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THE ROLE OF CENTRAL BANKS IN BANK SUPERVISION IN THE UNITED STATES AND THE UNITED KINGDOM

*Heidi Mandanis Schooner**

I. INTRODUCTION

Super regulators are the new wave in financial market regulation. “Super,” or “integrated,” regulators are agencies vested with primary supervisory responsibility for more than one of the three traditional financial sectors — banking, securities, and insurance.¹ Many countries have revamped their regulatory systems to establish a single regulator for all three sectors.² One of the most important examples of this trend is the United Kingdom (“U.K.”), which, pursuant to the Financial Services and Markets Act of 2000 (“FSMA”),³ established its Financial Services Authority (“FSA”) as an integrated supervisor in 2001. Significantly, just prior to the creation of the FSA, the U.K. had transferred bank supervisory authority from the Bank of England to the Securities Investment Board, which later became the FSA.⁴ As a result, the U.K.’s current financial regulatory regime is integrated, but also separated from the central bank.

Meanwhile, across the ocean, Congress awarded the central bank of the United States (“U.S.”) an expanded supervisory

* Associate Professor, Columbus School of Law, The Catholic University of America. I thank Professors Patricia McCoy, Steven Schooner, and Dr. Michael Taylor for their valuable contributions and Ed Loughlin for his diligent and able research assistance. I also thank the participants at Brooklyn Law School’s symposium, *Do Financial Supermarkets Need Super Regulators?*

1. In this Article, the concept of “integration” is used in a broad sense. It can also be viewed more narrowly. For example, an informal group of integrated regulators (including regulators from Australia, Canada, Denmark, Iceland, Japan, Norway, Singapore, Sweden, and the U.K.) define the term “integrated regulation” to encompass any agency responsible for prudential regulation of both banks and insurance companies. See Jeffrey Carmichael, *Experiences with Integrated Regulation*, 6 FIN. REGULATOR 57, n. 2 (2001).

2. See *infra* Part II.

3. Financial Services and Markets Act, 2000, c. 8 (Eng.).

4. See *infra* Part III.B.

role. The Gramm-Leach-Bliley Act of 1999 ("GLBA")⁵ established the Board of Governors of the Federal Reserve System ("Federal Reserve") as umbrella regulator for financial holding companies — newly created entities that promise to become the U.S. version of the financial supermarket.⁶ The umbrella scheme rejects the integrated supervisory model and retains a hybrid of both functional and institutional regulation⁷ — the hallmark of the balkanized system of financial regulation in the U.S.

At least on the surface, the U.K. and U.S. adopted opposite approaches to the oft-debated questions of whether single-agency integrated supervision is necessary to effective financial regulation and whether central banks must be directly involved in bank supervision. While this Article focuses on the question of the role of central banks in bank supervision, given the trend toward integrated supervision, the question of single-agency supervision will touch upon the analysis of the central bank's role as well.

Part II provides context for the discussion by describing the current status of central banks as supervisors around the world, first examining the role of the new European Central Bank and then surveying the role of the central banks in all Organisation for Co-operation and Development ("OECD") countries.⁸ Part III considers the supervisory roles of the Bank of England and the Federal Reserve following the passage of the FSMA and GLBA, respectively. Part IV synthesizes the current debate, both theoretical and empirical, on whether the implementation of monetary policy and bank supervision should be separated. In light of the pros and cons set forth in Part IV, Part V evaluates the current status of the Bank of England and the Federal

5. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).

6. See *infra* Part III.A.

7. For a full discussion of the hybrid model of functional and institutional regulation, see Heidi Mandanis Schooner, *Functional Regulation: The Securitization of Banking Law*, in FINANCIAL MODERNIZATION AFTER GRAMM-LEACH-BLILEY 189 (Patricia A. McCoy ed., 2002).

8. Comprised of thirty member countries, the OECD is "an international organisation helping governments tackle the economic, social and governance challenges of a globalised economy." OECD, at <http://www.oecd.org> (last visited Jan. 23, 2003).

