's responsibilities for administering deposit insurance have been viewed, at various times, either as predisposing the agency toward excessively conservative regulation or, by internalizing the costs of bank failures, as providing it with appropriate incentives to prevent banks from taking undue risks.⁹

Although each agency has a primary functional responsibility, these responsibilities are often blurred in practice. For example, the OCC and OTS are the federal agencies responsible for chartering. These agencies--as well as state chartering authorities--permit institutions to enter the industry; they also determine when an institution should be closed. Each agency examines the institutions under its jurisdiction, receives regular reports of condition and income from them, and enforces applicable federal or state regulations.

In the wake of the thrift crisis, however, the FDIC also now plays a key role in determining entry and closure. Indeed, its actions can supplant the authority of the chartering agencies. This influence is most evident at the state level. All 50 states now require that newly chartered banks and thrifts qualify for federal deposit insurance. Thus, a decision by the FDIC to deny insurance is tantamount to rejecting a charter application. Moreover, the FDIC could, in principle, force the hand of a state regulator reluctant to close an operating state bank by instituting proceedings to revoke the bank's deposit insurance. Similarly, the Federal Reserve can influence a decision to close a bank by refusing to provide continuing liquidity assistance through its discount window. Thus, decisions about whether an institution should be closed, and when, potentially involve several federal banking regulators. Indeed, virtually all closures of large national banks in recent decades have involved extensive consultations--often fraught with sharp differences of opinion--between the

8. Discussions of this issue are provided in Shull, "How Should Bank Regulatory Agencies Be Organized?"; and Robert R. Davis, "Reorganizing Federal Banking Supervision," *Bankers Magazine*, vol. 162 (September/October 1979), pp. 72-76.

9. A discussion of these issues is found in Kenneth Scott, "The Patchwork Quilt: State and Federal Roles in Bank Regulation," *Stanford Law Review*, vol. 32 (April 1980), pp. 687-742.

three federal bank supervisory agencies before the final decision to close the bank is made.

Regulatory Competition

Banks and thrifts are permitted to change their charters, Federal Reserve membership, and deposit insurance status. It is not surprising, therefore, that a number of institutions have recently engaged in "charter flipping" or "forum shopping" for the most advantageous regulator. In 1992, about 160 institutions changed their charter classification, an increase from about 100 institutions in 1991; about the same number converted insurance coverage.¹⁰ Similarly, because their budgets, number of employees, and influence within the government depend on the number and size of institutions under their jurisdiction, the regulatory agencies have a strong incentive to make their constituencies as large as possible. This incentive, in combination with existing differences in regulatory philosophy, may have encouraged competition among the regulators.

Most observers and virtually all regulators have decried competition between the agencies that results in an undue relaxation of banking laws and an undermining of the soundness and safety of the banking system. In 1974, Arthur F. Burns, Chairman of the Federal Reserve Board, observed:

The present regulatory system fosters what has sometimes been called competition in laxity. Even viewed in the most favorable light, the present system is conducive to subtle competition among regulatory authorities, sometimes to relax constraints, sometimes to delay corrective measures.¹¹

Nonetheless, regulation today is just as likely to be viewed as excessively stringent as unduly lax, largely because the benefits to customers of more liberal regulation and more intense competition are difficult to measure, whereas bank failures and disruption to financial markets are highly visible. Consequently, regulators have often opted for a "safety first" policy, relying on interagency cooperation or political activism to protect their constituencies from attrition. A conspicuous example was the Federal Reserve's successful effort to stem a continuing loss of membership (and

10. Federal Deposit Insurance Corporation, *A Statistical Profile of the United States Banking Industry, 1991* (1992); FDIC, *A Statistical Profile of the United States Banking Industry, 1992* (1993); and FDIC, *FDIC Annual Report 1991* (1993).

11. Arthur F. Burns, "Maintaining the Soundness of Our Banking System" (address to the American Bankers Association Convention, Honolulu, Hawaii, October 21, 1974).

hence control over monetary policy) by persuading the Congress to require all insured institutions offering transactions (that is, checking) accounts to join the Federal Reserve System.¹² Research on this topic does not support the conclusion that regulatory competition necessarily means offering the most lax treatment.

