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Submitted electronically to http://www.regulations.gov

Re: Review by the Treasury Department of the Regulatory Structure Associated with Financial Institutions; TREAS-DO-2007-0018

Dear Sir or Madam,

The American Bankers Association (ABA) and America's Community Bankers (ACB)[1] appreciate this opportunity to respond to the solicitation of comments[2] by the United States Department of the Treasury (Treasury Department) for views of the current structure for regulating financial institutions. This review is part of a broader effort by the Treasury Department to reduce regulatory and structural barriers to the efficiency and competitiveness of the American financial system.

The Treasury Department is to be commended for its leadership in this important and timely initiative. The record of achievement of American banks and other financial institutions in meeting customer financial services needs, with ever increasing variety of choices and products at continually lower costs, is unparalleled in the world. We believe that a thorough and careful review, employing long-term service to customers as a yardstick, will identify important ways to improve our regulatory program. At the same time, we believe that such a review will lead to the recognition that our financial institutions, and especially the customers that we serve, are greatly benefited by the choice and variety and resilience currently found in our financial regulatory structure.

As is discussed in more detail below, the ABA and ACB present the following key points for consideration:

1. Charter choice, undergirded by a system of specialized financial regulators, works well in promoting the vitality, innovation, and

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[1] ABA and ACB will merge December 1, 2007. The combined organizations will unite community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks under one association that works to enhance the competitiveness of the nation's banking industry. The merged association's members -- the majority of which are banks with less than $500 million in assets -- represent 95 percent of the industry's $11.5 trillion in assets and employ nearly 2 million men and women.

[2] "Review by the Treasury Department of the Regulatory Structure Associated with Financial Institutions," 72 Fed. Reg. 58939 (Oct. 17, 2007) (Treasury Review).

adaptability necessary for financial institutions to adjust to the changing needs of our customers. At the same time, the current regulatory structure, developed through experience (including some trial and error) over the past 150 years, has fostered a vibrant, creative, and resilient regulatory environment that promotes the overall safety and soundness of our nation's banking institutions.

2. There are opportunities for improving the current structure, including –
   a. Creating an optional federal insurance charter;
   b. Improving the supervision of state-chartered, non-depository mortgage lenders; and
   c. Taking key steps to promote a more prudential program of securities and futures supervision.

3. As regulation continues to evolve, it must always have as its primary objective facilitating the ability of financial institutions to meet the needs of their customers.

1. Charter choice—undergirded by a system composed of specialized financial regulators—works well.

The current regulatory system is the product of decisions made over the course of more than 150 years, often during times of great economic challenges or in response to clear deficiencies in the regulatory landscape. The most significant driver in developing our current system has been experience, often with significant trial and error. This latter point is a powerful reason for reviewing the system regularly and making improvements, but it is not an argument for abandoning the basic architecture resting on variety, specialization, and choice. These qualities are hard, if not impossible, to create in more centralized regimes, and they should not be discarded.

While our financial regulatory system is complex, this complexity is in many ways a fundamental reason for its success. By offering financial institutions a range of options, and by having regulators with complementary areas of expertise, the current system has fostered a dynamic environment that encourages innovation and cultivates a continually changing variety of products and services. It also accommodates vigorous competition among the financial institutions, with the greatest benefits inevitably being passed on to customers.

a. Origins of the current system

A brief overview of the origins of financial institution regulators and the evolution of their authority helps place the current system in context and illustrates the unique features of each regulator. It also demonstrates how our current system, which some would criticize as haphazard, has in fact been shaped and developed by real-world experience, growing and evolving along with our economy.

Office of the Comptroller of the Currency (OCC). The OCC was created in 1863 in part to address the problems created by each bank issuing its own currency and in part to finance the Civil War. By 1860, there were over 1500 state banks, circulating a total of over 9,000 different types of bank notes. This made commerce very difficult. Notes issued by a bank in one market either would not be accepted by banks elsewhere or would be accepted at widely varying rates, counterfeiting was a serious problem, and a bank's notes frequently remained in circulation after that bank had defaulted.

To address these concerns, Congress created the OCC in 1863[3] and later imposed a 10% tax on state bank notes.[4] This effectively ended the issuance of such notes, and many state banks converted to a national charter thereafter. The creation of the national charter also helped defray the costs of the war by requiring all national banks, before opening for business, to buy government bonds to secure bank-issued notes. National banks also were required to tender to the United States Treasurer government bonds in an amount equal to one-third of the bank's capital.

Treasury Secretary Chase's goal of eliminating the state banking system was almost realized, as the number of banks with state charters declined to 247 by 1868. Fortunately for bank customers and the nation as a whole, state banks were allowed by their charters to innovate, resulting, for example, in the development of consumer deposit and checking accounts. State banks again thrived, with over 10,000 banks operating under state charters by 1906, competing alongside more than 6,000 national banks.[5] Unwittingly, Secretary Chase succeeded in launching our dual banking system, a key driver in the development and vitality of the American banking industry for over a century.

Board of Governors of the Federal Reserve System. The nation experienced a series of sharp economic declines in the late 19th and early 20th centuries, culminating in the financial panic of 1907. The stock market had fallen over 50% from its high the previous year, there were several runs on banks, and the money supply was tight. The Treasury Department and several bankers (most notably J. P. Morgan) took several steps to inject additional liquidity, and the economy quickly recovered.

The nation's vulnerability to an unpredictable money supply was underscored by these events, however. To address this problem, Congress established the National Monetary Commission in 1908, which issued a report that ultimately led to the creation of the Federal Reserve System in 1913. That system was created "…to furnish an elastic currency, to afford means of rediscount and commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."[6]

Federal Deposit Insurance Corporation (FDIC). In response to an unprecedented number of bank failures during the Great Depression (over 4,000 banks closed in 1933 alone), Congress created the FDIC to supervise a new program of federal insurance for bank deposits. Specifically, the FDIC was established to protect bank depositors, maintain confidence in the banking system, and

[3] 12 Stat. 665 (1863).

[4] 13 Stat. 484 (1865).

[5] States vested state-chartered banks with several powers that were unavailable to national banks at the time, including the authority (a) to obtain funds from deposits instead of through the issuance of bank notes, (b) to establish branches, and (c) to engage in trust activities. As a result, the state bank charter prospered, as evidenced by the fact that by 1892 state banks outnumbered national banks and have done so ever since.

[6] 38 Stat. 251 (1913).

promote safe and sound banking practices.[7] All national banks and all members of the Federal Reserve System were required to be insured, while state non-member banks could obtain deposit insurance by applying to the FDIC.

Federal Home Loan Bank Board (FHLBB). Savings associations were experiencing problems in the 1930s as well, but the problems they faced were unlike the problems experienced by banks. These institutions were all in the mutual form of organization and were unable to raise capital to support the home mortgage lending that was their single line of business except through the gathering of deposits or membership shares.[8] During their earliest history, mutual institutions raised funds that they then used to make mortgage loans by selling shares in the institution to the borrowers of mortgage credit. These shares had a long duration, often exceeding 12 years, and shares were liquidated when the mortgage needs of all shareholders were satisfied.

In the 1930s, savings associations had a mortgage foreclosure rate of approximately 14 percent (as compared to approximately 6 percent for commercial banks). Because savings associations' portfolios consisted primarily of mortgage loans, investors became wary of buying shares in the associations, and the number of thrifts shrank by 25 percent from 1930 to 1933. In 1932, as a result of the number of foreclosures, the Federal Home Loan Bank System was created as a source of liquidity for its members. The twelve Federal Home Loan Banks provided low-cost advances to the mortgage lenders.

The Home Owners Loan Act was enacted in 1933 to address continuing foreclosure problems. It authorized the Home Owners' Loan Corporation to acquire and refinance mortgage loans, and it authorized the FHLBB to charter federal savings associations. Additional responsibilities and powers were granted to the twelve Federal Home Loan Banks, which became part of the FHLBB regulatory structure. The Federal Home Loan Bank System functioned as the central bank and primary federal regulator for federal savings associations. The Federal Savings and Loan Insurance Corporation (FSLIC) was created a year later to insure savings accounts, thereby making it easier for savings associations to attract funds that could be used for additional home mortgage credit. The FSLIC was also granted regulatory authority over state savings associations. As originally created, the FSLIC was a separate entity under the direction of the FHLBB. Thus, the FHLBB had authority for chartering, supervising, and insuring federal savings associations, and the Federal Home Loan Bank System had additional authority over state associations. The Federal Home Loan Bank System's secondary market role was deepened when the Federal Home Loan Mortgage Corporation (Freddie Mac) was created in 1970 and placed under FHLBB supervision.

The FHLBB's responsibilities for prudential regulation, insurance, and oversight of the secondary market continued until 1989. Congress, responding to the problems that developed in the thrift industry in the 1980s, enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which abolished the FHLBB and decentralized its functions, dividing its responsibilities among four agencies. Insurance of accounts was transferred to the FDIC (which was given authority to administer the newly-created Bank

[7] 48 Stat. 162 (1933).

[8] Savings associations were prohibited from offering transaction accounts until 1968. See Pub. L. 90-448, § 1716(a).

Insurance Fund and Savings Association Insurance Fund). Prudential supervision of state and federal savings associations was transferred to the newly-created Office of Thrift Supervision (OTS). The regulatory authority of the Federal Home Loan Banks over savings associations was transferred to the OTS, oversight of the Federal Home Loan Banks advance business and other operations was transferred to the newly-created Federal Housing Finance Board, jurisdiction over Freddie Mac was given to the Office of Federal Housing Enterprise Oversight.

Regulation of bank and thrift holding companies. The next major piece of banking legislation that affected the structure and supervision of financial institutions came in 1956 with the enactment of the Bank Holding Company Act (BHC Act). This legislation was conceived in response primarily to two developments: the increased involvement of banks in non-traditional bank activities and the ownership of multiple banks by a single corporation to accommodate business growth within the context of interstate branching restrictions. The Federal Reserve System was given jurisdiction over multi-bank holding companies – bank holding companies (BHCs) that own more than one bank – in 1956 and jurisdiction over single BHCs in 1970.

Congress enacted legislation in 1967 affecting the activities of savings and loan holding companies (SLHCs). The comprehensive Savings and Loan Holding Company Act differed from the legislation governing BHCs in that "unitary" SLHCs – *i.e.*, SLHCs that owned only one savings and loan association – were permitted to mix banking and non-financial commerce. In 1987, Congress determined that savings association subsidiaries of SLHCs must meet the "qualified thrift lender" (QTL) test.[9] FSLIC (under control of the FHLBB) was given jurisdiction over SLHCs, although jurisdiction for SLHCs was transferred to the OTS upon its creation in 1989.