Reserve. Part VI concludes by offering certain recommendations for reform and making predictions for the future.

II. CENTRAL BANKS AS BANK SUPERVISORS

Central banks have a long history.⁹ Therefore, the question of whether a nation's central bank should or should not be tasked with bank supervision is normally complicated by long-standing traditions and relationships. Contrast this with the European Central Bank ("ECB").¹⁰ The establishment of the ECB generated lively discussion regarding the role of central banks as supervisors.¹¹ Thus, the ECB's supervisory role provides a back-

9. For example, the Federal Reserve System was established in 1913 — a mere babe compared with the Bank of England, which was founded in 1694.

10. See European Central Bank, at <http://www.ecb.int> (last visited Jan. 23, 2003). For a comprehensive discussion of legal issues relating to the ECB, see CHIARA ZILIOLI & MARTIN SELMAYR, *THE LAW OF THE EUROPEAN CENTRAL BANK* (2001).

11. See, e.g., Carmine Di Noia & Giorgio Di Giorgio, *Should Banking Supervision and Monetary Policy Tasks Be Given to Different Agencies?*, 2 INT'L FIN. 361 (1999); Dr. Willem F. Duisenberg, *The Future of Banking Supervision and the Integration of Financial Markets*, Speech Presented to the Euro Group (May 22, 2000), available at <http://www.ecb.int/key/00/sp000522.htm>; Charles M. Kahn & João A. C. Santos, *Allocating Lending of Last Resort and Supervision in the Euro Area*, SSRN ELECTRONIC LIBRARY (Apr. 2002), at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=310542 (last visited Mar. 31, 2003); Tommaso Padoa-Schioppa, *EMU and Banking Supervision*, Lecture at the London School of Economics, Financial Markets Group (Feb. 24, 1999), available at <http://www.ecb.int/key/sp990224.htm>.

The ECB also issued the following press release on its position in the debate:

The recent debate on the reorganisation of the supervisory structures in some euro area countries has led the Governing Council of the ECB to assess the involvement of central banks in prudential supervision.

The Governing Council is firmly convinced that there are valid reasons, also in relation to the effects of the introduction of the euro, arguing in favor of maintaining a strong involvement of central banks in prudential supervision.

Press Release, European Central Bank, *The Role of Central Banks in Prudential Supervision* (Mar. 22, 2001), available at <http://www.ecb.int/press/01/pr010322.htm>. Of course, this position is not surprising given the fact that the Governing Council's membership is dominated by the governors of member states' central banks.

drop for broader consideration of the role of central banks internationally.

The Treaty Establishing the European Community ("EC Treaty")¹² established the ECB as the central bank for the countries that adopted the euro.¹³ The European System of Central Banks ("ESCB") is comprised of the ECB and the central banks of member states.¹⁴ The ESCB's primary objective is the maintenance of price stability.¹⁵ The ECB does not act as a prudential supervisor.¹⁶ Rather, the EC Treaty provides that the ESCB shall "contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system."¹⁷ Consistent with the treaty provisions, the ECB's statute (annexed to the EC Treaty) provides:

The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system.¹⁸

Nonetheless, the statute does contemplate a potential, albeit limited, supervisory role for the ECB even in the absence of an amendment to the EC Treaty:

In accordance with any decision of the Council under Article 105(6) (ex Article 105(6)) of this Treaty, the ECB may perform specific tasks concerning policies relating to the prudential

12. TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Nov. 10, 1997, O.J. (C 340) 3 (1997) [hereinafter EC TREATY].

13. Twelve European Union member states have adopted the euro: Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, The Netherlands, Austria, Portugal, and Finland. Member states not participating in the euro are: Denmark, Sweden, and the U.K. For information on the U.K.'s position with regard to any future adoption of the euro, see HM Treasury, *The Government's Policy on Economic and Monetary Union (EMU)*, at http://www.hm-treasury.gov.uk/documents/the_euro/euro_index_index.cfm (last visited Mar. 10, 2003).

