Remarks by
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Anyone assessing the impact of the Gramm-Leach-Bliley Act, which was signed into law five months ago, has to be struck by the magnitude of the changes it brought about. First and foremost, it tore down the wall between commercial banking and investment banking that was erected in the Glass-Steagall Act of 1933. Second, it obliterated a major premise of the Bank Holding Company Act of 1956 -- that special measures are needed to avoid concentrations of economic power in financial conglomerates.

Yet, as far reaching as the new law is, it left entirely unchanged the structure of financial regulation -- a fact that some observers have found surprising. "Why," asked editors of The Economist, "if politicians are at last to do something about the depression-era rules that govern financial firms, have they not tried to update America's supervisory structure at the same time?"

The decision in Gramm-Leach-Bliley not to address fundamental issues of supervisory structure struck some as particularly curious in light of developments in financial regulation in other countries. The irony is stark: while other major financial powers continue to look to the United States for new approaches to financial regulation, they are increasingly rejecting the confusing structural model of U.S. supervision in favor of a unified agency approach, such as that adopted by Great Britain in 1997, and many other countries, including Canada and Japan, since then.

Of course, the idea of consolidating the federal banking agencies in this country is not a new one. Even defenders of the present structure concede that no one would ever design it that way from scratch. The product of a long accretion of legislative decisions, piled one on top of the other, the U.S. financial regulatory structure is complicated, confusing, duplicative, and, at least at the margins, costly. It's not surprising that our colleagues from abroad would seek positive inspiration elsewhere.

Proposals to rearrange the responsibilities of the federal financial agencies have been a perennial of public policy for many years. Such proposals began surfacing almost from the moment that complexity was introduced into supervision on the national level, with the creation of the Federal Reserve in 1913. At that time, of course, the Comptroller of the Currency and the Secretary of the Treasury sat as members of the Federal Reserve Board. Between 1917 and 1923, no fewer than three separate bills were introduced in Congress -- none of them acted upon -- to fold the 50 year-old OCC into the fledgling Fed. In the 1930s and 1940s, private and government proposals variously contemplated merging the OCC into the FDIC; or the OCC and the FDIC into the Federal Reserve; or the FDIC into the OCC. In 1971, the Hunt Commission recommended the transfer of the Fed's supervisory authority to the FDIC.

In more recent years, agency consolidation proposals have looked to the creation of a new independent agency, to which the bank supervision and regulation functions of each of the existing agencies would be transferred. During the 1970s, Senator William Proxmire advocated the creation of a new federal banking commission. A similar proposal was made during the 1980s, in the Reagan Administration, by a task force headed by Vice President Bush. And to underscore the bipartisan appeal of such proposals, the Clinton Administration offered a regulatory consolidation bill of its own in 1993.

Yet none of the proposals for consolidation of bank supervision in a single agency came to fruition, and it may be instructive to consider why. A major reason why the idea of agency consolidation has not been accepted -- despite its appeal to neatness -- has undoubtedly been the lack of agreement on a basic assumption implicit in all of the more recent proposals: that the federal deposit insurer and the central bank do not need involvement in the banking system in order to discharge their primary responsibilities. The FDIC has argued that controlling risk at the source is essential to protecting the deposit insurance interest, and the Federal Reserve has said that it needs a "window" into the banking system, to help it prepare to meet the threat of systemic crises and to be a more effective administrator of the country's payment and settlement systems.

Another reason for opposition to the consolidation of federal bank regulation has been a concern about its impact on the dual banking system. State banking interests have been concerned that banks might lose interest in state charters if <u>all</u> banks were to have the same federal regulator.

But what these proposals for regulatory consolidation have lacked most of all is a compelling <u>practical</u> reason for restructuring. While our system surely does not conform to any standard model of bureaucratic orderliness, it has worked extremely well. Indeed, if our current system were as flawed as some critics suggest, you might expect the banking industry to be leading the charge for structural reform. After all, it's bankers who have to put up with the system's complexities and any cost burden resulting from the structure. But the industry has been at best lukewarm -- and often hostile -- to most consolidation proposals. Bankers know the system's not perfect. But they also recognize the risk in discarding one that works.