Securities and Exchange Commission (SEC). Confidence was lacking not only in banks but also in the stock markets in the early 1930s. In September of 1929, the Dow Jones Industrial Average reached what was then an all-time high of 381. However, due to a combination of factors, prices declined until July of 1932, when the Dow bottomed out at 41.

Congress created the SEC in 1934 in an attempt to restore investor confidence in the capital markets by preventing abuses arising in connection with the sale of securities. The SEC was given exclusive jurisdiction over the securities markets and securities activities not conducted by banks. Over time, much of the SEC's regulatory activity has been conducted via a network of SEC-supervised self-regulatory organizations (SROs), such as the National Association of Securities Dealers and the stock exchanges.[10]

Gramm-Leach-Bliley modernization. The landscape governing the charter choices available to, and the regulation of, financial institutions was changed significantly with the enactment of the Gramm-Leach-Bliley Act (GLBA) in 1999. GLBA was enacted to remove legislative

[9] Originally, the QTL test required that 70 percent of the assets of a savings association must be housing-related loans. The current QTL test requires that at least 65 percent of an institution's assets must be "qualified thrift investments." These investments include, for instance, home loans, educational loans, small business loans, and credit card loans. *See* OTS Regulatory Bulletin 32-24 (2002).

[10] The National Association of Securities Dealers has been succeeded by the Financial Institutions Regulatory Authority (FINRA), which also incorporates the former enforcement arm of the New York Stock Exchange (NYSE Regulation, Inc.). NASD and NYSE Regulation, Inc. merged on July 26, 2007.

impediments to the full realization of financial institutions' potential. In a sense, the law was playing catch-up to the innovations that were taking place rapidly in the years leading up to its passage. It did so by embracing regulatory diversity, clearing the way for financial holding companies to accommodate a wide variety of business models with the mix of financial charters most appropriate to meet the needs of their customers.

GLBA brought about the following changes, among others:

- Bank holding companies were permitted to engage in activities that are (a) financial in nature[11] or incidental to financial activities or (b) complementary to a financial activity, provided the complementary activity does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.[12]

- A new entity – called a "financial holding company" (FHC)[13] – was recognized and authorized to engage in the nine activities enumerated in GLBA as "financial in nature" (including securities underwriting and dealing and insurance underwriting and sales) and any other activity that is financial in nature or incidental or complementary thereto. The Federal Reserve Board was designated as the "umbrella supervisor" of FHCs.

- The newly permitted activities were made subject to "functional regulation," whereby the securities activities of non-depository subsidiaries of holding companies are regulated by the SEC and the insurance activities of such subsidiaries are regulated by state insurance departments. Securities activities conducted directly by a bank are regulated by either the bank's primary regulator or the SEC (depending on the activity),[14] while insurance activities conducted directly by a bank are regulated by the bank's primary regulator.

- The SEC was given jurisdiction over "investment bank holding companies" (which are diversified nonbank investment banking organizations) and "consolidated supervised entities" (which are broker-dealer holding companies that own bank and nonbank subsidiaries).

- The ability of newly-formed unitary savings and loan holding companies to have commercial parents or affiliates was repealed. The activities and authorities of unitary savings and loan holding companies existing in 1999 were grandfathered. Any savings

[11] GLBA identified several activities as "financial in nature," including lending, providing insurance, and engaging in underwriting or dealing in securities. GLBA § 103(a), codified at 12 U.S.C. 1843(k).

[12] GLBA provided for a grandfather period of 10 years (subject to one 5-year extension) for nonconforming activities engaged in by a company that was predominantly engaged in financial activities. *Id.*, codified at 12 U.S.C. 1843(n). The new activities authorized for bank holding companies were in addition to the activities they could engage in prior to the enactment of GLBA (*i.e.*, banking activities and those so closely related to banking as to be a proper incident thereto).

[13] An FHC is a bank holding company, a securities firm, or an insurance company that acquires a bank.

[14] Bank transfer agency activity is regulated by the SEC under Section 17A of the Securities Exchange Act of 1934, 15 U.S.C. 78qA.

and loan holding companies created after 1999, with some exceptions, have the authorities of financial holding companies.

These changes reflected the steady evolution in the business of providing financial services leading up to the enactment of GLBA. Financial innovation and competition led banks, securities firms, and insurance companies to offer products that increasingly shared common characteristics. As a result, the distinctions between deposit products, securities, and insurance have become difficult to discern at times. A good—but by no means the only—example of how competing products were developed under differing charters is provided by the bank investment contract: this product can be regulated as an insurance product, a security, or a deposit.

Recognizing the similarities of many of the products offered by the wide range of financial institutions, Congress established a procedure in GLBA for determining what is a banking product and what should be treated as a security or as insurance. Several products were identified as "banking products" or "financial in nature" in GLBA. The Federal Reserve Board and the Treasury Department were given authority to determine what else is "financial in nature," while the SEC was directed to conduct a rulemaking before concluding that any "new hybrid product"[15] is a security.

Thus, today we have a system of multiple regulators supervising and regulating different components of the financial services industry. The system is undeniably complex, and no one set out to design what we have. But it works. It works because it evolved through experience in our financial markets. As it has evolved, our system progressively has provided more room for innovation and competition. While there are opportunities for improvement (discussed below), our basic structure of regulation and supervision has fostered the most effective, creative, and resilient financial system in the world. It is a financial system that neither relies upon a single firm nor a single regulator to succeed or to progress.

Our financial system also is dynamic, with a dynamism that inheres in the regulatory program while finding even more expression among the firms in the financial industry. That dynamism continues to provide new and better products to serve ever more financial services customers. The regulatory system operates under a tempered dynamism, however, with key policy changes usually relying upon the cooperation of other regulatory players. The result is not nimble, but it is an effective check against risky regulatory experimentation. In effect, our system provides ample room for experimentation in the marketplace while moderating experimentation among regulators.

A key and important question in the Treasury's inquiry, simply put, is whether a fundamentally different regulatory structure would be better for American financial customers. For the reasons outlined below, we respectfully suggest that the general outlines of our current regulatory system are superior for the United States—and particularly for our 300 million-plus beneficiaries—than the various untested regulatory schemes prevalent in common debate.

[15] A "new hybrid product" is defined as any product that was not regulated by the SEC as a security before GLBA, is not an "identified banking product" as GLBA defines that term, and is not an equity swap that is sold directly to a non-qualified investor.

b. Benefits of the current system

Charter choice and regulatory diversity are assets, not liabilities. Charter choice provides benefits both when organizing a financial institution at its inception and as the institution operates as a going concern and evolves to meet customer needs and demands.

The complexity of the current system is first and foremost a "gateway" issue. Once an institution decides which type of charter—or array of charters—best fits its business plans, the fact that there are several financial institution regulators becomes less of an operational issue. But it is precisely this choice of gates that provides one of the fundamental strengths of the system.

A wide variety of considerations may enter into the decision of which charter to select. Below are a few examples:

- A financial institution that intends to have a multi-state footprint may conclude that there are efficiencies in having one primary regulator instead of several state regulators.

- Conversely, a financial institution may value the unique mix of banking powers authorized in a given state or conclude that proximity to its regulator is the paramount consideration.

- Institutions primarily engaged in mortgage lending or that desire to have the same regulator of both the depository institution and the holding company may opt for a consolidated supervision with the thrift charter.

- Institutions may chose a stock or mutual form of organization.

- Institutions that are primarily focused on engaging in securities activities may conclude that regulation by the SEC as a consolidated supervisor is preferable and opt for a state bank or thrift charter.

Once the initial determination about which charter to select is made, charter choice remains a useful check against the primary regulator neglecting its duties, becoming too calcified for an ever-changing financial marketplace, growing overly bureaucratic and ineffective or otherwise imposing regulatory conditions inconsistent with the ability of financial firms to serve their customers. All of these ills have happened and do happen, but our current regulatory system of charter choice and regulatory diversity—particularly in the case of banking regulators—works to prevent these ills from persisting. Instead, there is an institutional premium on developing regulatory programs attractive to financial firms. Those programs most attractive to firms are the ones that best facilitate the ability of firms to serve their customers. The result is a win-win convergence of interests, since financial customers well served are also government constituents well served.

Charter choice also remains an important consideration as financial institutions' business models evolve. For instance, while a community bank may conclude that a state charter is best when the bank first begins operations, it may conclude later that its expansion plans would best be facilitated by a national bank or federal thrift charter. Or it may conclude that some services are best met with a mix of charters, perhaps concentrating mortgage business in one, commercial lending in another, credit card activities in yet another, and trust activities in still another. The combinations are as diverse as the purposes and markets and customers to be served.

In this way, charter choice produces a maximum of benefits for financial customers. The dynamic, flexible nature of our current system has facilitated the development of new products and new ways to meet the needs of customers. It is no accident that nearly all new financial products are invented in the United States and that the United States is a net exporter of financial services to the world. Regulatory agencies, recognizing the need for the financial institutions within their jurisdiction to evolve in order to remain competitive, have applied the laws within their purview in ways that continually strive to balance *safety and soundness* with *innovation*, both of which are high priorities for financial customers. The result is more products, and more convenient access to products at lower costs, to more customers than ever before—and more so than anywhere else in the world.[16]

Ours is also a system that does not rely upon enlightened regulation from every regulator at all times. But it is a system that *promotes* enlightened regulation. Bad regulatory programs—*i.e.*, programs not in the long-term interests of customers—are offset and tempered by good programs of other regulators, the system rewarding the latter and penalizing the former.

This applies not only to choices among federal charters but also to choices between federal and state charters. As one leading commentator has noted,

> It is widely acknowledged that the dual banking system has facilitated a healthy evolution of the banking system by allowing banks to experiment with new products and services at the state level when they were foreclosed from doing so at the federal level.[17]

States have been pioneers in developing products such as interest-bearing checking accounts (also known as negotiable order of withdrawal, or NOW, accounts) and adjustable rate mortgages. States also have led the evolution of ideas such as interstate banking. Some states currently permit a broader range of powers for banks than is permitted for national banks,[18] and the FDIC is authorized to approve equity investments for state banks that are impermissible for national banks if the activity would pose no significant risk to the deposit insurance fund and if the bank in question is well-capitalized.[19] It is important that the state banking system remain a

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[16] It is worthwhile noting that when financial innovation does occur abroad, it is usually in response to a domestic U.S. regulatory excess, such as the development of the Eurodollar markets when U.S. regulatory action drove that business from our shores. It was the relatively heavy-handed, unchecked authority of the Commodity Futures Trading Commission that opened the door for the development of foreign-based futures markets—a problem to some degree addressed by the Commodity Futures Modernization Act of 2000. It is not clear that regulatory consolidation plans would do anything to reduce the likelihood of domestic regulatory excesses and indeed may remove the checks and balances that our current regulatory system provides.

[17] M. Fein, 1 *Banking and Financial Services: A Regulatory Guide to the Convergence of Banking, Securities and Insurance in the United States* (2005), at 3-34.