14. EC TREATY art. 106(1) (ex art. 105a).

15. *Id.* art. 105(1).

16. *Id.*

17. *Id.* art. 105(5).

18. PROTOCOL ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK, art. 25.1, Feb. 7, 1992, O.J. (C 191) 73 (1992).

supervision of credit institutions and other financial institutions with the exception of insurance undertakings.¹⁹

In euro area Europe, therefore, prudential supervision remains a matter of national responsibility.²⁰ That responsibility may be held by a national central bank, which, however, no longer conducts monetary policy.

Even in situations in which a central bank is not the prudential supervisor, (e.g., the ECB), a central bank cannot remain divorced entirely from the supervisory process, particularly during a financial crisis. Moreover, even when central banks are not the *primary* supervisor, central banks' supervisory role may vary to a large degree. For example, the central bank may retain the power to conduct back-up examinations²¹ or it may not. Moreover, the central bank's role (when it is not the primary supervisor) is likely to be strongly influenced by the general reputation and stature of the central bank and its governors, as much as by its positive legal authority. As Carmine Di Noia and Giorgio Di Giorgio observe:

In some countries, an agency in charge of banking supervision could be formally separated from the central bank but acting very closely to it. Such an agency could, in reality, turn out to be strongly dependent on the central bank, even more dependent than a banking supervision department located inside the central bank in another country.²²

Given these qualifications, Figure 1 provides some quantitative data on the supervisory role of central banks in general.²³ Figure 1 illustrates the seat of primary bank supervision in the OECD countries. The term "primary bank supervision"²⁴ is used

19. *Id.* art. 25.2.

20. Of course, this issue is by no means closed off to debate; many proposals have been made that would alter the current scheme of supervisory responsibility. See Jeroen Kremers et al., *Does Europe Need a Euro-wide Supervisor?*, 6 FIN. REGULATOR 50 (2001).

21. The Federal Reserve retains such power. See *infra* Part III.A.

22. Di Noia & Di Giorgio, *supra* note 11, at 364 n.5.

23. Other studies have used slightly different dividing lines. For example, Di Noia and Di Giorgio examined whether the central banks had monopolist control over bank supervision in the then 25 OECD countries. See *id.* at 366 (table 1).

24. In this Article, this concept of "primary" bank supervisor is derived from U.S. law, under which various supervisory and regulatory provisions are

here to refer to the agency that conducts regular bank examinations. In Figure 1, central banks with such responsibility are noted in bold.

Figure 1 is constructed to identify which central banks are *primary* bank supervisors rather than which central banks have a *role* in bank supervision. Few would debate the need for a central bank to be involved — at some level — in bank supervision. This will remain true as long as: (1) banks remain important to the overall economy; (2) central banks are responsible for the payment system; and (3) central banks are the lend-

the responsibility of the “appropriate federal banking agency.” Federal Banking law defines the term “appropriate Federal banking agency” to mean:

(1) the Comptroller of the Currency, in the case of any national banking association, any District bank, or any Federal branch or agency of a foreign bank;

(2) the Board of Governors of the Federal Reserve System, in the case of —

(A) any State member insured bank (except a District bank),

(B) any branch or agency of a foreign bank with respect to any provision of the Federal Reserve Act, 12 U.S.C. § 221 *et seq.*, which is made applicable under the International Banking Act of 1978, 12 U.S.C. § 3101 *et seq.*,

(C) any foreign bank which does not operate an insured branch,

(D) any agency or commercial lending company other than a Federal agency,

(E) supervisory or regulatory proceedings arising from the authority given to the Board of Governors under section 7(c)(1) of the International Banking Act of 1978, 12 U.S.C. § 3105 (c)(1), including such proceedings under the Financial Institutions Supervisory Act of 1966, and

(F) any bank holding company and any subsidiary of a bank holding company (other than a bank);

(3) the Federal Deposit Insurance Corporation in the case of a State nonmember insured bank (except a District bank), or a foreign bank having an insured branch; and

(4) the Director of the Office of Thrift Supervision in the case of any savings association or any savings and loan holding company. Under the rule set forth in this subsection, more than one agency may be an appropriate Federal banking agency with respect to any given institution.

