Remarks by
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There's been a surprising degree of confusion about the roles assigned by Congress to the various financial regulators under the Gramm-Leach-Bliley Act. Some say that the legislation exacerbated an already balkanized system of financial regulation -- that it parceled out responsibilities among the agencies based on considerations of industry politics and regulatory turf. Others view it as having created a new hierarchical structure, under which a single "umbrella" regulator, with unique responsibilities for guarding against systemic risks, is to assume a position of preeminence among the financial regulators. Each of these views is, in my opinion, unfounded -- and confused.

A little confusion can actually be a healthy thing when it's the product of an inquisitive and critical mind -- one that rejects facile analysis and simple solutions to complex problems. The legendary journalist Edward R. Murrow once said, in trying to explain the nuances of the Vietnam War: "anyone who isn't confused doesn't really understand the situation."

Of course, confusion has been a hallmark of our financial regulatory structure for nearly a hundred years -- ever since Congress started layering new agencies on top of old ones and giving them overlapping jurisdictions. Certainly, no sensible person would characterize our structure as straightforward -- and no one would recreate the present structure if they were designing it from scratch today. But underlying the complexity of the structure is a great deal more consistency and simplicity than meets the eye.

In my view, Congress didn't intend to create a new hierarchical structure of regulation in GLB. Nor did it mean to further fragment an already complex system of financial supervision. On the contrary, GLB strongly reaffirmed the existing roles of each of the financial regulatory agencies, and emphasized the importance of the special and complementary roles they play.

In doing so, it adopted an approach that puts a tremendous premium on cooperation and coordination among the various participants -- something that has always been of key importance in our multipartite structure -- both in order to assure that each can perform its respective role properly, and to reduce the burden of overlapping supervision on the regulated entities themselves.

This conclusion, it seems to me, is compelled both by the text of the new law and the history behind it. A brief review of that history not only explains how we came to the structure we have today, but provides a frame of reference for interpreting what Congress intended in GLB.

We can pass over Congress' early experiments with federal involvement in banking in its creation of the First and Second Banks of the United States, for while the Banks assumed something of a regulatory role, it was the result more of aggressive management than legislative intent. In 1863, however, when Congress created the national banking system and the Office of the Comptroller of the Currency, it took an explicit move – its first such move -- into the realm of financial regulation. Since the expectation at the time was that state chartered banks would find the new national charter irresistible and would convert in droves, there was no need for Congress to address the question of state regulation – although when that expectation was not vindicated, Congress attempted to eliminate the state charters by imposing a discriminatory tax on state bank notes.

As we know, of course, state banks survived, by moving to deposit banking and away from note issuance. Thus, by 1913, when the Federal Reserve was created, no less than 16,000 state banks remained in business. Congress made Fed membership optional for these institutions, and established the Fed as the regulator of state member banks.

In 1933, when Congress created the Federal Deposit Insurance Corporation, it provided that all national banks and state member banks would automatically be covered by deposit insurance, and it extended the option of coverage to state nonmember banks. For those nonmember banks that elected coverage, the FDIC became the primary federal regulator, just as the Fed had been tapped for state member banks. Thus, coming out of the Great Depression we had the basic tripartite structure of federal bank regulation that's remained with us ever since -- the OCC responsible for national banks, the Fed for state member banks, and the FDIC for state nonmember insured banks.

During the 1950s, Congress became alarmed that the prudential and regulatory rules applicable to banks, both state and national, might be evaded through the use of holding companies. While holding companies had, ever since Glass-Steagall in 1933, been required to obtain permits from the Federal Reserve in order to vote their shares in the banks they held, the limitations that generally applied to banks – such as the restrictions on permissible activities and constraints on geographic expansion – did not apply to holding companies.

Faced with the prospect that the regulatory structures for the banking industry might be circumvented through the use of holding companies, Congress enacted the Bank Holding Company Act of 1956. This legislation designated the Fed as the regulator of holding companies. At the time, fewer than two percent of all banks were controlled by holding companies, and Congress felt comfortable applying the new law only to those companies that controlled two or more banks.

By the late 1960s, however, the holding company format had been rediscovered as a mode of diversification, and following Citibank's conversion to the one-bank holding company format in 1968, banks by the score followed suit, primarily in order to expand into nonbanking financial activities. Congress responded in 1970 by amending the Bank Holding Company Act to cover one-bank companies.

While the Fed's work expanded significantly with the extension of the BHCA to one-bank holding companies, Congress, both before and after the 1970 amendments, reinforced its dedication to the tripartite division of primary supervisory authority that had been the pattern since 1933. In 1964, for example, it coined the term "appropriate federal banking agency," or AFBA, to refer to the primary regulator, to which the other agencies were expected to defer in carrying out their own responsibilities. And since then, in one law after another, whenever new supervisory responsibilities have been conferred on the federal banking agencies, Congress has almost always dispersed them in parallel form to the respective agencies.