[18] The State of Virginia, for instance, permits state-chartered banks to engage in real estate brokerage activities. *See* VA. ADMIN. CODE §§ 6.1-11(12) and 6.1-58.3.

[19] *See* 12 C.F.R. § 362.3.

vibrant part of our banking landscape, both to fulfill its oft-characterized role as a laboratory of change and to provide options for institutions that choose the benefits of the state charter.

The dangers to the dual banking system posed by a concentration of power in a federal regulator were discussed during another landmark Treasury review of the banking landscape. In a report offering suggestions for how to improve the regulatory landscape in 1991, then-Secretary of the Treasury Nicholas Brady noted that some argued against consolidating because—

> The existence of fewer agencies would concentrate regulatory power in the remaining ones, raising the danger of arbitrary or inflexible behavior. A single Federal regulator, for example, might favor the type of institution making up the preponderance of those it regulates, i.e., federally-chartered institutions over state-chartered ones, thus potentially undermining the "dual banking system" and "states rights." Agency pluralism, on the other hand, may be useful, since it can bring to bear on general bank supervision the different perspectives and experiences of each regulator, and it subjects each one, where consultation and coordination are required, to the checks and balances of the others' opinions.[20]

This system of regulatory checks-and-balances—or regulatory pluralism—has resulted over time in better regulation. Not all regulators agree on all issues. As is often said of legislation, regulation is the art of the possible, with the actors making accommodations in order to obtain the best result that is achievable. The consultative process may even develop better results than any of the original individual proposals. The following recent examples illustrate the benefits of bringing the perspectives of multiple regulators to bear on specific regulatory issues:

- The recently issued guidance on commercial real estate (CRE) concentrations provides an example of where one regulator – the OTS – benefited the entire industry by insisting on further discussion and consideration. Initial proposals presented the very real danger that well-managed banks would be forced to back away from good CRE loans. At issue was potential supervisory application of rigid numerical limits that took inadequate notice of risk management efforts by individual banks. After multi-agency review, the new guidelines retained their appropriate focus on excessive concentrations, but with the important flexibility to acknowledge genuine differences among assets in the portfolio and effective bank strategies to manage and diffuse risk. An idea with potentially serious consequences for creditworthy commercial borrowers was converted into a flexible supervisory tool. Moreover, remaining agency differences in the guidelines hold out the promise of further adjustments in the future in line with actual customer and regulatory experience.[21]

[20] *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks*, published by the United States Department of the Treasury, February, 1991, at XIX-6. It is worthwhile noting that this Treasury study laid the groundwork for GLBA, which at its core embraced regulatory diversity.

[21] *Compare* 71 Fed. Reg. 75295, 75301 (Dec. 14, 2006) (OTS) *with* 71 Fed. Reg. 74580 (Dec. 12, 2006) (OCC, FRB, and FDIC). The OTS eschewed the use of numerical thresholds in its discussion to avoid creating the impression that the thresholds – which the other agencies used to provide "high level indicators of risk" – would be misinterpreted as caps above which no CRE loans may be made.

- The experience in implementing the "push out" provisions in the securities title of GLBA illustrates the value in having multiple regulators participate in rulemakings of common interest. As initially envisioned by Congress, the SEC was given the authority to write rules implementing the bank exceptions from broker-dealer registration provided under GLBA. A lengthy (and, at times, contentious) rulemaking failed to produce acceptable rules, prompting Congress to vest rulemaking authority jointly in the SEC and the Federal Reserve Board, with both consulting with the other federal banking regulators. Once the interagency process was put in place, a final rule was developed and agreed upon by all of the regulators.[22]

- The ongoing Basel risk-based capital standards rulemakings provide an example of where the different regulators, representing in some respects very different points of view, have worked to achieve a more risk-based approach to allocating regulatory capital for all banks, big and small. Collectively, they are working to develop a menu of capital options, applicable more closely to the wide diversity in size and complexity of institutions making up the American banking industry. It is easy to imagine that one banking mega-regulator, acting alone, would have focused attention on the large, internationally active banks. The interaction of the various banking regulators has been operating to ensure that competitive imbalances are not created through the new capital standards.

Having multiple regulators also minimizes the risk that any one regulated institution influences bank policy inappropriately. The collaboration that is required when bank policy is shaped by several regulators tempers the ability of any one institution to exercise undue influence. Moreover, each regulator under the current system knows that it must regulate a wide range of actors, all of whom may choose another primary regulator. Thus, no regulator can reflexively accept suggestions offered by the most influential institutions within its jurisdiction without risking action that would be contrary to the agency's interests in the long run.

The benefit for regulation that comes from a program of multiple regulators has been acknowledged by the regulators themselves. For instance, Federal Reserve Board Governor (now Vice Chairman) Donald Kohn has observed—

> Moreover, regulation can benefit from competition. Running regulated and unregulated markets side by side gives people a choice of whether they want protection and helps to constrain regulation. Some of the same purposes can be served by having multiple regulators for the same function; in some circumstances, the possible adverse consequences of competition in laxity may be smaller than the potential for regulatory conformity and regulator risk-aversion to impinge on innovation and change.[23]

Writing twenty years earlier, the Task Group on Regulation of Financial Services, chaired by then-Vice President George Bush (the Bush Task Group) wrote—

[22] *See* Regulation R, 72 Fed. Reg. 56514 (October 3, 2007).

[23] Remarks by Governor Donald L. Kohn, "Panel discussion: Financial Markets, Financial Fragility, and Central Banking," delivered at a symposium hosted by the Federal Reserve Bank of Kansas City at Jackson Hole, Wyoming (Aug. 27, 2005).

> [U]nlike the private sector, governmental organizations frequently do not face the same competitive pressures for efficiency and good management that are encountered by private firms. Consequently, there must be checks and balances among the branches of government in order to prevent excessive concentration of government power from developing.[24]

Thus, there are very good reasons to retain the basic architecture of the current system. These reasons were cogently summarized by former Comptroller of the Currency Eugene Ludwig, who wrote recently, "Giving banks the choice of charter has fostered innovation and minimized the dead hand of a monolithic regulatory mechanism."[25]

c. Obstacles to changing the current system

Viewed from another perspective, there are other good reasons *not to make* wholesale changes to our regulatory landscape. A change to the fundamental underpinnings of our regulatory structure would be disruptive, too disruptive for what are at best uncertain benefits. Clearly there would be significant challenges created by rearranging jurisdictions. Agencies would need to expand or contract staff, as appropriate. New areas of expertise would need to be developed or acquired. And new relationships would need to be developed between the regulators and the regulated in order to facilitate an effective and constructive dialogue.

Banking is an industry built upon customer confidence, which confidence is protected by a regulatory program that employs confidential examination and consultation as its chief method, reinforced by a history of trust between regulator and regulated. Preserving that confidence and maintaining that trust are essential burdens that must be met in any kind of regulatory restructuring. While these challenges are surmountable, they nevertheless bespeak caution rather than adventure in regulatory design.

The brief overview set out above of how our regulatory landscape was developed demonstrates that fundamental changes in banking and finance laws were enacted either in response to economic crises or in order to eliminate significant features that were impeding the ability of financial firms to respond to customer needs and demands. Neither situation is present today to such a degree as to justify a wholesale change in our program for regulating financial institutions.

That assessment includes the current problems in the subprime mortgage markets. While they present challenges, they do not warrant a fundamental overhaul of the basic regulatory structure. Banking regulators have collaborated on subprime mortgage lending guidance and have since responded in a coordinated and measured way to preserve both confidence and liquidity in the banking system. Indeed, the U.S. regulatory response compares favorably with that of other countries with more centralized regulatory programs.

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[24] "Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services," Washington, DC (July 2, 1984) (the Bush Task Group Report), at 42.

[25] E. Ludwig, "How to Keep Charters But Gain Coherence," *American Banker* (October 19, 2007), at 10.

Several ideas frequently surface in proposed plans to redesign the U.S. bank regulatory system. For instance, some have suggested that meaningful efficiencies could be achieved by merging the OCC and OTS or by having a bank's primary federal regulator also regulate the bank's holding company. However, as discussed below, each presents serious real-world problems that should give policy makers pause.

- **Continued roles for the OCC and OTS.** A merger of the OCC and OTS frequently is cited as one way to improve the current system. Those in favor of such an idea note that (a) there are growing similarities in the activities in which both a national bank and a federal thrift may engage, (b) the number of institutions within each agency's primary jurisdiction is declining,[26] and (c) both the OCC and OTS are bureaus within the Treasury Department, making a merger potentially easier.

  We strongly oppose any such plan. The national bank and federal thrift charters are distinct and each offers unique advantages. The same is true for the chartering agencies that supervise them. For instance –

  - The federal thrift charter often is cited as having a stronger preemptive attribute, stemming from courts' recognition of the OTS's "cradle to grave" authority over federal thrifts.[27]
  - National banks have greater flexibility in their asset diversification, given that they are not limited by a test comparable to the "qualified thrift lender" test.
  - Federal thrifts have greater flexibility to establish interstate branches.
  - Those federal thrifts that are subsidiaries of a thrift holding company operate pursuant to the single jurisdiction of the OTS, while the holding companies of national banks are regulated by the Federal Reserve System.
  - Many institutions regulated by the OTS and the FDIC are "mutual institutions,"[28] an option unavailable to national banks.
  - Grandfathered unitary thrift holding companies engage in a wide assortment of commercial activities, ranging from manufacturing[29] to retail sales of clothing.[30]
  - Several diversified financial companies operate under a thrift holding company, supervised by the OTS, seeing that option as more conducive to their business model than operating as a Federal Reserve-supervised financial holding company.

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[26] For instance, in 1994 there were 3,186 national banks and 1,241 federal thrifts. As of June of 2007, there were 1,677 national banks and 736 federal thrifts. Source: FDIC Summary of Deposits, available at http://www2.fdic.gov/sod/sodSumReport.asp?barItem=3&sInfoAsOf=2007.

[27] *See, e.g.*, *Fidelity Federal Sav. & Loan Ass'n v. De La Cuesta*, 458 U.S. 141 (1982).

[28] A mutual savings institution is owned by depositors, who are "members" of the institution. Because they do not have shareholders, mutual institutions have different motivations than is the case with stock institutions.

[29] General Electric Company, for instance, engages in an extraordinarily broad range of manufacturing activities and owns GE Money Bank. Deere and Company also engages in manufacturing and owns FPC Financial, F.S.B.

[30] Nordstrom, Inc. owns Nordstrom, FSB, while Federated Department Stores owns FDS Bank.

As a result of these and other differences, the OTS and OCC have developed unique proficiencies in addition to the many proficiencies they have in common. Combining the two agencies might result in some minor cost savings as back-room operations and other support functions are combined.[31] Nevertheless, the fundamental activities of regulating and supervising the wide range and variety of activities in which national banks and federal thrifts engage would continue to be just as important as ever. Thus, merging the agencies would appear likely to result in little better than a rearranged organizational chart.

