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Statement of the Shadow Financial Regulatory Committee

on

Standards for Safety and Soundness (Implementation of Section 132 of FDICIA)

September 14, 1992

The Shadow Financial Regulatory Committee endorsed the basic thrust of the FDIC Improvement Act of 1991 (FDICIA) in Statement No. 76, December 16, 1991. Among FDICIA's major components is the requirement of prompt regulatory action keyed to a bank's capital ratio. This provision attempts to limit regulatory forbearance and special treatment for large institutions ("too-big-to-fail"). FDICIA also pushes the banking supervisory process in the direction of greater emphasis on the market value of assets and liabilities, both on and off balance sheet.

FDICIA requires the banking agencies to issue regulations to implement these and other provisions of the statute. Section 132 of FDICIA requires each of the banking agencies to prescribe safety and soundness standards with respect to internal controls and audit, information systems, asset quality, loan documentation, credit underwriting, interest rate risk, asset growth, earnings, executives' and directors' compensation, the ratio of stock market to book value, and such other operational and managerial standards as the agencies determine to be appropriate. These standards must be promulgated by August 1, 1993 and they become effective by December 1, 1993.

The Committee is concerned that implementation of some parts of Section 132 could become unduly costly. Properly implemented, structured intervention and prompt corrective action should make many of the Section 132 provisions unnecessary. Rather than impose strict operating rules on banks, the Committee urges that the agencies seize the opportunity to promulgate standards of behavior that reinforce structured intervention and prompt corrective action.

For example, standards for loan documentation for well-run institutions could be put forward rather than prescribing specific rules for documentation. Violation of these standards would trigger increased supervisory scrutiny which, in turn, might result in requirements for revision in a particular institution's procedures.

Another example is the FDICIA requirement that agencies prescribe standards specifying a minimum ratio of stock market to book value for publicly traded shares. Appropriately construed as a standard that triggers closer supervisory attention, reductions in this ratio should alert the supervisory authorities to information that is not reflected in the book values of an institution's assets or liabilities.

Similar principles could be applied to most of the other components of Section 132. Such a regulatory response would enhance regulatory discretion and enforcement policy without resulting in increased forbearance.