The system works for a variety of reasons -- not the least of which is that the regulatory agencies have learned over many years to capitalize on its strengths and maneuver around its weaknesses. Regulatory competition has stimulated innovation and efficiency. Competition keeps all of us on our toes, and provides incentives to add real value to our supervision. While the system unquestionably provides opportunities for regulatory arbitrage, there is little evidence that it has stimulated the "competition in laxity" that former Federal Reserve Chairman Arthur Burns discussed 30 years ago.

Above all, the agencies themselves have learned the importance of coordination, both substantive and procedural, as well as the need to avoid inconsistencies in their policies that might encourage arbitrage. To this end, the agencies, on their own, formed an interagency coordinating committee during the mid-1970s, which was formalized by Congress in 1978 as the Federal Financial Institutions Examination Council, or FFIEC.

For more than 20 years, the FFIEC has served as a forum for promoting common standards for bank supervision and for reconciling many interagency differences. The tradition of coordination has become so ingrained that the agencies now routinely confer on <u>all</u> matters of common interest and concern, both within and beyond the purview of the FFIEC.

Moreover, Congress has not merely tolerated the multipartite division of supervisory and regulatory jurisdiction; it has resoundingly reaffirmed it in virtually every major piece of banking legislation since 1964. It was then that Congress coined the term "appropriate federal banking agency," or AFBA, to refer to the primary federal regulator of each class of regulated depository institution, to which the other agencies were expected to defer in carrying out their own responsibilities. Whenever Congress has imposed new supervisory and regulatory duties on federal banking agencies, it has almost always parceled them out to the respective AFBAs. As a result, each agency has an extensive set of parallel responsibilities for the institutions it supervises -- the OCC for national banks and their subsidiaries, the Fed for state banks that have elected to be members of the Federal Reserve System, the FDIC for state nonmember insured banks, and the Office of Thrift Supervision for most federally-insured thrifts, whether state- or federally-chartered. The Federal Reserve has also been designated the AFBA for bank holding companies and their nonbank subsidiaries.

In the case of national banks, the OCC has "cradle to grave" responsibilities, which range from approving new charters to declaring insolvencies. We determine for national banks what "the business of banking" consists of, and what is "incidental" to that business. In our role as the AFBA for national banks, we are charged by Congress with the responsibility for setting and enforcing requirements relating to capital adequacy, risk management systems, internal controls and audit, information systems, loan loss reserves, loan documentation and credit underwriting, and interest rate exposure, among other things. We are required to pass on mergers and changes in control involving national banks, the establishment of bank subsidiaries, and the permissibility of bank investments. We are empowered to impose a formidable array of sanctions and remedial measures against national banks, and we enforce a lengthy catalogue of safety and soundness and consumer protection laws and regulations. Finally, we, and we alone, are charged with the responsibility of performing regular, on-site, full-scope examinations of national banks. While the FDIC and the Federal Reserve do not charter or close banks, they have virtually identical responsibilities as ours in their roles as the AFBAs for state banks.

This principle of allocating parallel jurisdictions has repeatedly been reinforced and reaffirmed -- in the International Lending Supervision Act of 1983, the Competitive Equality Banking Act of 1987, the Federal Deposit Insurance Corporation Improvement Act of 1991, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, and most recently in Gramm-Leach-Bliley.

There have, of course, been occasions when Congress has imposed regulatory responsibilities on a single agency. The Federal Reserve, for example, has been given the task of drafting most consumer protection rules, while enforcement of those rules has been allocated in the usual manner to the respective AFBAs. Bank holding company regulation has been similarly treated. From the time they first appeared, in the early decades of the 20th century, bank holding companies have been viewed as a potential threat to bank safety and soundness -- as the means by which bankers might evade legal restrictions applicable to the bank itself. In 1956, these concerns led to the passage of the Bank Holding Company Act, with the Federal Reserve denominated as the federal regulator of bank holding companies. But the consistent goal of that law has been to supplement the work of the primary bank regulators by protecting insured banks from risks that might emanate from activities outside the bank, elsewhere in the corporate family, where the jurisdiction of the primary regulator might not reach.

In Gramm-Leach-Bliley, the unique structure of U.S. bank supervision has again received strong affirmation. As in the past, Congress has dispersed many new supervisory responsibilities in parallel across the federal banking agencies. Some early versions of this legislation permitting financial conglomeration would have authorized new unregulated financial holding companies, outside the scope of the Bank Holding Company Act. But both the Administration's proposed bill, as well as the final enactment, preserved the Federal Reserve's role as the regulator of bank holding companies, with the mission of supplementing the work of the primary bank regulators by focussing on risks arising outside the bank.