Combining the two agencies also would raise difficult questions concerning the regulation of bank holding companies. As previously noted, the OTS currently has jurisdiction over savings associations and their holding companies; the OCC, by contrast, has jurisdiction over national banks but not companies that own national banks (*i.e.*, bank holding companies and financial holding companies). These latter two are supervised by the Federal Reserve Board. Any proposal for the merger of the OCC and the OTS immediately prompts questions about the role of the Federal Reserve Board, inviting a deep debate that is likely to sidetrack policymakers from the more important tasks of ensuring the safety and soundness of our financial institutions and protecting consumers. Enactment of the Gramm-Leach-Bliley Act nearly foundered over the respective roles of the Federal Reserve and the OCC in supervising the new activities of holding companies and bank subsidiaries. Merger of the OCC and OTS invites a renewal of a rather bitter debate, and one that is largely irrelevant from the point of view of customers.

The benefits of charter choice set forth above in Section 1.b can be realized only if we preserve bank agency pluralism and specialization. Charter choice contributes to a regulatory structure that is likelier to respond more quickly to changes in the industry and in customer needs. Conversely, a concentration of authority in any one regulator is likely to make the regulator less responsive for the simple reason that there are fewer checks on the exercise of the authority, less institutional incentive to change and adjust, and more incentive to keep things "as they are." The various charters available retain their vitality because in each case there is a regulatory agency dedicated to preserving the relevance, value, and safety and soundness of that charter option. Some charter options—and the customers best served by them—would inevitably become neglected under a merged agency.

- **Federal Reserve Board supervision of banks and bank holding companies**. Some question the benefit of having the Federal Reserve Board supervise banks or bank holding companies.[32] Those in favor of changing the current system suggest that removing that job from the Federal Reserve would remove the potential for conflicts of

[31] We note that other proposals to bring about operational efficiencies are being discussed that would not require a merger of the OCC and OTS. For instance, Comptroller John Dugan recently suggested that the federal banking agencies combine their customer service functions. *See* Remarks of John C. Dugan, Comptroller of the Currency, Before the Interagency Consumer Complaint Conference, Houston, TX, October 15, 2007.

[32] The Federal Reserve Board has primary federal supervisory jurisdiction over state-chartered banks that have elected to become members of the Federal Reserve System.

interest between the conduct of monetary policy and the supervision of banks.[33] They also maintain that the Federal Reserve is capable of conducting monetary policy without having a role in bank supervision, and that supervision of bank holding companies merely adds a redundant (and, at times, inconsistent) layer of regulation and supervision when the bank is regulated by a different federal banking agency.

The Federal Reserve and others maintain that it needs to have the kind of hands-on knowledge of banks that can be obtained only through its role as primary supervisor of a fair portion of the banking industry. Some also maintain that the Federal Reserve, as lender of last resort and overseer of the nation's payments system, is more sensitive to systemic risk than other bank supervisors would be and is better able to respond appropriately in a crisis if it has a detailed working knowledge of the institutions involved.[34]

We would note that this debate illustrates the kind of hard issues and level of detail that have to be faced by anyone credibly advocating major restructuring. We would further add that such major overhaul would not optimally use policymaking and regulatory talent. Such talent is better invested, we submit, in ensuring that our current regulatory program continues to benefit from highly experienced and informed regulators focusing on the important day-to-day issues of financial supervision.

- **FDIC's role as a regulator.** The Department of the Treasury has also requested comment on the optimal role of the deposit insurer of depository institutions. Specifically, Treasury has inquired whether the FDIC should have regulatory and supervisory authority over all or some of the institutions that it insures.

  The FDIC is the primary federal regulator for state-chartered banks that are not members of the Federal Reserve System as well as for state-chartered savings banks. The agency is also responsible for insuring bank deposits, up to certain limits. While the FDIC's role as an insurer and as a regulator has evolved over time, its dual responsibilities provide important benefits to the financial system. The FDIC's supervisory function helps the agency better gauge risk to the deposit insurance fund.

  In addition to performing supervisory functions for some institutions, the FDIC is authorized to undertake special examinations of any bank or savings association that represents a heightened risk to the deposit insurance funds or that exhibits deteriorating conditions or other adverse developments. This important authority helps the FDIC to assess and mitigate risk to the deposit insurance funds. To exercise this authority, the FDIC must have experienced personnel that can comprehensively and efficiently evaluate

[33] Some commentators have suggested that monetary policy and bank supervision can lead to inconsistent approaches in the face of a downturn. As the economy worsens, monetary policy may argue in favor of banks making more loans. However, supervisory concerns may suggest that a bank should be taking a more conservative approach to lending. As credit tightens, the intensity of the business downtown increases, thus complicating the task of monetary policymakers. *See* R. Kushmeider, "The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation," *FDIC Banking Review*, Vol. 17, No. 4 (2005) (Kushmeider), at 12-13 and sources cited therein.

[34] Kushmeider, at 13.

an institution. As a result, the FDIC's current supervisory role provides the agency with the relevant experience to utilize its back-up examination authority when it is necessary.

- **Creation of a super-regulator.** Some have suggested that our financial system would best be served by a super-regulator that has jurisdiction over all financial institutions. The assertion is that such an agency could act more nimbly than a regulatory system involving more than one agency. It is possible that any alacrity of movement could derive from giving short shrift to the needs of one class or group of institutions that it supervises. Or, perhaps equally likely, such a regulator could easily become paralyzed in an effort to meet conflicting goals and directives, including conflicting statutory requirements placed upon the different industries and charters that the new entity would supervise.

  Each regulator faces the challenge of weighing and controlling some level of conflict of interest in its mission. The creation of a super-regulator could merely compound the conflicts, making a consistently successful effort impossible. It is not clear how a regulator supervising intensely competitive classes of financial institutions could reliably ensure that its regulatory actions and decisions do not favor one class or harm another. Such conflicts would in practice over time likely tend toward policy inaction, and inaction can open the door for a far greater degree of political influence on financial regulators than has been usually present under our current program.

d. Perceived shortcomings of our current system

Some have suggested that we revamp our regulatory system to address problems created by our regulatory and supervisory system such as impediments to global competition, gaps in enforcement or inconsistent enforcement, or delays in regulators' actions. These points are addressed below.

- **Global competition**. A perception frequently is expressed that the U.S. structure is so complex that it impedes the ability of U.S. institutions to compete with financial institutions in other countries. Some suggest that institutions subject to the jurisdiction of a single regulator, such as the United Kingdom's Financial Services Authority (FSA), are in an advantaged position because of the efficiencies obtained from regulatory consolidation.

  We do not share this view. Short-term regulatory efficiency may be nice to have, but once obtained (if obtained), it yields decreasing dividends. Moreover, it pales in comparison to the value of innovation and adaptation at which our financial industry excels. As discussed above, along with the regulatory "efficiency" come heightened risks of agency calcification and resistance to change (and a reinforced bureaucratic interest in the perpetuation of the status quo). Our multi-agency structure has proven to be a source of competitive strength for our financial system, especially the banking industry. Its loss would likely erode our competitiveness over time, certainly once any brief regulatory efficiency gains are realized.

  Concerns about whether the regulatory environment is keeping pace with developments in the regulated institutions have been with us for a long time. Indeed, the Bush Task

Group report in 1984 called for fundamental changes to the jurisdiction of the banking agencies, noting –

> The rapid pace of change in U.S. financial markets has raised fears of two kinds. On the one hand, a cumbersome regulatory system raises costs and may unnecessarily slow the rate of innovation. Lack of adequate flexibility in the regulatory system may both impair the competitiveness of particular types of firms and undermine overall safety and soundness by fostering inefficiency or predatory competition from less regulated firms. On the other hand, excessive division of regulatory responsibility to promote flexibility may create such a confused and diverse pattern of responsibilities that regulatory effectiveness may be impaired and inequities may proliferate.[35]

Despite the almost chronic calls for change to avert anticipated disaster, the American financial system has not just survived; it has become the world's leader. In short, reports of its demise have been greatly, and repeatedly, exaggerated. Regulatory adjustments have occurred, but rather than make the case for dramatic structural overhaul, they have proven the resilience of our basic regulatory program.

- **Gaps in supervision and enforcement.** Some commentators suggest that agency consolidation is needed to ensure that large, complex organizations cannot hide problems from a multitude of regulators. This concern appears predicated on the assumption that each regulator is content to risk that affiliates will not adversely affect the condition of the banks within the regulator's jurisdiction. This assumption is not valid.

  Each bank regulator has broad authority to examine the activities of non-functionally regulated affiliates to determine the extent to which the affiliate is affecting the condition of the bank.[36] Functionally regulated affiliates, such as broker-dealers, investment companies, investment advisers, and insurance firms, are regulated by the SEC and state regulators. GLBA contains a detailed set of rules governing the supervision of financial institutions that is designed to ensure that there are no supervisory gaps or redundancies.[37] Each bank regulator emphasizes in its exam policies and procedures the need to understand the insured institution's affiliates and their possible impact on the institution. Illustrative of the agency guidance is as follows:

  - The OTS, in guidance to its examiners of thrift holding companies, states: "You must determine whether there are elements of the holding company structure, or business interests of the holding company enterprise, that hold potential risks for the thrift. This means considering not only the activities of the holding company and other affiliates, but also activities of the thrift itself."[38]

[35] Bush Task Group Report, at 34.

[36] *See* 12 U.S.C. 334 (Federal Reserve Board); 12 U.S.C. 481 (OCC); 12 U.S.C. 1467(b) and 1467a(b)(4) (OTS); and 12 U.S.C. 1820(b)(4) (FDIC).

[37] *See* GLBA, §§ 111-115.

[38] OTS Holding Companies Handbook (December 2002), at 400.1.

- The OCC Handbook on Related Organizations observes that "The OCC's supervision by risk approach takes into account current and planned activities of all related entities, including nonbank subsidiaries and affiliates, to determine how much risk they pose to the bank."[39]

In short, there is no gap in supervision or enforcement. While there have been, and likely will be, problems that should have been caught during an examination, these problems do not provide a basis for restructuring our entire regulatory system. A more appropriate solution might be to clarify, to the extent additional clarity is needed, precisely which agency is accountable in the system of functional regulation. Discussions of this nature occur regularly and are valuable to ensure prudential supervision. A greater risk would occur that a single super regulatory agency could develop blind spots for types of risk that our current network of specialized agencies is less likely to miss.

- **Inconsistent treatment.** Some maintain that the number of regulators should be reduced to minimize the likelihood of inconsistent treatment from one regulator to the next. These commenters note the "convergence" of many financial institution products and suggest that differences in how the various regulators treat similar products only serve to introduce artificial influences into a process of deciding which products to offer, decisions that should be made in response to market forces.

