SHADOW FINANCIAL REGULATORY COMMITTEE

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Statement of the Shadow Financial Regulatory Committee

On

The Federal Reserve Board and Prudential Supervision

December 7, 1998

A prolonged and unseemly turf fight between the Board of Governors of the Federal Reserve System (the Fed) and the Treasury was left unresolved when H.R. 10 was blocked at the end of the last Congress. The apparent issue was whether new financial activities of banking organizations should be permitted only through the subsidiaries of bank holding companies, as the Fed argued, or through both subsidiaries of banks and bank holding companies, as the Treasury preferred.

The Committee believes that the dispute between the Treasury and the Fed offers Congress the opportunity to review the role of the Fed in a more comprehensive way than it has done in the past. Indeed, it is the Committee's view that the Fed should not retain responsibility for both monetary policy and the prudential regulation of banks or bank holding companies.

There is at times a clear conflict of interest inherent in the Fed's carrying on roles as both a promoter of stability in the domestic and international financial markets and as a supervisor of banking organizations. This year, as in past years, the Fed has both complained about the relaxation of bank lending standards and encouraged banks to lend to or in foreign countries that were experiencing financial difficulties.

Moving bank supervisory responsibilities out of the Fed will resolve the turf dispute that arose in connection with H.R. 10. The authority to supervise national banks and their holding companies should rest with the Comptroller of the Currency, while similar responsibility for state-chartered banks and their holding companies should be transferred to the Federal Deposit Insurance Corporation.

This transfer of authority would not, of course, resolve the question of whether future new activities for banking organizations should occur through holding companies alone, or through the subsidiaries of both bank holding companies and the banks themselves.

The Shadow Committee has previously concluded in Statements 118, 136, and 142, that, despite the Fed's arguments to the contrary, there is no prudential reason to prefer that new nonbanking financial activities be conducted in the subsidiaries of holding companies rather than the separately capitalized subsidiaries of banks. Moreover, the Committee has pointed out that the risk of extending the federal safety net is the same for separately capitalized subsidiaries of banks as for subsidiaries of holding companies. Accordingly, the Committee does not believe that either of the Fed's arguments for placing new financial activities solely in the subsidiaries of holding companies are valid.

Eliminating the turf issue associated with whether deregulation should occur through holding companies or banks will permit this issue to be addressed by Congress on its merits. Even more important, eliminating the Fed's role as both a bank supervisor and as the agency responsible for promoting financial system stability will improve administration of government policies in both bank supervision and monetary policy.