In addition, researchers are divided over the relative merits of competition versus uniform regulation. An argument favoring the existing structure is that a fragmented regulatory system imposes checks on arbitrary government authority while promoting experimentation and innovation. Having several agencies, some independent and some directly under the Administration's control, contributes to open debate on policy decisions. This arrangement may give regulated depositories some protection against precipitous and arbitrary change.

Differences in Administrative Structure

The fundamental differences in the administrative structures and assigned functions of the three agencies have helped to produce systematic differences in their regulatory stances. Because the OCC has a single administrator, its policies have borne the distinctive stamp of the incumbent.¹³ Consequently, it has been able to alter course relatively quickly and to adapt more quickly to changes in the political, economic, and intellectual climate.

In contrast, the Federal Reserve is administered by a Board of Governors with seven members, each appointed by the President and confirmed by the Senate for a 14-year term, with the terms staggered such that one term expires every two years. In the absence of a high rate of turnover through resignations or deaths, even a President intent on altering Federal Reserve policy would have to serve two terms before appointing a majority of the board. For many years, this arrangement provided a great deal of stability and continuity in policy. Only since the mid-1970s, when limits on the compensation of board members became severely binding, did the rate of resignations rise dramatically at the Federal Reserve Board. And, although it may only be coincidental, the board has taken a much more

12. "Uniform reserve requirements" were one of the provisions of the Depository Institutions Deregulation and Monetary Control Act enacted in March 1980.

13. Both the Federal Reserve and the FDIC have had a chairman with such a dominating personality that those agencies also have resembled single-administrator agencies. That was true of the Federal Reserve under Arthur F. Burns and during the early years of Paul Volcker's tenure as chairman; it was also true of the FDIC during the recent term of William Seidman.

lenient regulatory stance since that period, overturning several precedents of long standing, particularly in the area of banks' securities activities.¹⁴

The organizational structure of the FDIC occupies an intermediate position relative to that of the OCC and the Federal Reserve. Until recently, its board of directors had three members (including the Comptroller of the Currency as an ex officio member) with five-year terms. Since the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, however, the FDIC has had five members, including the Comptroller of the Currency and the Director of the Office of Thrift Supervision as regular members.

PAST PROPOSALS FOR REGULATORY RESTRUCTURING

Proposals to reorganize the structure of banking regulation have been made throughout U.S. history, beginning with Alexander Hamilton's proposal for a national bank and continuing to the present. The proposals most relevant to today's issues, however, are those advanced since the end of World War II. Two points stand out. One is that the basic ideas of regulatory restructuring--in particular, eliminating regulatory competition and replacing regulation by type of charter with regulation by function--have had a broad appeal among students of banking and within the Congress. The other is that the agencies that regulate federal banks have generally opposed such proposals, except where they stood to gain additional powers and responsibilities, and have been supported by strong constituencies--primarily among the institutions that they regulate--that resist change in the status quo.

In 1947, President Truman appointed the Commission on Organization of the Executive Branch of the Government (the Hoover Commission) to make recommendations for reducing waste in government. Chaired by former President Herbert Hoover, the commission focused on eliminating duplication of effort, overlapping jurisdiction, and overhead costs, primarily by reducing the number of agencies. Its Task Force on Regulatory Commissions recommended that all federal bank supervisory activities be combined in one agency, preferably the Federal Reserve.¹⁵ But the whole commission, in its

14. For a detailed discussion of the Federal Reserve Board's recent decisions in this area, see George G. Kaufman and Larry R. Mote, "Glass-Steagall: Repeal by Regulatory and Judicial Reinterpretation," *Banking Law Journal*, vol. 107, no. 1 (January/February 1990). The Federal Reserve's policy has changed for a variety of reasons, one being that certain restrictions that may have been appropriate many years ago could not be maintained under changing competitive conditions in financial markets.