  It is indisputable that the various financial regulators have different approaches to certain issues.[40] There may well be opportunities to harmonize different approaches. However, there are systems in place to resolve disputes, including –

  - The Federal Financial Institutions Examination Council (FFIEC). The FFIEC was created in 1979 to ensure that differences between the bank regulators would be minimized. Each federal bank regulator is represented. The states, as represented by the Conference of State Bank Supervisors, were given a vote on the FFIEC earlier this year.
  - The Federal Reserve Board as umbrella supervisor of FHCs. As umbrella supervisor, the Federal Reserve is to coordinate efforts to supervise companies that control both a depository institution and a company engaged in other financial activities.
  - The President's Working Group on Financial Markets. This group (which includes the Treasury Secretary and the Chairmen of the Federal Reserve Board, the SEC, and the Commodity Futures Trading Commission (CFTC) was created to provide a collaborative forum for other financial markets regulators to resolve differences in their respective approaches. We certainly support such efforts and encourage further interagency collaboration to ensure that no charter is disadvantaged by rules that are legacies of an outdated view of financial institution supervision.

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[39] Comptroller's Handbook on Related Organizations, at 1. *See also id.* at 73 ("National banks and their operating subsidiaries are normally examined on a consolidated line of business basis without regard to corporate structure.").

[40] For example, the capital rules applicable to broker-dealers require a 100 percent haircut to illiquid assets, with loans being treated as "illiquid." This makes it impractical for banks to register as broker-dealers.

Having said that, we note that there are times when inconsistency is a virtue. The previously-cited example of the CRE concentration guidance is one such instance. There, the OTS, unlike the other three banking agencies, adopted final guidance that avoided the use of concentration thresholds. The OTS took this approach for the simple reason that they were concerned that numerical thresholds, no matter how presented, risked being applied as caps. Which approach is right? The point is that no one knows. Only experience will tell whether the concerns of the OTS were justified. Indeed, it very well may prove that this objection to numerical thresholds, highlighted by the regulatory difference, acts to keep the other regulators attentive to prevent the hardening of these numbers that the OTS has warned of. Our current program allows differences while keeping them within tolerable bounds.

- **Delays in interagency actions.** Another criticism of the current structure is that interagency action takes too long. There are, indeed, many examples of protracted interagency rulemakings. However, while fewer regulators might result in quicker action, this result is by no means certain. Moreover, the multiplicity of voices in an interagency rulemaking typically improves the final product and minimizes the likelihood that any one agency will act unilaterally in an inappropriate manner.

We should always remain focused on the ability of our financial institutions to remain competitive. Rather than harming our competitiveness, however, our financial regulatory program is a source of competitive strength. Our program fosters vigorous domestic rivalry in meeting customer needs, bringing forth the innovation and performance that make our financial firms, particularly our banking firms, world leaders.

That is not to say that there is no need for reform and improvement. Competitiveness is built upon change and improvement, and there is plenty to work with to make things better in our financial and legal environments, as noted below in Section 2.

e. Past experience with regulatory restructuring proposals.

As the Treasury Department is well aware, the current initiative is only the most recent in a long line of initiatives to restructure the bank regulatory landscape. There have been at least 24 proposals, dating back to the 1930s, to change who regulates what—almost none of which were not acted on.[41] Each appears to have been motivated by a desire to find a simpler, more rational way to regulate and supervise financial institutions. While these goals are laudable, their merits are most readily perceived in a vacuum. When the ideas are tested against the reality of a financial regulatory program that successfully promotes industry growth, innovation, and adaptability notwithstanding – or in large measure because of -- the complex regulatory structure, enthusiasm invariably wanes.

We support efforts to improve the quality of our financial regulatory program, as measured by enhancing the ability of the industry to serve its customers. As set forth in the discussion that follows, we believe there are opportunities for meaningful improvements that would result in

[41] Kushmeider, *supra*, Appendix at 25-29. The Kushmeider Appendix is attached in full as an appendix to this letter.

benefits that far outweigh the costs of change. We do not subscribe to a Panglossian view that this is the best of all possible worlds. Our support for the basic regulatory structure for the industry does not silence our criticism of particular regulations and mandates—and in particular of the excessive cumulative weight of the regulatory burden faced by banks. We urge the Treasury Department to focus its energies on the changes outlined below and on its continuing efforts to eliminate rules that are unnecessary impediments to efficient markets and best service to customers.

2. There are opportunities to improve the current structure.

While we do not support wholesale changes in the regulatory landscape, we do support a number of changes that we believe would significantly improve the current system. These changes are outlined below.

a. Create an optional federal charter for insurance companies.

Today's global insurance industry is governed by fifty-one separate state regulatory regimes and is the most notable sector of the financial services industry whose regulatory system has not been modernized to meet customer needs. This regulatory structure presents significant obstacles to providing the best products, price, and overall service to insurance customers. These obstacles are most acutely felt in three areas: producer licensing, product approval, and price controls.

- **Licensing**. Currently, different states impose different qualification and testing standards and different continuing education requirements on producers. Licenses recognized in one state are not necessarily recognized in another state. For firms that operate agent networks in multiple states, these differences impose compliance costs and other financial burdens that are significant and, ultimately, borne by consumers.

  In 1999, as part of GLBA, Congress adopted a requirement designed to promote the adoption of uniform agent licensing rules by the states. The so-called "NARAB provision" of GLBA[42] required the establishment of an organization to develop uniform licensing rules and regulations, but only if a majority of the states did not adopt either uniform or reciprocal licensing laws and regulations within three years of the date of enactment of GLBA. To facilitate compliance with GLBA, the National Association of Insurance Commissioners developed a reciprocal licensing Model Act, which has been adopted by approximately 40 states. However, because the states could avoid the NARAB provision and its uniformity mandate if a simple majority of states enacted the model, some states, including some of the largest states like California, have been able to avoid the issue of licensing reform entirely.

- **Product Approval**. Most states' insurance departments will not approve an insurance policy for sale unless the product is subject to *prior review* by the insurance regulator. Under the current state system, it can take years for a company to receive permission from state insurance regulators to introduce a new product in every state. Such delays are an inevitable result of a system in which every state has an opportunity to review and

[42] GLBA, Title III, subtitle C, codified at 15 U.S.C. 6751 - 6766. "NARAB" refers to the National Association of Registered Agents and Brokers.

approve insurance products and where the standards of review differ from state to state. As a result, consumers are deprived of innovative insurance products.

- **Price controls**. In most states, an insurance product can only be sold after the state insurance regulator approves the price of an insurance product. Some states regulate the price of an insurance policy, while other states regulate the loss ratio a given product line must maintain. Generally, the effect of price controls has been higher prices and fewer choices.

  Price controls were imposed initially to ensure that consumers could afford insurance but, in fact, they work against consumers' interests in the overwhelming majority of cases. When prices are set artificially high, consumers are denied access to lower costs even if there is a willing seller. When price controls are set artificially low, the number of willing sellers is reduced, resulting in greatly diminished consumer choice. In a market as competitive as the insurance industry, competition among firms will protect consumers from unfair pricing schemes much more efficiently than can the government. More importantly, allowing markets to set prices efficiently controls risk by making riskier choices more expensive.

The problems noted above impede not only the ability to operate efficiently within the U.S. but also the ability of domestic firms to compete abroad. This is a point with which even foreign financial regulators agree. For instance, Sir Howard Davies, Director of the London School of Economics and a former chairman of Britain's Financial Services Authority, has observed that,

> There is no federal regulator or federal charter available to US companies. As a result, there is a lack of leadership in insurance regulation nationally and internationally. This is unfortunate when insurers are engaged in far more complex financial transactions than they used to be. Many US insurers would welcome the opportunity to seek federal oversight: the Treasury could make it possible for them to do so. A positive side-benefit would be to strengthen US influence in the International Association of Insurance Supervisors and make it more effective in dealing with problems of unregulated insurers and reinsurers in offshore centres.[43]

The current insurance regulatory system greatly impedes our ability to negotiate in the international regulatory arena. Domestic institutions are represented by a variety of state insurance regulators who, by definition, do not and cannot speak for the United States as a whole. Moreover, the difficulty of entering the U.S. markets under the current state regulatory system dissuades foreign capital from investing in the U.S., thereby restricting overall insurance capacity and reducing the number of insurance products available to U.S. consumers. It simply is the case that relatively few foreign companies are willing to expend the time and resources necessary to navigate all of the harbors in our state-based regulatory system.

An optional federal charter and the attendant safety and soundness standards could address these problems. Any proposal for an optional federal charter likely would be coupled with rigorous rules governing financial solvency and permissible investments, and insurance companies would

[43] H. Davies, "A Word of Advice to Hank Paulson," FT.com (July 4, 2006), available at http://search.ft.com/ftArticle?queryText=%22reinsurers+in+offshore+centres%22&aje=true&id=060704009791&ct=0.

be examined to ensure compliance with these rules. In this way, customers would have confidence that a federally-chartered insurer would be able to pay claims on its policies.

Customers also would benefit from nationwide, uniform policies and sales practices. An optional federal charter would make it possible to offer the same life insurance policy in every state. Companies could use the same policy form, same disclosure statements, and same administrative procedures throughout the country. And, because their conduct would be governed by uniform rules, insurance companies no longer would be impeded by the many variations in state laws from using the Internet to offer insurance products.

b. Raise the bar for loosely-regulated mortgage originators.

The recent problems in the mortgage markets have been very troubling to the banking industry. However, for the most part these problems have been caused by non-bank lenders that are not affiliated with an insured depository institution. This point recently was made by Rep. Barney Frank, Chairman of the U.S. House of Representatives Financial Services Committee, who wrote—

> Reasonable regulation of mortgages by the bank and credit union regulators allowed the market to function in an efficient and constructive way, while mortgages made and sold in the unregulated sector led to the crisis. At every step in the process, from loan origination through the use of exotic unsuitable mortgages to the sale of securities backed by those mortgages, the largely unregulated uninsured firms have created problems, while the regulated and FDIC insured banks and savings institutions have not. To the extent that the system did work, it is because of prudential regulation and oversight.[44]

Banks have long been subject to the Truth in Lending Act and the Home Owner's Equity Protection Act amendments thereto, the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, and the Fair Lending Act, among other consumer protection laws. These laws require numerous disclosures relating to mortgage loans generally, and “high-cost” loans[45] in particular, as well as restrictions on fees and other terms for high-cost loans. Additionally, continually updated regulatory guidance is enforced by

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[44] B. Frank, “Lessons of the Subprime Crisis,” Boston Globe (Sept. 14, 2007).. The recently-released report of the Majority Staff Joint Economic Committee of the United States Senate contains a similar finding, stating --

> The mortgages underwritten by subprime lenders come from many sources, but the overwhelming majority is originated through mortgage brokers. For 2006, Inside Mortgage Finance estimates that 63.3 percent of all subprime originations came through brokers …. **Because they are not deposit-taking institutions, the independent mortgage companies and bank subsidiaries are not subject to the safety and soundness regulations that govern federal or state banks**.

