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Administrative Office
c/o Professor George Kaufman
Loyola University Chicago
820 North Michigan Avenue
Chicago, Illinois 60611
Tel: (312) 915-7075
Fax: (312) 915-8508
E-mail: gkaufma@luc.edu

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For information contact:

George J. Benston
(404) 727-7831

Hal S. Scott
(617) 495-4590

Statement of the Shadow Financial Regulatory Committee

on

Proposal on Full Cost Pricing of Supervisory and Examination Services by the Federal Banking Agencies

May 8, 2000

The Gramm-Leach-Bliley Act of 1999 grants additional powers to banks and bank holding companies, a development we applaud. However, the expanded activities may increase risk, as well as the cost of monitoring such activities. This cost should be borne by banks and bank holding companies, not taxpayers. More generally, the Shadow Financial Regulatory Committee recommends that federal bank regulatory agencies publish their functional budgets and charge explicitly for the full cost of examinations and supervision. Those banks and bank holding companies that require more extensive time and attention should have to pay more, which will encourage them to internalize the cost of risk monitoring associated with their activities.

At present, the Office of the Comptroller of the Currency (OCC) charges national banks fees, primarily based on bank assets, to cover the agency's entire budget. However, the Federal Reserve does not charge any fee for examinations and supervision. Its costs for providing this function are charged to the earnings generated by its asset portfolio, thereby consuming funds that otherwise would be transferred to the U.S. Treasury. The FDIC also does not charge for examinations and supervision. Its costs are covered

by revenue derived from deposit insurance premiums and earnings from investments of deposit insurance funds.

Banks pay in at least three ways for the cost of regulation. First, all banks are subject to the Federal Reserve's non-interest-bearing reserve requirements. Second, banks have financed the FDIC's deposit insurance fund and are subject to insurance premiums. These charges bear little direct relation to the agencies' provision of examination, supervision, and regulation. Third, national banks pay for regulation with general fees to the OCC, and state-chartered banks pay fees to state banking agencies.

The Committee proposes that all costs pertaining to examination and supervision should be borne by charges to banks and bank holding companies and that these charges should reflect the cost to the agencies of regulating individual institutions. The specific way these charges are imposed should be determined by each agency. For example, a two-part charge could be made, a variable charge that covers direct examination and supervision costs and an amount that covers all other overhead and general costs (perhaps a percentage of balance sheet assets and off-balance-sheet items).

This proposal could achieve several benefits. First, it would put other banks on the same basis as national banks with respect to bearing the full cost of examination and supervision. This would reduce national banks' incentives to change their charters to avoid such discrimination. Second, it will align an institution's charges with the costs incurred by its supervisory agency. Third, it makes the cost of examination and supervision more transparent, permitting comparisons among the costs of each agency.

This proposal should improve the efficiency with which examinations are conducted. For example, it might lead the banking agencies to rely more on the work product of independent public accountants to reduce the costs of examinations. The proposal should result in more competition among regulatory agencies in providing examinations. If banks believe that the costs of examinations are excessive they can switch charters. For instance, a national bank could switch to a state charter and be examined by the Federal Reserve or the FDIC. Although only a few banks might choose to do this, the possibility should provide an incentive to the agencies to conduct examinations efficiently. We believe that the bank agencies have too much of their reputations and prestige at stake to deliberately weaken the examination process as a means of keeping or attracting bank charters.