12 U.S.C. § 1813(q) (2000).

ers of last resort. The true debate centers on two queries: (1) Should the central bank be *the* or *one of the* primary bank supervisors? (2) If the central bank is not a primary regulator, what then is its appropriate non-primary role? Figure 1 further notes whether the primary bank supervisor is also an integrated supervisor.

Figure 1: OECD Countries: Agency with Primary Bank Supervisory Authority

| Country | Primary Bank Supervisory Authority | Notes and References |
|----------------|--|--|
| Australia | Australian Prudential Regulatory Authority | The APRA is responsible for prudential regulation of banks and insurance companies. http://www.apra.gov.au . |
| Austria | Finanzmarktaufsicht (Austrian Financial Market Authority) | The FMA was established on April 1, 2002 as an integrated financial supervisor. http://www.fma.gov.at |
| Belgium | Commission Bancaire et Financière (Banking and Finance Commission) | http://www.cbf.be/mov.htm |
| Canada | Office of the Superintendent of Financial Institutions | http://www.osfi-bsif.gc.ca/eng/default.asp |
| Czech Republic | Ceska narodni banka (Czech National Bank) | http://www.cnb.cz/en/index.php |

| | | |
|---------|---|---|
| Denmark | Finanstilsynet (Danish Financial Supervisory Authority) | The FSA is an integrated financial supervisor organized under the Minister for Economic Affairs. http://www.ftnet.dk |
| Finland | Rahoitustarkastus (Financial Supervision Authority) | The FSA was established in 1993 as an integrated financial supervisor. Furthermore, the FSA "operates in connection with the Bank of Finland but is an independent decision-making body." http://www.raha.bof.fi/english/index.asp |
| France | La Commission Bancaire (The Banking Commission) | While the Banking Commission conducts bank examinations, the Banque de France provides the Commission with some staff and resources. http://www.banque-france.fr/gb/baque/main.htm |

| | | |
|---------|---|---|
| Germany | Bundesanstalt für Finanzdienstleistungsaufsicht ("BAFin") (German Financial Supervisory Authority) | BAFin was established on May 1, 2002 as an integrated financial supervisor. http://www.bafin.de/english/index_e.htm |
| Greece | Τράπεζα της Ελλάδος (Bank of Greece) | http://www.bankofgreece.gr/en/ |
| Hungary | Zügyi Szervezetek Állami Felügyelete (Hungarian Financial Supervisory Authority) | The FSA was established in April 2000 as an integrated financial supervisor. http://www.pszaf.hu/english/start.html |
| Iceland | Fjármálaeftirlitið (Financial Supervisory Authority) | The FME was established in 1998 as an integrated financial supervisor. http://www.fme.is/fme.nsf/pages/index.html |

| | | |
|---------|--|---|
| Ireland | Banc Ceannais na Héireann (Central Bank of Ireland) | The Bank is an integrated financial supervisor. "The Bank is statutorily responsible for the supervision of most financial institutions in Ireland including banks, building societies and a broad range of non-bank firms, exchanges and collective investment schemes." See http://www.centrabank.ie/mainpage.asp |
| Italy | Banca d'Italia (Bank of Italy) | http://www.bancaditalia.it |
| Japan | Financial Services Agency | The FSA was established in 1998 as an integrated financial supervisor. http://www.fsa.go.jp/indexe.html |
| Korea | Financial Supervisory Commission | The FSC was established on April 1, 1998 as an integrated financial supervisor. http://www.fsc.go.kr/eng/about/index.htm |