“The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here,” Report and Recommendations by the Majority Staff of the Joint Economic Committee, October 2007 (Joint Economic Committee Report), at 17-18 (emphasis in original).

[45] A “high cost” loan is, generally speaking, a loan secured by a consumer’s principal dwelling with either (a) an APR at least 8 percentage points higher (or 10 points for subordinate lien mortgages) than the yield on Treasury securities of comparable duration or (b) total points and fees exceeding the greater of 8 percent of the total loan amount or $400. 12 C.F.R. § 226.32(a)(1).

the banking agencies, including those recently promulgated on nontraditional mortgages[46] and subprime mortgage lending.[47]

Independent mortgage brokers and other originators, by contrast, operate in a much less regulated environment, are not examined, and have different reputational concerns. They have not been subjected to the breadth of consumer protection laws and regulations with which banks must comply. Equally importantly, a supervisory system does not exist to examine them for compliance even with the comparatively few laws that do apply to them. In addition, independent brokers typically do not have long-term business relationships with their customers. Instead, they originate a loan, sell the loan to a third party, and collect a fee. This results in a very different set of incentives and can work at cross purposes with safe and sound lending practices.[48]

Hindsight reveals what perhaps should have been obvious a long time ago: the combination of little or no regulation, little or no supervision, new products designed to expand mortgage lending, and an incentive structure independent of the market discipline of a long-term customer relationship is a combustible brew. Clearly the unchecked misuse of legitimate credit products has resulted in a supervisory failure that justifies additional regulation of state-chartered mortgage originators that are not either insured depository institutions or affiliates thereof.

Several bills have been introduced in Congress that would address the problems in the regulation and supervision of state-chartered non-depository lenders. We support bringing these non-bank lenders up to the standards that apply to insured depository institutions and their affiliates. We also support a meaningful state licensing system of originators that currently are largely unregulated, provided that any such system has rigorous inspection and enforcement components and a requirement that ensures an adequate measure of financial stability. However, the legislative and regulatory responses should be only as broad as is required to address the actual problems. Anything greater becomes counterproductive, by adding burdens that serve to render the market less efficient and credit less available to credit-worthy borrowers. This ultimately hurts consumers, their communities, and the national economy.

c. Take key steps to promote a more prudential program of securities and futures supervision.

Many banking organizations are affiliated with securities broker-dealers, futures commission merchants (FCMs), commodity pool operators (CPOs), and commodity trading advisers (CTAs) that trade securities and futures for their own account as well as on behalf of their customers. The Department's focus on the regulation of the securities and commodity futures markets is of major importance to the banking industry. It has been almost twenty years since the

[46] 71 Fed. Reg. 58609 (Oct. 4, 2006).

[47] 72 Fed. Reg. 37569 (July 10, 2007).

[48] *See* Joint Economic Committee Report, *supra*, at 20.

Administration last studied this issue,[49] and it is appropriate that these issues be revisited within the context of the global competitiveness of American financial firms.

We strongly support a principles-based approach to modernizing our federal securities laws, with appropriate tiering of those laws based on type of customer and other similar considerations. A principles-based approach would also facilitate cross-border recognition of other regulatory regimes. In keeping with these recommendations, we support efforts to realign supervision by the SEC more towards a prudential approach. Collectively, these steps would help reinvigorate our capital markets domestically and globally and enable participants in those markets to access more easily the benefits of our increasingly global financial marketplace.

Background

In response to the 1929 stock market crash and the desire to restore the public's faith in the capital markets, Congress enacted the Securities Act of 1933 to require companies that sought to issue securities to the public to provide investors with full disclosure concerning the company and its business, the planned use of the proceeds from the public offering, and the risks associated with investing in the company's securities. One year later, Congress followed with the enactment of the Securities and Exchange Act, directed toward the regulation of the sellers of securities—broker-dealers and the exchanges—and the provision of further investor protection. It was this Act that created the SEC as an independent agency of the federal government. Since 1934, Congress has charged the Commission with enforcing three additional statutory schemes of regulation, the Trust Indenture Act, the Investment Company Act, and the Investment Advisers Act, as well as expanding its mission beyond investor protection. Specifically, in 1996 Congress charged the SEC with ensuring the maintenance of fair, orderly, and efficient markets and facilitating capital formation whenever it engages in rulemaking or oversight of self-regulatory organization rulemaking.[50]

Federal regulation of the commodities markets actually predates federal regulation of the securities markets when, in 1922, the Congress enacted the Grain Futures Act. The Commodity Exchange Act (CEA) was later adopted in 1936, extending federal regulation of commodities beyond grains to include cotton, rice, mill feeds, butter, eggs, and Irish potatoes. Regulation of the commodities markets was vested in a variety of departments or commissions housed within the Department of Agriculture. It was not until 1974 that the Congress transferred regulation of the commodities markets to the CFTC. Today, the CFTC, an independent agency, is charged with the protection of market users and the public from fraud, manipulation and abusive practices related to the sale of commodity and financial futures and options, and with fostering open, competitive, and financially sound futures and option markets in the United States.

Financial futures and options on futures, like their securities counterparts, are used by investors for investment and hedging of risk. The interrelationship between the futures markets and the cash markets has led, over the years, to calls for consolidation of jurisdiction of these financial markets into one federal agency.[51]

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[49] *Report of The Presidential Task Force on Market Mechanisms*, at 55-69, January 1988 (hereinafter cited as "Market Mechanisms Task Force").

[50] National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416.

[51] *Cf.* Market Mechanisms Task Force, *supra*, at n. 49 (suggesting one agency for intermarket issues).

SEC-CFTC Consolidation

We do not take a position on consolidation of the SEC and the CFTC. Consolidation of two equal regulatory authorities into one might eliminate regulatory inefficiencies associated with parallel regulation of related products. On the other hand, concentration of authority in a single bureaucracy could stifle innovation in securities and futures products and lead to loss of specialized regulatory expertise. Several years ago, then-Federal Reserve Board Chairman Greenspan, on this very issue of CFTC-SEC consolidation, testified that, "[w]e should not lose sight of the fact that under the existing system of split jurisdiction over financial instruments, our financial markets have been the most innovative in the world, with many of the new products spurred by the introduction of index futures and other futures."[52] That perspective needs to be factored in as policymakers evaluate the advisability of CFTC-SEC regulatory consolidation.

Principles-Based Regulation

We nevertheless believe that much can be done to improve current regulations applicable to our domestic securities and futures markets, including a shift towards more principles-based regulation. A good example was set by Congress in the 2000 Commodity Futures Modernization Act (CFMA). That watershed legislation, among other things, provided legal certainty that over-the-counter derivatives were not subject to the CEA; allowed trading of single stock futures and futures on narrowly-based stock indices, and tiered application of the CEA based on sophistication of market participants, or activities of trading platforms and exchanges. Five years later, acting CFTC Chairman Sharon Brown-Hruska briefed the Congress on the CFTC's progress in implementing the CFMA, noting that the futures and derivatives industry had changed much in the intervening five years and that "much of that change ha[d] been facilitated by the flexibility and innovative foresight of that [CFMA] legislation."[53]

Prior to enactment of the CFMA, the futures markets were regulated according to a "one-size fits all" approach that too often relied upon pre-regulatory approvals before industry could move forward with innovations. With enactment of the CFMA, "[t]he industry is no longer overburdened with prescriptive legal requirements…" while, at the same time, the CFTC remain[s] empowered to ferret out fraud and market abuses. Under the CFMA, Congress "put in place a practical, principles-based model and gave the CFTC the tools to regulate markets that were challenged by competition brought about by technology and an increasingly global marketplace."[54] We recognize that the CFMA's adoption of principles-based regulation unfortunately did not extend beyond the exchanges to market intermediaries.[55]

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[52] Testimony of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, before the Committee on Agriculture, Nutrition, and Forestry, United States Senate, May 8, 1990.

[53] Testiony of Sharon Brown-Hruska, Acting Chairman of the Commodity Futures Trading Commission, before the Committee on Agriculture, Nutrition and Forestry, United States Senate, March 8, 2005.

[54] *Id.*

[55] Many of the forward-looking changes put in place by the CFMA can be directly attributable to the recommendations made by the PWG. We would encourage the PWG to continue to take a similarly strong leadership role in addressing other pressing capital market issues, including, as we discuss above, the need to modernize US securities laws.

The federal securities laws generally follow a one-size fits all approach to registration and regulation of market participants. Too often pre-regulatory approval is needed before industry can implement innovations or try new products. We would strongly urge the adoption of a principles-based, tiered approach to federal regulation of securities markets, as well as securities and futures market intermediaries.[56] Such an approach might address, for example, the differential treatment of margin between the futures and securities exchanges, as well as the ability of market participants to choose on a prospective basis whether to trade stock futures on either a futures or a stock exchange.

Mutual Recognition

A principles-based model also would facilitate regulatory recognition (whether unilateral or mutual, through bilateral or multilateral agreements) between various foreign regulatory schemes. The ABA, through its securities and international affiliates, the ABA Securities Association (ABASA) and the Bankers' Association for Finance and Trade (BAFT), respectively, have joined with other domestic and international trade associations to advocate for the urgent need for regulatory modernization of wholesale cross-border transactions in equities and equity-derivatives contracts.[57] The goal of this EU-US Coalition on Financial Regulation is to increase the efficiency and coherence of applicable rules and regulations, without undermining investor protection.

In this connection, the Coalition has posited that modernization of regulation applicable to cross-border transactions can be achieved through a number of non-exclusive approaches, including regulatory recognition of other countries' regulations, exemptive relief (as appropriate) from compliance with host country laws in the case of large, wholesale businesses, and the development of targeted common approaches through harmonization or convergence.

SEC Chairman Cox has similarly suggested that in order to allow investors to enjoy the benefits of cross-border markets, global regulators need to harmonize, recognize, and standardize their home country regulations.[58] As an example of the international convergence efforts, Chairman Cox noted the SEC's proposal to allow issuers who use International Financial Reporting Standards (IFRS) in their home countries also to use IFRS in their SEC filings, without the need to reconcile those filings to U.S. GAAP.[59] Moreover, the SEC is considering offering U.S. domestic issuers a similar ability to file with the SEC using IFRS.

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[56] We strongly support efforts by FINRA to consider tiering its rules "according to firm size, business model or type of customer" and to consider "areas where a more principles-based approach [to regulation] could be appropriate." Speech by Mary Schapiro, CEO of FINRA, before the SIFMA Annual Meeting, Boca Raton, Florida, November 9, 2007.