15. Commission on Organization of the Executive Branch of the Government, Task Force on Regulatory Commissions, *Report* (1949), pp. 116-117.

final report, offered no recommendations for restructuring the federal bank regulatory agencies.¹⁶

In 1961, the Commission on Money and Credit, a private study group established to recommend reforms in financial regulation and monetary policy, called for transferring the functions of the OCC and the FDIC to the Federal Reserve.¹⁷ However, President Kennedy's Committee on Financial Institutions (the Heller Committee), which was established to translate the commission's recommendations into concrete legislative proposals, backed off from that recommendation.¹⁸

In the early and mid-1960s, Federal Reserve Governor James L. Robertson repeatedly called for relieving the Federal Reserve of its regulatory responsibilities so that it could devote more time to monetary policy. The system's regulatory responsibilities, together with those of the OCC and the FDIC, would be combined in a new Federal Banking Agency to centralize the regulation and supervision of banks and to eliminate conflict in those activities.¹⁹ A 1966 article by Howard Hackley, General Counsel for the Federal Reserve, makes clear that the Federal Reserve's annoyance over a long series of rulings by then-Comptroller of the Currency James Saxon was an important motivation for the proposal.²⁰ The Comptroller's response was to recommend transferring the regulatory authority of the Federal Reserve and the FDIC to the OCC.

The report of the President's Commission on Financial Structure and Regulation (the Hunt Commission) in 1971 renewed the call for regulatory restructuring, also recommending some consolidation of the existing agencies.²¹ The commission called for the creation of a new Administrator of National Banks to take over the supervisory responsibilities of the OCC;

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16. Commission on Organization of the Executive Branch of the Government, *Report on the Independent Regulatory Commissions* (1949).
 17. Commission on Money and Credit, *Money and Credit: Their Influence on Jobs, Prices, and Growth* (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1961), p. 174.
 18. Committee on Financial Institutions, *Report to the President of the United States* (1963).
 19. See, for example, James L. Robertson, address to the National Association of Supervisors of State Banks, Bretton Woods, New Hampshire, September 19, 1962, reprinted in *Banking* (June 1962); and "Federal Regulation of Banking: A Plea for Unification," *Law and Contemporary Problems*, vol. 31 (Autumn 1966), pp. 673-695.
 20. Howard H. Hackley, "Our Baffling Banking System," *Virginia Law Review*, part I, vol. 52 (May 1966), pp. 597-632, and part II, vol. 52 (June 1966), pp. 771-782.
 21. President's Commission on Financial Structure and Regulation, *Report* (1971).

an Administrator of State Banks to take over the supervisory responsibilities of the Federal Reserve and the FDIC; and a Federal Deposit Guarantee Administration to take over the insurance functions of the FDIC, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Share Insurance Fund while retaining the individual funds for each type of institution. But like virtually all of the commission's other recommendations, these were ignored at the time.

In the late 1970s, Senator William Proxmire, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, repeatedly introduced legislation to take away the supervisory responsibilities of the Federal Reserve and transfer them to a new Federal Bank Commission created by merging the OCC and the FDIC. Like previous recommendations for reorganizing the bank regulatory agencies, however, this one encountered heavy opposition from the existing agencies and was eventually dropped.

In 1982, President Ronald Reagan appointed the Task Group on Regulation of Financial Services to develop proposals for increasing the effectiveness of federal regulation of financial services while promoting competition and the elimination of unnecessary costs. The task group consisted of 13 top officials of the executive branch and independent regulatory agencies and was chaired by Vice President George Bush. In addition to many specific recommendations for liberalizing existing regulations, the task group's final report contained a detailed proposal for reorganizing the federal bank supervisory structure.²²

The task group proposed that the OCC be replaced by a Federal Banking Agency that would regulate, supervise, and examine all national banks and all holding companies in which the lead bank was a national bank. Early drafts of the task group's report would have stripped the Federal Reserve of most of its bank supervisory responsibilities, but opposition from Federal Reserve Chairman Paul Volcker apparently caused the members of the task group to back off from that recommendation. Under the final proposal, the Federal Reserve would be given authority to regulate, supervise, and examine all federally insured state-chartered banks and their holding companies but would be required to transfer responsibility for the day-to-day exercise of such authority, insofar as feasible, to the banking departments of the individual states. In addition, the Federal Reserve was to have authority to regulate all "international class" holding companies, whether their lead banks were state or national banks. Like the recommendations for regulatory reorganization of the many commissions that preceded it, those of the Bush task group were never carried out.

