Files: Banks

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

April 18, 1994

MEMORANDUM FOR GENE LUDWIG
FRANK NEWMAN
ELLEN SEIDMAN

FROM: Christopher F. Edley, Jr.

SUBJECT: **Whither Bank Agency Consolidation?**

I am concerned that we are not together as an Administration on the impending agreement between Treasury and the Fed on regulatory consolidation. We disagree about the merits of the plan, as well as questions of timing. The current proposal presents a number of policy problems as follows:

- Complexity. The Fed/Treasury proposal is, we feel, hardly an improvement over the current regulatory system and is much more complex than the previous proposals introduced by either the Administration or Congress. To be fair, in general, the proposal would streamline the current examination process by designating one Federal regulator per banking organization. However, the overall supervision system, including regulatory, would remain complex. It would be difficult to justify this proposal, which achieves neither of our previously stated goals: simplifying the regulatory system and eliminating redundancy and duplication in the supervision process.

- Industry Support. The new proposal is unlikely to garner support from the industry since State nonmember banks, which represent over 60 percent of the commercial banking industry by number, would have 3 Federal regulators as compared to 1 under current law. In addition, state-chartered institutions may oppose the proposal since they would face higher assessments than they currently pay.

- No Gain. The Administration has little to gain from this proposal (other than asserting that we've done something about bank regulation) but a lot to lose relative to what we already have. First, given the current Congressional environment, we are likely to end up with a FBC much like the FDIC or even the Fed. Second, the new proposal is basically the LaWare proposal, with the exception of the State nonmember bank supervision component. This proposal would give a greater share of bank supervision to the Fed. Finally, we are likely to end up losing on other issues that may come up during the negotiation, such as a potential Fed seat on the FDIC Board.

- Competition in Laxity/Charter Shopping. The new proposal would retain the current incentive for State nonmember institutions to switch their Federal regulator to the Fed. As described above, under the new proposal, State nonmember institutions would see an increase in regulatory overlap. In addition, since State banks would continue to pay less than national banks in exam fees, the current incentive to escape the Federal system would continue to exist. This has an important implication for funding in the long-term because, as State nonmember and national institutions leave the FBC, it would ultimately face the same financial situation as the OTS today. More importantly, as more institutions convert to a State charter because of lower fees, the FBC and Fed could find it difficult to cover their costs of supervision without either increasing the Fed subsidy or exam fees.

  Finally, the new proposal would allow easy charter-shopping by weak banks. The Fed still argues, I understand, that it would be politically infeasible to give the primary regulator a chance to veto or delay a charter conversion. The Fed proposal would create a loophole for weak institutions to seek lenient regulation.

- Increased Fed Jurisdiction. The Fed has proposed a definition of a "designated" bank holding company that is too inclusive and broad, thereby substantially increasing the number of the largest banks under the Fed jurisdiction. In addition, the Fed would have rulemaking authority over most institutions except Federally chartered institutions. The Fed's rulemaking authority would extend to "designated" bank holding companies as well as their nonbank subsidiaries. This also means that the Fed would gain rulemaking authority over State nonmember banks and foreign activities of U.S. national banks. (The FDIC currently has rulemaking authority over State nonmember banks; however, the FDIC, at least, is headed by a board that includes two Treasury officials.)

- Presidential Policy Role. In the current environment, and building on the present Treasury-Fed deal, there is good reason to fear that any legislation which ultimately wins passage in this Congress would be a setback for the goal of making general policy directions for this segment of the economy subject to broad White House guidance. The risks of hyper-independence are serious, and we have no counter-strategy.

I am not unmindful of some pressing needs, including stabilization of the OTS and stemming the perceived decline in the value of the national banking charter. But at what cost? Delays in presenting an Administration position to the Congress, the dishearteningly partisan and often rancorous character of much Hill discussion, and the very great challenges we face with the rest of the President's legislative agenda in the short time remaining this session -- all of these concerns make me question the wisdom of moving forward with this deal at this time.

How, then, to get to closure on these issues? OMB staff will be briefing Leon in detail within the next couple of days, and we should consider a NEC Principals' meeting sooner rather than later. My immediate concern is that in its discussions with the Fed, the industry and the Hill, the Treasury Department not get so far out ahead of the rest of the Administration that it becomes costly for us change course.

cc: Leon Panetta
Alice Rivlin
Elaine Kamarck
Rick Carnell
Michael Levy
Josh Steiner
Bo Cutter
Sally Katzen
Joel Klein

[Drafted by Alice Cho]