[57] *The Transatlantic Dialogue in Financial Services: The Case for Regulatory Simplification and Trading Efficiency*, EU-US Coalition on Financial Regulation (available at www.aba.com/ABASA).

[58] *Learning from the Shogun—Toward IOSCO's Vision of a Global Market*, Speech delivered by SEC Chairman Christopher Cox before the IOSCO Technical Committee Conference, Tokyo, Japan, November 8, 2007.

[59] On November 15, 2007, the SEC unanimously approved doing so.

Recently, SEC Commissioner Paul Atkins, sounding the mutual recognition drumbeat, noted the need to be careful when employing the term "mutual recognition."[60] We wholeheartedly agree with Commissioner Atkins that the principles of mutual recognition are not served if recognition requires a rule-by-rule comparison to ensure exact equality of regulations. Global capital markets are better served by a "top-down approach" that approximates regulatory outputs, principles, and objectives of various country regulatory authorities, not by a "bottom up" approach that requires each country's rules to be equivalent.

Prudential Regulation

We would also encourage the SEC to adopt a more prudential approach to regulation, similar to that of the banking regulators. Many of our members have expressed appreciation for the bank regulators' practice of publicly issuing guidance to examiners on various topics. This guidance assists banks in adopting appropriate policies and procedures to enable them to conduct their business. Further, because examiners have experience reviewing many banks for compliance, they frequently are able to identify specific areas for improvement. While we appreciate that the SEC is not a "safety and soundness" regulator, the "benchmarking" capability provided by bank examiners is sorely needed in the securities environment, where securities firms currently are reluctant to consult with their examiners on issues for fear that an enforcement action could result.

Dual System of State and Federal Regulation

As the Department is aware, Congress addressed many of the difficulties associated with the dual system of state and federal regulation of securities activities when it passed the National Securities Markets Improvement Act of 1996 (NSMIA). That Act made clear that the state registration of national traded securities and securities of registered mutual funds is preempted under the Securities Act of 1933. National traded securities include securities that are traded on the NYSE or NASDAQ. With respect to broker-dealers, NSMIA also preempted state laws on capital, financial responsibility, and record-keeping to the extent the state law conflicts with SEC requirements. We believe there may be room for improvement in this area, specifically, the need to preempt state broker-dealer laws that conflict with the exceptions from broker-dealer registration under the Gramm-Leach-Bliley Act and Regulation R, recently adopted jointly by the FRB and the SEC.[61]

3. Regulation must always be focused on facilitating the efforts of financial institutions to meet the needs of their customers.

Treasury aptly summarized the issue that underlies the entire discussion of regulatory reform when it asked, "What should be the key objectives of financial institution regulation?"[62] In our view, the primary objective must always be to improve the ability of financial institutions to serve their customers.

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[60] *The SEC's Role in Globalization of the Capital Markets*, Speech delivered by Commissioner Paul Atkins before the American Chamber of Commerce in Japan, Tokyo, Japan, October 16, 2007.
[61] *See* 72 Fed. Reg. 56514 (October 3, 2007).

[62] Treasury Review, *supra*, at 58940.

This objective has several facets. First, regulation needs to foster safe and sound operations. Second, it must work to remove barriers to access to products and services. Third, it needs to promote competition. These facets, while distinct, are wholly compatible. A financial institution will best be able to achieve its business objectives by responsibly managing its risks; by providing a full range of products and services to all customers who can responsibly manage *their* risks; and by competing against others based on price, product quality, reputation, and other customer interests, not by undermining standards of integrity. We believe it is incumbent upon policy makers to create the legal framework that supports these goals.

However, once that legal framework is created, lawmakers should step in only when there is a supervisory failure that impedes the attainment of the goals outlined above. Efforts to expand the extent to which "unbanked" or "underbanked" individuals use the banking system, for instance, are laudable in their intent but, unless they are sustainable over the long run, no one benefits. Thus, regulators need to tread carefully when considering ways to incentivize financial institutions to grow in ways that the market heretofore has not supported.[63]

Similarly, regulators should avoid efforts to dictate the terms of products and services offered by financial institutions. Everyone likes getting something for free, but lack of financial return undermines the ability of banks to continue to offer a service over the long term. Government attempts to dictate this result (in the form of price controls) only stifle innovation and hurt customers and the economy in the long run.

Regulators of financial institutions also must avoid looking at the banking system as the solution to problems wholly unrelated to the business of banking. A misplaced faith in technology and a misperception that banks have unlimited resources can lead policymakers to conclude that banks should be deputized to achieve a wide range of disparate social goals. This is a mistake. It unfairly and inappropriately treats financial institutions as public utilities, and it distracts from the business of meeting the financial needs of the communities they serve.

It is important to emphasize that regulation is most effective when it can adapt readily to new developments and conditions. Certain conduct – such as discriminating on the basis of race or defrauding customers – will always be unacceptable. Other actions present a degree of risk that simply is inconsistent with safe and sound practices. However, there are many instances where the path is less clear. Frequently, financial institutions will have to make judgment calls based on the best available information in situations lacking a clear right or wrong answer. But the same can be said for their regulators as well. For this reason, the regulators must be open to an "upstreaming" of information from the regulated institutions, both in the context of rulemakings and in the context of day-to-day supervision. Appropriate collaboration between the regulator and the regulated will lead to better decisions and enhanced credibility for the supervisory process.

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[63] We commend the FDIC for recently undertaking an in-depth review of efforts by banks to provide small-denomination, short-term loans to individuals who currently use non-bank lenders. (*See* http://www.fdic.gov/smalldollarloans/.) By engaging in a two-year review of banks that are actively trying to reach this market, the FDIC will help the entire industry determine whether there are unrealized opportunities for banks to expand their markets. We believe that such an approach is appropriate and preferable to a government-imposed mandate to offer products in ways that the market cannot sustain. The FDIC's review will help inform everyone – policymakers and bankers alike – about the issues this type of lending presents.

* * * *

The Treasury Department is to be commended for its efforts to ensure that U.S. financial institutions remain leaders in the global economy. This review is important and timely. There are opportunities to improve the regulation of financial institutions, and we have offered several ideas for how to do so. We believe, however, that a careful analysis of the strengths and weakness of our regulatory program will find that our current structure of regulatory variety and specialization, supporting an assortment of financial charter choices, works best for our nation's consumers and the financial institutions that serve them. A fundamental reconfiguration of financial institution regulators would be a major distraction and a step backward from promoting our competitiveness at home and abroad. We appreciate the opportunity to share our views, and we welcome the opportunity to continue the important dialogue that you have begun.

Sincerely,

Edward L. Yingling
President
American Bankers Association

Diane Casey-Landry

Diane Casey Landry
President and CEO
America's Community Bankers

Appendix

APPENDIX

Past Proposals for Regulatory Restructuring

This appendix briefly describes the 24 major proposals for regulatory restructuring that have been made (but not acted on) since the bulk of the federal regulatory system was instituted in the early 1930s.

1. ***Brookings Study***. In the 1930s, the Brookings Institution analyzed the federal bureaucracy for a Senate committee. Among the recommendations was one to reorganize the bank regulatory structure. The FDIC would have become the principal federal bank regulator, the OCC would have been abolished, and the Federal Reserve's examination and supervisory responsibilities for state banks would have been transferred to the FDIC.

2. ***Hoover Commission***. In 1949, three Hoover Commission task forces recommended that federal bank regulatory authority be centralized. One task force wanted to transfer the FDIC to the Federal Reserve, the second wanted to transfer the OCC to the Federal Reserve, and the third wanted to fold both the FDIC and the OCC into the Federal Reserve. The Commission itself opted for a fourth approach, recommending that the FDIC be transferred to the Treasury Department.

3. ***Commission on Money and Credit***. In 1961, the Commission on Money and Credit recommended that the functions of the FDIC and the OCC be transferred to the Federal Reserve.

4. ***Advisory Committee on Banking***. In 1962, the OCC's Advisory Committee on Banking proposed eliminating the Federal Reserve's bank supervisory role. All supervisory authority relating to national banks would have been exercised by the OCC. All supervisory authority relating to state banks would have been exercised by the FDIC, which would have been placed within the Treasury Department.

5. ***Patman Bill***. A proposal in 1965 by House Banking Committee Chairman Wright Patman, H.R. 6885, would have consolidated all federal bank regulation, including deposit insurance functions, in the Treasury Department.

6. ***Hunt Commission***. In 1971 the Hunt Commission, formally titled the Presidential Commission on Financial Structure and Regulation, recommended the establishment of three new independent agencies: (1) the Administrator of National Banks, which would have replaced the OCC; (2) the Administrator of State Banks, which would have assumed the supervisory functions of the FDIC and the Federal Reserve; and (3) the Federal Deposit Guarantee Administration, which would have incorporated the FDIC, the FSLIC, and the credit union insurance agency.

7. ***Compendium of Major Issues in Bank Regulation***. In 1975 the Senate Banking Committee commissioned a series of papers on issues of structural reform from preparers outside the government. Several papers recommended that the FDIC become the primary federal bank supervisor, mainly because the deposit insurer has ultimate responsibility for all bank supervisory activities.

8. ***Wille Proposal***. In testimony before Congress in 1975, FDIC Chairman Frank Wille proposed the creation of a five-member Federal Banking Board to administer the deposit insurance system. He also called for a Federal Supervisor of State Banks to assume the combined supervisory functions of the FDIC and the Federal Reserve vis-à-vis state banks.

9. ***FINE Study***. In 1975, the House Banking Committee held a series of hearings on regulatory structure. The product of the hearings was a four-volume work titled Financial Institutions and the Nation's Economy (FINE) "Discussion Principles." The study recommended the establishment of a Federal Depository Institutions Commission to administer all supervisory functions of the FDIC, the Federal Reserve, the OCC, the FHLBB, and the NCUA. Insurance functions

would be handled by a subsidiary agency within the commission.

10. ***Senate Governmental Affairs Committee Proposal***. In 1977, the Senate Governmental Affairs Committee recommended the consolidation of the bank regulatory agencies into a single agency. The Consolidated Banking Regulation Act of 1979 would have merged supervisory functions into a five-member Federal Bank Commission.

11. ***Deposit Insurance in a Changing Environment***. In a 1983 study, the FDIC recommended the merger of the FSLIC into the FDIC. In addition, it recommended that the FDIC be removed from all regulatory functions not directly related to safety and soundness. The bank and thrift regulatory and supervisory functions of the Federal Reserve Board, the OCC, and the FHLBB would be consolidated in a new separate agency. The FDIC would have the authority to conduct examinations, require reports, and take enforcement actions, but it would limit its attention to problem and near-problem institutions.