22. Task Group on Regulation of Financial Services, *Blueprint for Reform* (1984), pp. 71-82.

In February 1991, the Treasury released a study that contained the Bush Administration's recommendations for reforming the regulation of depository institutions with a view toward making such institutions safer and enhancing their ability to compete with foreign banks.²³ In addition to introducing risk-related deposit insurance premiums, permitting interstate branching by depository institutions, and enlarging banks' powers to offer insurance and purchase securities, the proposals would rearrange the jurisdiction and authority of the existing federal agencies that regulate banks and thrift institutions.²⁴ The report called for replacing the current Office of the Comptroller of the Currency with a new Federal Banking Agency, also located in the Treasury Department, that would regulate all national banks and all thrift institutions now regulated by the Office of Thrift Supervision. The Federal Reserve would lose its existing authority over national banks but would continue to regulate state-chartered banks that are members of the Federal Reserve System and would take over the regulation of insured nonmember state banks from the Federal Deposit Insurance Corporation. The FDIC would be relieved of its regulatory and supervisory responsibilities, except that it would be empowered to determine whether activities of state banks that allowed broader powers than those of national banks would be acceptable risks for insured banks.

After the Treasury's study was released, a panel appointed by the House Committee on Banking, Finance and Urban Affairs recommended a compromise proposal that would preserve a supervisory role for each of the three federal bank regulatory agencies. Among other things, the proposal would reallocate jurisdiction such that the Federal Reserve would supervise all institutions with over \$100 million in assets and their holding companies, and the FDIC and the OCC would supervise the remaining state and national banks and their holding companies.

CURRENT OPTIONS FOR RESTRUCTURING THE FEDERAL AGENCIES THAT REGULATE DEPOSITORY INSTITUTIONS

Most options currently being discussed for reorganizing the bank regulatory agencies follow the outlines of the previous efforts described above. Although they assume that the dual (state and federal) banking system will continue, the options examined below focus only on the organization of the federal regulators.

23. Department of the Treasury, *Modernizing the Financial System*.

24. *Ibid.*, pp. 67-69.

Alternatives to the present system vary according to three aspects: function, degree of independence from the executive branch, and administrative structure of the agency (that is, single administrator or board). The present system has a separate primary regulator for each of the three different types of federally chartered depositories--banks, thrifts, and credit unions. The Federal Reserve and the FDIC, which derive their regulatory authority from their functional roles as chief monetary authority and deposit insurer, respectively, are not chartering authorities.²⁵ The OCC and OTS, which are chartering authorities, are run by single administrators under the authority of the Secretary of the Treasury. The FDIC and the Federal Reserve, in contrast, are structured as independent boards; the Federal Reserve is more independent than the FDIC.

Two bills to reform the agencies that regulate depositories have already been introduced in the House of Representatives in 1993. Both H.R. 1214 (introduced by Congressman Henry Gonzalez, Chairman of the House Committee on Banking, Finance and Urban Affairs) and H.R. 1227 (introduced by Congressman Jim Leach, the ranking minority member of that committee) would merge the Office of Thrift Supervision and the OCC into a new, independent Federal Banking Commission. One important difference between the bills is that H.R. 1214 would transfer the supervisory and regulatory functions of the Federal Reserve to the new agency, but H.R. 1227 would not. In addition, H.R. 1214 would establish the new agency as a seven-member commission, but H.R. 1227 would create a single administrator. Neither bill would include the regulation of credit unions within the new agency.

