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Statement of Shadow Financial Regulatory Committee

on

Disclosure of Examination Reports and Ratings

May 6, 1996

Under current law, examination reports and ratings by the regulators of financial institutions are considered to be the property of the regulatory agency and are not disclosed to the public, either by the agency or financial institutions. Although it gets a copy of its examination report, the financial institution is currently told only its overall CAMEL rating and not its rating on the individual components. (C is for capital, A is for assets, M is for management, E is for earnings, L is for liquidity.)

In the Shadow Financial Regulatory Committee's view, the arguments for continuing secrecy are outweighed by those in favor of disclosure.

Regulators and many financial institutions have long opposed disclosure of examination reports. Banking agency regulations prohibit institutions from disclosing examination reports and even from complying with validly issued subpoenas requiring their disclosure. For example, the Board of Governors of the Federal Reserve System has recently warned banks and bank holding companies not to disclose their examination reports to potential acquirers of the institution.

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The traditional argument for maintaining the confidentiality of examination reports is that it promotes candor in exchanges between the supervisors and the supervised. In addition, there is always the chance of examiner error, disclosure of which could seriously damage the reputation of the financial institution. Alternately, it has been argued that examiners--knowing that their reports would be made public and have to be defended--might soften their criticism of management or its policies, thus reducing the value of the examination report to the institution's board of directors.

On the other hand, transparency in this area, as in others, should enable depositors and analysts to make more informed decisions about financial institutions, and lead to greater market discipline on both banks and regulators than is currently possible. Disclosure of ratings and the information in examination reports would enable analysts and depositors to make a more informed evaluation of the institution's current condition and prospects.

In addition, permitting public disclosure of criticism of an institution's management or policies--information that is routinely included in examination reports--would provide a greater incentive for improvements by management, and supervision by its board of directors, than a confidential report.

The Committee believes that government policies should move away from treating banks and other financial institutions as special entities whose financial condition must be obscured. The argument that full disclosure of a depository institution's true condition could be a threat to stability of the financial system is without demonstrated merit and is not a justification for veiling institutions in secrecy. Recent changes in law that require the banking agencies to disclose enforcement actions against financial institutions have not resulted in any exaggerated consequences for the stability of the institutions charged in these proceedings.

These factors lead the Committee to three conclusions:

1. The supervisory rating should be released to the public.
2. Components of the overall rating should be disclosed to the institution and its board of directors.
3. Prohibition of disclosure of the component ratings and examination results by the financial institution should be ended, giving the institution the choice of what to disclose to the public.