As time's gone on, the roles of the AFBAs have become almost indistinguishable. The OCC, for example, has cradle-to-grave responsibilities for national banks -- responsibilities that range from approving new charters to declaring insolvencies. We determine for national banks what the business of banking consists of, and what's incidental to that business. In our role as AFBA for national banks, we're 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're required to pass on mergers and changes in control involving national banks, the establishment of bank subsidiaries, and the permissibility of bank investments. We're empowered to impose an 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 pass on membership and insurance applications, and across the board their responsibilities are virtually identical to ours in their roles as the AFBAs for state banks.

While these jurisdictions unquestionably overlap at various points – the Fed, for example, has some duties that apply to all member banks, state and national; and the FDIC has some responsibilities for all insured banks -- the basic pattern has been well established: primary supervisory authority is vested in the respective AFBAs, and the holding company regulator stands as a backup protector to assure that the activities of corporate owners of banks will not prejudice the interests of the banks themselves.

Let's now turn back to Gramm-Leach-Bliley. GLB is surely one of the most far-reaching pieces of banking legislation of the 20th Century. It took a significant new direction and broadly expanded permissible activities for banking organizations. But what did it do to -- and what, if anything does it imply for -- the structure of financial regulation? Does it represent a break with the past or a reaffirmation of it? And does it alter in any fundamental way the respective responsibilities of the federal banking agencies or the nature of the relationships among them?

In my view, GLB strongly reaffirms Congress' commitment to the preexisting structure of financial regulation among the three banking agencies. It reinforces the roles of the AFBAs as the primary line of defense for the safety and soundness of depository institutions. It perpetuates the role of the Federal Reserve as the regulator of holding companies, with its traditional function of helping to protect banks from risks that might arise elsewhere in the corporate family, outside the bank.

To be sure, GLB might have been an opportunity for Congress to rationalize the structure of financial regulation by unifying it under a single agency -- in much the same way as has been done in the United Kingdom and Japan. But it chose not to do so. Consolidation of financial regulation is not an issue that has any public constituency; no one was arguing for it in the context of GLB; and the last few times any initiative has been pursued to achieve consolidation, the result has been dismal failure.

Congress' reaffirmation of the role of the AFBAs runs throughout the new law. Jurisdiction for enforcing the new privacy and CRA "sunshine" provisions of GLB, for example, was allocated on the conventional pattern. Similarly, in conditioning eligibility to engage in new financial activities, whether through financial holding companies or financial subsidiaries of banks, on the respective banks being well capitalized and well managed, Congress made clear that these determinations had to be those of the AFBA, not a third party.

GLB also reinforced the role of the primary bank regulators in two important additional ways. First, it required the Federal Reserve, in its role as the 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 on bank subsidiaries, requiring that the Fed use the examination reports of the primary supervisors to the fullest extent possible. In both regards, it reinforced the precept that the primary role of the holding company regulator is to protect the bank against risks that emanate from the holding company, and not to duplicate bank regulation itself.

In both cases, moreover, the new law used stronger language than has ever been used before in this context, in order to underscore its intention that the work of the primary bank regulator not be needlessly duplicated, and that the burdens of regulation on banks be kept to the absolute minimum. By thus reemphasizing the AFBA'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 effectively underscored its intention that the bank safety net not be extended to the holding company affiliates of banks -- an intention that might have been clouded were holding company regulation to have become more integrated with bank supervision.

At the same time, Congress preserved the role of the Federal Reserve as the regulator of all bank holding companies -- a result that was by no means taken for granted in earlier versions of financial modernization legislation. As you'll recall, some proposals, such as that advanced by Chairman D'Amato in an earlier Congress, would have created a new type of financial services holding company that would not have been subject to Fed supervision.

Nevertheless, the final version -- just as the legislative proposal sent to the Hill by former Secretary Rubin -- retained the Fed in its conventional role as the bank holding company regulator. While the Fed lost the ability to pass on applications for new financial activities, and was required to share with Treasury some of the rulemaking jurisdiction it previously had to itself, its fundamental role remained unchanged.

GLB's strong focus on functional regulation -- that is, recognizing the primacy of securities and insurance regulators as to the matters traditionally within their jurisdictions -- is completely consistent with its retention of the long-established pattern of allocating supervisory authority with respect to banks to the agencies having principal expertise in banking.

Congress determined that, in the world of financial conglomeration, the old exemptions that banks enjoyed, and the assumption by bank supervisors of supervisory responsibilities over bank-related insurance and securities activities, no longer made sense. Congress made the judgment that consumers of insurance and securities products should be entitled to exactly the same legal protections irrespective of whether those services were offered by a bank or by an entity not related to a bank. This objective was assured by making clear that the functional regulators would have primary jurisdiction in these areas.