Organization Based on Regulatory Function

These bills, and virtually all alternatives to organizing the agencies by charter type, call for an agency structure that is organized by regulatory function. The primary functions are chartering, administering deposit insurance, and central banking. At one extreme, the separate functions would be performed by separate agencies, and the chartering authorities of the OCC and OTS would be combined into the OCC or a new agency. At the other extreme, all of the functions would reside within one agency, and each function might be performed by a different bureau. An intermediate alternative would combine the chartering authority and the deposit insurer but leave the central bank as a separate entity. In any case, the chartering authority would be the primary

25. The Federal Reserve is a chartering authority in the sense that it is responsible for registering bank holding companies, but the depository subsidiaries of these holding companies are separately chartered by either state or federal authorities.

regulator responsible for supervising, monitoring, and examining depositories and for enforcing regulations. The central bank and the deposit insurer would rely on the chartering authority for supervision and regulation. The narrower options are consistent with either an agency subordinate to the Treasury Department, as the OCC and OTS are now, or an independent board, which could include representatives of the Administration.²⁶ A fully integrated banking agency that included the central bank functions of the Federal Reserve, however, might be granted greater independence from the Administration.

Organization Based on Functional Regulation

Another set of options, not examined here, is based on "functional regulation"—that is, federal regulation that is organized on the basis of the various financial products that the regulated institution might offer. Thus, under functional regulation, separate regulators might issue separate licenses for each activity a financial institution wanted to engage in, such as accepting insured deposits or making commercial loans. This option would be a radical departure from both the current system and most proposals to reform that system. Although it could be introduced with or without changes in fundamental banking powers, this alternative could permit regulation to be tailored to a policy that allows banks to engage in a wider range of activities, such as allowing banks to expand into insurance or real estate.

Chartering Authority

The dominant option among critics of the current structure calls for merging the OCC with the OTS. The primary advantage of such a merger is that having one agency as primary regulator would simplify the regulatory process and eliminate some cost differentials (although the difference in regulatory fees paid by federally and state-chartered depositories would still be an issue). Such a merger, however, would only partially consolidate chartering. State-chartered banks and thrifts would not be included; although they would continue to fall within the purview of the federal deposit insurance agency, that agency would have to rely on state regulators for primary oversight. Although the combined agency could achieve some cost savings by reducing overhead expenses, those savings would most likely be minimal; in all

26. A major question, however, is whether the central bank should be completely or partially independent of the Administration. The Banking Act of 1935 replaced the Federal Reserve Board, which had the Treasurer and the Comptroller of the Currency as ex officio members, with a Board of Governors that has no representatives of the Administration. The FDIC currently includes the Comptroller of the Currency and the Director of OTS on its five-member board of directors.

likelihood, there would be no savings if the agencies were separated into specialized bureaus based on charter type.

An obvious drawback to this organizing principle is that banks and thrifts might need different primary regulation because they serve different roles or are subject to different legislated rules or mandates. Thus, to the extent that the type of charter grants different powers or requires different activities, the argument for separate regulators would be stronger. However, previous differences between banks and thrifts that formed the basis for separate charters appear to be much less meaningful today. For most purposes, banks and thrifts compete fairly directly and are not much affected by differences in allowed activities or legislated requirements.

Deposit Insurance

Another question critics raise is whether it is desirable for the deposit insurer to be actively engaged in supervising banks and thrifts and, by extension, whether the insurer should be incorporated into a combined regulatory agency. Some critics have suggested that the FDIC's stewardship of the deposit insurance fund predisposes the agency toward an unduly conservative regulatory stance that sacrifices efficiency to safety. Including the FDIC with the chartering agencies could be a means of balancing the chartering agencies' opposite tendencies and potentially synthesizing any conflicts between the regulatory philosophies of the different agencies.

The discussion chapter in the Treasury's 1991 study makes the opposite argument: that the FDIC should be relieved of its regulatory responsibilities on the grounds of a conflict "in having a single regulatory agency simultaneously promote and protect an industry."²⁷ Although this was one of the more serious criticisms leveled against the Federal Home Loan Bank Board, which had been given the explicit charge by the Federal Home Loan Bank Act to foster the growth of the savings and loan industry as a source of residential financing, it does not seem applicable to the FDIC, which has no role in promoting banking other than assuring the safety of its deposits. A closely related criticism, however, was leveled at the FDIC for allegedly failing to close banks fast enough during the recent period when its fund balance was negative.