At the same time, Congress reinforced the role of the primary bank regulators, both federal and state, in two ways: first, it required the Federal Reserve, in its role as holding company regulator, to limit "to the fullest extent possible," the focus and scope of its holding company examinations to the holding company itself and to nonbank subsidiaries that could have a materially adverse effect on the safety and soundness of any bank subsidiary. Second, it required the Fed to give deference to the primary federal or state supervisor when seeking information from bank holding companies by using their examination reports "to the fullest extent possible." In both cases, the new law used stronger language than has ever been used before in this context, in order to underscore its intention that the role of the primary regulator not be needlessly duplicated, and that the burdens of regulation on banks be kept to the absolute minimum. By thus reemphasizing the primary regulator's responsibility for assuring the safety and soundness of the bank, and the holding company regulator's role with respect to activities outside the bank, Congress implicitly underscored its intention that the bank safety net not be extended to holding company affiliates of banks.

One novel aspect of Gramm-Leach-Bliley is its emphasis on the role of "functional regulation" -- the principle that just as banking activities should be regulated by banking regulators, and holding company activities by the holding company regulator, securities activities should be regulated by securities regulators, and insurance activities by insurance regulators. Where prior law imposed no constraints on the authority of bank and bank holding company regulators to examine into the operations of insurance and securities affiliates of banks and bank holding companies, respectively, the new law limits the circumstances under which they may examine or require reports from such functionally supervised subsidiaries and affiliates. Only if there is reasonable cause to believe that the subsidiary or affiliate is either engaged in activities that pose a material risk to the bank or is operating in violation of a law for which that regulator has specific jurisdiction may the banking regulator cross this barrier. Otherwise the bank regulator must rely on the functional regulator for this information.

Some have expressed a concern that, by limiting the authority of the OCC and our sister banking agencies to examine functionally regulated companies, GLBA will make it more difficult for us to assess the consolidated risk of banks and bank holding companies. This would be serious if it were true.

But I don't believe it is. Viewed in perspective, I believe the new law simply extends the existing multi-agency concept of financial supervision that we've been refining for nearly a century. In fact, Gramm-Leach-Bliley adds depth to supervision by drawing on the specialized expertise of insurance and securities regulators to ensure that these highly complex activities -- which some banking organizations will be engaging in for the first time -- are conducted safely and soundly, in a way that lends strength to the bank instead of detracting from it.

Certainly the new law presents a major challenge to all financial regulators: to pursue the kind of interagency cooperation and coordination that is needed to ensure the safety and soundness of our financial services industry. The banking agencies are already discussing this objective with their counterparts in the insurance and securities industry, and with each other. What is essential is not only a common recognition of, and respect for, the primary regulatory roles assigned to individual agencies, but recognition by each of the interrelationships among these roles.

When Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act in 1989, the Washington Post published a wiring diagram purporting to show how FIRREA had changed -- and vastly complicated -- the relationships among the various supervisory agencies. It was a maze of solid and broken lines almost impossible to unravel. The diagram was widely reprinted, usually without comment, for the implication was clear: that the U.S. financial regulatory structure was hopelessly tangled and getting worse. If ever there was proof of our national penchant for convoluted bureaucratic “solutions” to critical public policy questions, this seemed to be it. If ever the case for rationalizing the structure of regulation had any force, it was then.

That was more than a decade ago. During that decade, we have been given new supervisory tools and have developed new approaches to supervision. We have been tested by crisis, and have learned from the experience. And we have seen an era of unparalleled prosperity for the U.S. banking industry. I think it is quite clear that we do a better job supervising banks today than we did when FIRREA was enacted.

There will always be purists who won’t be satisfied with anything less than wholesale restructuring of financial regulation. Their day may yet come. But I believe the odds are against it, as long as the financial regulatory agencies -- all of us -- work together in the spirit of cooperation that has long been the system’s strength. By carrying out our respective responsibilities with a view to minimizing duplication and maximizing coordination, and with mutual regard for our respective roles and responsibilities, we can assure that our present regulatory structure will serve us as well in the future as it has in the past.