It's certainly fair to ask whether, in an unconsolidated system of supervision, there may not be matters that fall between the chairs. Many large institutions, for example, pay little heed to internal organizational format in the way they actually conduct their operations or manage their risks. The insurance and securities departments of some banks may be no more than the people at the adjacent desks. And what about "systemic" risk? Who's looking out for that?

The simple answer, I believe, is that <u>all</u> of the relevant regulators have a legitimate and important interest in these matters. The securities regulator will be just as interested in knowing how a holding company's consolidated risk management affects its securities operations as will the holding company regulator. And if a bank engages in transactions with or related to the operations of an insurance affiliate, both the bank regulator and the insurance regulator will have an interest, just as the bank regulator will have an interest in what's going on at other holding company affiliates that are not functionally regulated. The very nature of modern financial conglomeration will necessarily involve the concerns of all of those agencies having responsibilities for some portion of the company's activities.

Similarly, systemic risk is not an esoteric or proprietary concern, unrelated to the responsibilities of individual regulators. The Federal Reserve has a clear concern from the perspective of its discount window and payments system functions. The FDIC, as the guardian of the deposit insurance funds, has a strong interest in the health of the banking system, as does the OCC, as the supervisor of the predominant number of large banks. The SEC, the Commodity Futures Trading Commission, and state insurance regulators have comparable concerns. None of these agencies can carry out its responsibilities without taking due regard of the potential for contagion -- both for problems within their areas of responsibility affecting other markets and other intermediaries, and for external problems affecting the entities they regulate.

What all of this makes clear is that close coordination and cooperation among the individual agencies -- as well as due regard for the specific responsibilities Congress has expressly imposed on each -- will be of utmost importance. The establishment of close working relationships, particularly at the field level, will be essential. When a bank examiner in the field identifies a problematic bank transaction involving an insurance or securities affiliate, and needs information, there may not be time for high level deliberations.

Similarly, if a bank is facing problems that give rise to concerns about its solvency, the interests of the FDIC as insurer of deposits, the interests of the Fed as the provider of liquidity and the holding company supervisor, even the interests of the SEC in its oversight role with respect to corporate disclosure and securities trading, are likely to be involved.

Coordination and cooperation are also essential to minimize the burdens on the regulated entities. If every agency having an interest were to make its own separate information demands on a bank, for example, each desiring information in a different format -- or if each were to decide to send its own examiners into every institution as to which they might have a colorable jurisdictional claim whenever they felt the need -- the resulting burdens could be intolerable. Congress clearly had this in mind in its GLB mandate that deference should be paid to the functional regulator of an entity, or to the primary federal or state regulator, in the case of a bank, when information is sought or examinations desired by the holding company regulator.

Coordination and cooperation are certainly not new concepts. Congress has made clear for many years that it has little patience for inconsistencies and disparities among financial regulators, and it has repeatedly expressed its desire that overlapping jurisdictions not result in the imposition of costly and needless burdens on regulated entities.

We at the OCC are committed to the course of cooperation and coordination. We've been engaged in discussions with our counterparts at the other banking agencies, as well as the functional regulators, aimed at assuring that we are all able to fulfill our respective responsibilities without stumbling over one another's feet or imposing needless burdens on the banks we supervise.

We believe that productive understandings are emerging from these discussions. We've reached an agreement with the Federal Reserve on the key principles of a pilot effort to coordinate our supervision of large national banks and their holding companies. We're in the midst of extensive discussions with the FDIC to ensure that both agencies have access to full and complete information about problem and non-problem banks under our respective supervision.

Our large bank examiners-in-charge meet quarterly with their counterparts at the Fed and FDIC to share information, discuss changes in their banks' risk profiles, and coordinate supervisory activities. Our large bank EICs now also routinely brief FDIC senior managers on supervisory strategies at their banks, and we're inviting the FDIC to participate in the examination of troubled banks at an early stage.

We're currently discussing information-sharing arrangements with the SEC, and we've concluded a model agreement with the National Association of Insurance Commissioners to share information about insurance complaints involving national banks. That model has provided the basis for agreements with 28 individual insurance regulators, and discussions with many of the others are underway as we speak. In the field, OCC supervisory staff has begun holding regular meetings with their regulatory counterparts in the insurance industry. The goal throughout is to expand the types of information shared by the OCC and state insurance agencies, to ensure effective and efficient supervision of bank insurance activities.

Key to each of these efforts is an understanding on the part of all concerned that we're operating neither in a fractionalized system of unrelated jurisdictions, nor in a hierarchical system in which one agency's role or interest is superior to that of another. Rather, we're in it together, bringing to bear different perspectives and different expertise, but all in the name of protecting the public interest.

It's really not so confusing, when you stop to think about it.