27. Department of the Treasury, *Modernizing the Financial System*, p. XIX-5.

Central Bank

An additional issue is the relationship between the conduct of monetary policy by the central bank and the role the Federal Reserve now plays as a bank regulator. Officials of the Federal Reserve, with few exceptions, have consistently argued that the ability to examine and supervise banks is critical for the Federal Reserve in carrying out monetary policy.²⁸ Recent chairmen of the Federal Reserve Board have argued for retaining and, in some cases, extending the Federal Reserve's supervisory responsibilities.²⁹ The most common argument has been that bank supervision provides the Federal Reserve with a "window on the world" that gives it access to information that is vital to the formulation of monetary policy.

Skeptics, however, have pointed out that it is unclear how such information would be used and how it would affect monetary policy in specific cases. And even if such information were important in formulating monetary policy, it does not follow that the Federal Reserve needs to be involved in supervising banks. Analysts have argued, for example, that whatever information the Federal Reserve now gains directly through the supervisory process could just as well be supplied to it by the other federal bank regulatory agencies. In addition, some past members of the Federal Reserve Board have argued that bank supervisory and regulatory matters placed too large a burden on the time of board members, which might be better devoted to monetary policy.

Another argument for preserving the Federal Reserve's regulatory role has been based on the incentives that such responsibilities give the Federal Reserve to minimize disturbances to financial markets that would adversely affect the banking system.³⁰ But critics of the Federal Reserve's regulatory role have pointed out that, in practice, its short-term concern about the effect of rising interest rates on the condition of depository institutions has sometimes distracted it from the pursuit of longer-term price stability. Indeed,

28. See, for example, Robert M. Garsson, "Greenspan Decries Limits on Fed in Treasury Plan," *American Banker*, April 24, 1991; Statement of Robert C. Holland in *Federal Bank Commission Act*, Hearings on S. 2298 before the Senate Committee on Banking, Housing, and Urban Affairs, October 31, November 1 and 8, 1975, pp. 285-288; and Board of Governors of the Federal Reserve System, "The Federal Reserve Position on Restructuring of Financial Regulation Responsibilities," *Federal Reserve Bulletin*, vol. 70 (July 1984), pp. 547-557.

29. See, for example, Burns, "Maintaining the Soundness of Our Banking System"; Testimony of G. William Miller before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs, June 21, 1978; and Testimony of Alan Greenspan before the Subcommittee on Financial Institutions of the House Committee on Banking, Finance and Urban Affairs, April 30, 1991.

30. Charles J. Partee, "Statement Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, February 28, 1979," *Federal Reserve Bulletin*, vol. 65 (March 1979), pp. 236-239.

in its 1984 statement on regulatory restructuring, the Federal Reserve Board explicitly acknowledged that situations requiring trade-offs between monetary restraint and stability of financial markets were likely to occur.

On those occasions when the economic environment may require particularly forceful monetary policy action, the failure of supervisors and regulators adequately to have foreseen potential strains on depository institutions could either constrain the ability of the central bank to act vigorously to meet monetary policy objectives or create a situation in which needed monetary restraint pushes the stability of the system to and beyond a breaking point.³¹

What this review of the apparent short-term conflict between monetary policy and the stability of the financial system ignores is that the longer-term swings in interest rates associated with longer-term fluctuations in the rate of inflation are probably the most devastating to financial institutions. Preventing such fluctuations would probably do much more to assure the health of depository institutions than continuously intervening to prevent short-run movements in interest rates.³²

The case for retaining a supervisory role for the Federal Reserve also rests partly on the assumption that bank supervisory policy and monetary policy need to be conducted by the same agency to foresee strains on depository institutions and take actions to forestall them. This assumption is brought into question by the fact that the Federal Reserve has frequently modified monetary policy to ease pressures in areas of the financial system for which it bears no direct supervisory responsibility. The Federal Reserve's provision of additional reserves to the banking system following the disruptions to financial markets resulting from the sudden collapse of Penn Central in 1970 is one example; its similar response to the massive "flight to quality" following the October 1987 stock market crash is another.

31. Board of Governors of the Federal Reserve System, "The Federal Reserve Position on Restructuring of Financial Regulation Responsibilities."