12. ***Bush Task Group***. In 1984, the Task Group on Regulation of Financial Services, chaired by then–Vice President George H.W. Bush, produced Blueprint for Reform. The recommendations would have reduced the number of agencies involved in day-to-day bank supervision from three to two. A new Federal Banking Agency (FBA) would continue the OCC's supervisory responsibilities. The Federal Reserve would take over supervision of all state-chartered banks except banks in states where the state supervisory authorities were "certified" to perform the function themselves. Except for about 50 international-class holding companies, the federal supervisor—the FBA or the Federal Reserve—of a bank would also supervise the parent holding company. The Federal Reserve would supervise the internationals. The FDIC would lose day-to-day supervisory authority; its responsibilities would be confined to providing deposit insurance, although it would be able to examine troubled banks in conjunction with their primary supervisor. Finally, functional regulation would play a role in that enforcement of antitrust and securities laws would be transferred to the Justice Department and the Securities and Exchange Commission, respectively.

13. ***Depository Institutions Affiliation Act (DIAA)***. The DIAA was a piece of legislation that languished in several Congresses in the 1980s. The act would have established a National Financial Services Committee consisting of the chairmen of the Federal Reserve, the FDIC, the SEC, and the Commodity Futures Trading Commission; the Secretaries of Commerce and the Treasury; the Comptroller of the Currency; and the Attorney General. The committee would seek to establish uniform principles and standards for the examination and supervision of financial institutions and other providers of financial services.

14. ***National Commission on Financial Institution Reform, Recovery and Enforcement***. In Subtitle F, Title XXV, of the Comprehensive Crime Control Act of 1990, Congress created an independent commission to examine the thrift crisis of the 1980s and to make appropriate recommendations. In its study, Origins and Causes of the S&L Debacle: A Blueprint for Reform, the commission recommended that federal deposit insurance be limited to accounts in "monetary service companies," which would be able to invest only in short-term, highly rated market securities. A corollary recommendation was that the FDIC be made the sole federal insurer of depository institutions and the sole federal charterer and regulator of insured institutions. The OCC and the OTS would be eliminated. The FDIC would remain an independent agency but would be required to consult regularly with the Federal Reserve and make available to it all pertinent information about the condition of insured depository institutions. The Federal Reserve would appoint an independent Oversight Board to evaluate new and proposed programs, statutes, rules, and regulations. The Oversight Board would not take actions on its own but would report its findings and recommendations to Congress and the public.

15. ***Modernizing the Financial System***. The regulatory structure recommendations of the 1991 Treasury-led study of the federal deposit insurance system largely followed the recommendations of the 1984 Bush Task Force. The four federal banking regulators—the Federal Reserve, the FDIC, the OCC, and the OTS—would be reduced to two, and the same federal regulator would be responsible for both a bank holding company and its subsidiary banks. A new Federal Banking Agency (FBA) within the Treasury Department would succeed to the responsibilities of both the OCC and the OTS. The FBA would also be responsible for the bank holding company parents of national banks. The Federal Reserve would have responsibility for all state-chartered banks and their parent holding companies. The Federal Reserve and the FBA would jointly agree on bank holding company regulatory policies. The FDIC would focus solely on the deposit insurance system and on the resolutions of troubled banks and thrifts.

16. ***H.R. 1227, the Bank Regulatory Consolidation and Reform Act***. This 1993 bill, introduced by Representative Jim Leach, would have combined the OCC and the OTS into a separate independent federal banking agency that would regulate all federally chartered thrifts and their holding companies as well as national banks and their holding companies unless a holding company's assets exceeded $25 billion. The FDIC would regulate all state-chartered thrifts and their holding companies as well as state-chartered banks and their holding companies unless a holding company's assets exceeded $25 billion. Bank holding companies with assets above $25 billion, and their subsidiary banks, would be regulated by the Federal Reserve.

17. ***H.R. 1214, S. 1633, the Regulatory Consolidation Act***. These 1993 bills, introduced in the House by Banking Committee Chairman Henry Gonzalez and in the Senate by Banking Committee Chairman Donald Riegle, would have consolidated federal bank and thrift regulatory functions into a single independent commission, the Federal Banking Commission. The OCC and the OTS would be abolished. The Federal Reserve would continue to manage monetary policy. The FDIC would continue to administer deposit insurance and exercise conservatorship and receivership functions, but its regulatory duties with respect to nonmember banks would be transferred to the commission. The bills differed in several respects. The main differences were the number of members on the independent commission and the composition of the FDIC Board of Directors. Under the House bill, the commission would have seven members: the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Chairman of the FDIC, and four public members, one of whom would serve as the commission's chairman. The five-member FDIC Board of Directors would be composed of the chairman of the commission and four public members, one of whom would be the FDIC Chairman. (And the commission would have a consumer division to enforce consumer protection laws.) Under the Senate bill, the commission would have five members: the Secretary of the Treasury or his or her designee, a Federal Reserve Board Governor, and three public members. The five-member FDIC Board would be composed of the Secretary of the Treasury or his or her designee, the chairman of the commission, and three public members, one of whom would be the FDIC Chairman.

18. ***Clinton Administration***. In a November 1993 document titled "Consolidating the Federal Bank Regulatory Agencies," the Treasury Department proposed the consolidation of federal bank and thrift regulatory functions in an independent Federal Banking Commission (FBC). The proposal is similar to the approaches of H.R. 1214 and S. 1633. The FDIC would be limited to insurance functions, including the handling of failed and failing institutions. The Federal Reserve would keep its central banking functions but would have no primary bank regulatory responsibilities, although it would be able to participate in the FBC's examination of a limited number of banking organizations—the ones most significant to the payments system. The states would continue to regulate the banks they char-

ter. Thus, state banks would be regulated by both the FBC and the states. The FBC would have five members: a chairperson appointed by the president; the Secretary of the Treasury or his or her designee; a member of the Federal Reserve Board, selected by the Board; and two other presidentially appointed members. An early 1994 revision of the proposal expanded the Federal Reserve Board's participation to include joint examinations of a sampling of both large and small banks, joint examinations of the largest bank holding companies, lead examinations of holding companies whose main bank is state chartered, and backup authority to correct emergency problems in any of the 20 largest banks.

19. ***Federal Reserve Board***. In January 1994, Federal Reserve Board Governor John P. LaWare advanced a five-component plan. First, the OCC and the OTS would be merged. The resulting agency might be called the Federal Banking Commission (FBC). Second, the FDIC would be removed as a regulator of healthy institutions. It would keep its insurance functions. Third, examination by charter would be replaced by the principle of one organization, one examiner. The FBC would examine organizations whose lead depository institution was a national bank or thrift. The Federal Reserve would examine organizations whose lead depository institution was state chartered. Fourth, as an exception to the previous point, a small number of financially important organizations would be treated somewhat differently. The holding companies and nonbank subsidiaries would be regulated and supervised by the Federal Reserve, whereas the bank subsidiaries would be regulated and supervised by the primary regulator of the lead bank. Fifth, the Federal Reserve would remain in charge of holding company rulemaking and supervision as well as the regulation of foreign banks. The FBC would write rules for national institutions, and the Federal Reserve would write rules for state institutions, but the two regulators would be required to make their rules as consistent (each with the other's) as possible.

20. ***H.R. 17, the Bank Regulatory Consolidation and Reform Act***. This 1995 bill, introduced by House Banking Committee Chairman Jim Leach, is similar but not identical to Leach's 1993 proposal (H.R. 1227). The OCC and the OTS would be consolidated into a new independent agency, the Federal Banking Agency, which would regulate all federal depository institutions (except those that are subsidiaries of depository institution holding companies regulated by the Federal Reserve or the FDIC); savings and loan holding companies whose principal depository institution subsidiary was a federal savings association; and bank holding companies that had consolidated depository institution assets of less than $25 billion and whose principal depository institution subsidiary had a federal charter. The FDIC would regulate all state-chartered nonmember depository institutions except those that were subsidiaries of depository institution holding companies regulated by the Federal Banking Agency or the Federal Reserve; savings and loan holding companies whose principal depository institution subsidiary was a state savings association; and bank holding companies that had consolidated depository institution assets of less than $25 billion and whose principal depository institution subsidiary was a state-chartered nonmember depository institution. The Federal Reserve would regulate all state-chartered Federal Reserve–member depository institutions except those that were subsidiaries of depository institution holding companies regulated by the Federal Banking Agency or the FDIC; bank holding companies that had consolidated depository institution assets of less than $25 billion and whose principal depository institution subsidiaries were state-chartered Federal Reserve–member depository institutions; and all bank holding companies with consolidated depository institution assets of $25 billion or more.

21. ***Federal Deposit Insurance Act Amendment of 1995***. House Banking Committee Vice Chairman Bill McCollum included a regulatory restructuring proposal in a bill (H.R. 1769) he introduced to capitalize the Savings Association Insurance Fund and spread the debt service costs

of the Financing Corporation to all FDIC-insured institutions. The McCollum proposal would consolidate the OCC and the OTS into a new independent agency similar to that in the Leach bill (H.R. 17).

22. ***The Thrift Charter Convergence Act of 1995***. Representative Marge Roukema included a regulatory restructuring proposal in a bill (H.R. 2363) she introduced to capitalize the Savings Association Insurance Fund and spread the debt service costs of the Financing Corporation to all FDIC-insured institutions. The Roukema proposal provided for the conversion of federal savings associations into banks; the treatment of state savings associations as banks for purposes of federal banking law; the abolition of the OTS; and the transfer of OTS employees, functions, and property to the OCC, the FDIC, and the Federal Reserve, as appropriate.

23. ***General Accounting Office***. In testimony before Congress in May 1996, the General Accounting Office, based largely on a review of foreign bank regulatory systems, made four recommendations for changes in the U.S. bank regulatory system. First, the number of federal agencies with primary responsibilities for bank oversight should be reduced by consolidating the OTS, the OCC, and the FDIC's primary supervisory responsibilities into a new agency. Second, the Federal Reserve and the Treasury Department should be included in some fashion in bank oversight. Third, the FDIC should have the necessary authority to protect the deposit insurance funds. Fourth, mechanisms to help ensure consistent oversight and reduce regulatory burden should be incorporated into the regulatory system.

24. ***Financial Modernization, 105th Congress***. Financial modernization was a topic of broad interest in the 105th Congress (1997–1998). As reported out of the House Banking Committee in June 1997, H.R. 10, the Financial Services Competition Act of 1997, combined elements of several bills, including the House version of the Depository Institution Affiliation Act and a Department of the Treasury proposal. Regarding regulatory restructuring, H.R. 10 would have abolished the OTS, merging it into the OCC, and would have created a National Council on Financial Services composed of the Secretary of the Treasury; the Chairmen of the Federal Reserve Board, the FDIC, the SEC, and the CFTC; the Comptroller of the Currency; a state securities regulator; a state banking supervisor; and two presidential appointees with experience in state insurance regulation. These regulatory restructuring measures were not in the version of H.R. 10 that was passed by the House in May 1998, and they were not revived in later versions of the bill.