32. For a systematic discussion of how concern about the volatility of interest rates has caused the Federal Reserve to pursue a policy of smoothing interest rates in the short run that has resulted in higher rates of inflation and higher nominal interest rates in the long run, see Larry R. Mote, "Looking Back: The Use of Interest Rates in Monetary Policy," *Economic Perspectives*, Federal Reserve Bank of Chicago, vol. 12 (January/February 1988), pp. 15-29. See also Thomas Mayer, "The Structure and Operation of the Federal Reserve System: Some Needed Reforms," in House Committee on Banking, Currency and Housing, *Financial Institutions and the Nation's Economy*, Compendium of Papers Prepared for the FINE Study, Book II (1976), p. 712.

Moreover, commercial banking is no longer the dominant supplier of credit in the economy. Concerns about disturbances in financial markets must encompass all financial providers, of which banks are a decreasing subset. But if the Federal Reserve's actions in response to strains on the financial system outside its immediate area of supervisory authority undermine the argument that combining monetary policy with supervision is necessary to protect the system, they also nullify arguments against such a combination based on the potential for counterproductive intervention by the Federal Reserve to smooth interest rates; the Federal Reserve may pursue such policies with or without direct supervisory authority over affected institutions.

An alternative argument for combining monetary policy and supervisory responsibilities in the same agency is that it would allow the use of supervisory policy to reinforce monetary policy. The current controversy surrounding the alleged contribution of an overly stringent examination policy to a "credit crunch," and efforts to relax examination policy as a means of stimulating the economy, is a case in point. Indeed, this controversy is reminiscent of the late 1930s, when the Federal Reserve pushed hard for a countercyclical supervisory policy designed to reinforce monetary policy. Although the FDIC and the OCC eventually prevented implementation of this policy, it is clearly reflected in the recent calls for a relaxation of examination standards. As has been frequently pointed out, however, there are enormous difficulties in getting an examination force of several thousand examiners to pursue a consistent and coherent countercyclical supervisory policy, alternatively tightening and relaxing standards to foster the Federal Reserve's goals for monetary policy.

Administrative Structure

One approach to assuring greater uniformity among the federal banking agencies would be to revamp their administrative structures--for example, by requiring that the OCC, OTS, and the FDIC be governed by boards similar to the Federal Reserve's Board of Governors. As discussed above, the current differences in administrative structure may predispose the Federal Reserve toward greater conservatism and the OCC toward greater activism. Nevertheless, although the Federal Reserve's administration by a seven-member board with long, staggered terms tends to cause it to be slow to abandon precedent, it does not dictate what the Federal Reserve's policy will be in the long run. That it has tended toward stricter regulation than the OCC over the past several decades probably reflects its conservatism in the face of what has been a general trend toward more liberal regulatory policies. A reversal of that trend could make the Federal Reserve appear more liberal than the other regulatory agencies. Moreover, although political inde-

pendence may sometimes be desirable, political responsiveness may also be desirable, especially when the public is looking to political leaders to solve specific problems and when coordination among agencies is important.

CONCLUSIONS

Regulatory restructuring has the potential to make only a modest contribution to the effectiveness of banking regulation. The great danger, however, is that the benefits of moving around the boxes on the organization chart will be oversold. There is no substitute for having the Congress adopt sound and relatively detailed policy guidelines and for the federal bank regulatory agencies to administer those guidelines in an efficient and equitable manner.

The number of conclusions regarding the desirability and feasibility of specific proposals to restructure the federal bank regulatory agencies that can be said to be firmly grounded in either theory or empirical evidence is quite small. In part, this is because of the inherent difficulty of finding adequate means of projecting the effects of organizational changes that are not like any that have taken place in the past. For example, although a plausible a priori case can be made that consolidating the supervisory and regulatory functions of two or more of the existing federal bank regulatory agencies should result in some reduction in overhead, legal, research, and occupancy costs, precise estimates are simply not available. In any event, the savings that the public would derive from such consolidation are likely to be fairly small and insignificant compared with the presumed private benefits, such as reducing the burden of complying with multiple jurisdictions or improving the quality of federal banking regulation.

From the standpoint of cost-effectiveness and certainty on the part of the depository institutions, minimizing the number of regulators with which each institution must deal is probably desirable. Regardless of the total number of federal bank regulatory agencies, there is much to be said for assuring that each banking organization must deal with only one of them.