| | | |
|-------------|--|---|
| Luxembourg | Commission de Surveillance du Secteur Financier ("CSSF") | CSSF is an integrated supervisor (banking and securities). http://www.cssf.lu |
| Mexico | Comision Nacional Bancaria y de Valores (National Banking and Securities Commission) | CNBV is an integrated supervisor (banking and securities). http://www.cnbv.gob.mx |
| Netherlands | De Nederlandsche Bank (Nederlandsche Bank) | http://www.dnb.nl/english/index.htm |
| New Zealand | Reserve Bank of New Zealand | http://www.rbnz.govt.nz/banking/supervision/index.html |
| Norway | Kredittilsynet | Kredittilsynet is an integrated financial supervisor. http://www.kredittilsynet.no |
| Poland | Nadzór Bankowy (Commission for Banking Supervision). | It has strong ties to the National Bank of Poland ("NBP"). For example, the Commission's Chairperson is the president of the NBP.) http://www.nbp.pl/en/onbp/index.html (see "banking supervision" for a description of the Commission) |
| Portugal | Banco de Portugal (Bank of Portugal) | http://www.bportugal.pt/default_e.htm |

| | | |
|-----------------|--|--|
| Slovak Republic | Narodna banka slovenska (National Bank of Slovakia) | http://www.nbs.sk/INDEXA.HTM |
| Spain | Banco de España (Bank of Spain) | http://www.bde.es/homee.htm |
| Sweden | Finaansinspektionen (Swedish Financial Supervisory Authority) | Finannsinspektionen is an integrated financial supervisor. http://www.fi.se/english/index.asp |
| Switzerland | Eidgenössische Bankenkommision (Swiss Federal Banking Commission) | http://www.sfb.admin.ch/ |
| Turkey | Hazine Müsteşarlığı (Turkish Treasury) | http://www.treasury.gov.tr/indexe.htm |
| United Kingdom | Financial Services Authority | The FSA was established on December 1, 2001 as an integrated financial supervisor. http://www.fsa.gov.uk/ |
| United States | Federal Reserve , Office of the Comptroller of the Currency ("OCC"), Federal Deposit Insurance Corporation ("FDIC"), State Agencies | http://www.federalreserve.gov/default.htm (Fed); http://www.occ.treas.gov/index.htm (OCC); http://www.fdic.gov/ (FDIC); http://www.csbs.org/links/state_links.asp (state banking agencies) |

In one-third of OECD countries, the central banks possess primary responsibility for bank supervision. The percentage can also be stated differently. In France, Poland, and Finland, the supervisory agencies are separate, but still have strong ties to the central bank.²⁵ If France, Poland, and Finland are included as countries whose central banks are primary bank supervisors, then 43% of OECD countries task their central banks with primary bank supervision.

Figure 1 also displays a significant recent phenomenon. Thirteen of the thirty OECD countries have integrated financial supervisory authorities, almost all of which were rather recently established. Most noteworthy in the context of the role of central banks is that only one of the integrated financial supervisors is a central bank (Central Bank of Ireland). Against this backdrop, Part III compares the supervisory roles of the Bank of England and the Federal Reserve following recent legislative initiatives.

III. THE ROLE OF THE CENTRAL BANK IN BANK SUPERVISION UNDER THE FSMA AND GLBA

Many OECD countries have enacted legislation that alters the regulatory responsibilities of existing financial regulators or creates new agencies. It is particularly interesting to study the recent approaches of the U.S. and U.K. given the very different results achieved in terms of the role to be played by the central bank. This Part describes the roles envisioned for the Federal Reserve and the Bank of England following the passage of the GLBA and FSMA, respectively.

A. *The Federal Reserve*

Prior to the passage of the GLBA, the Federal Reserve was the primary regulator for state member banks and for bank holding companies.²⁶ Under the GLBA, the Federal Reserve retains these responsibilities and is also the primary regulator for the new financial holding companies,²⁷ which are also bank

25. See *supra* Figure 1.

26. Federal Reserve Act of 1913, 12 U.S.C. § 221 (2000).

27. Financial holding companies are the vehicle for expanded activities permitted under the GLBA. See generally Heidi Mandanis Schooner & Michael Taylor, *United Kingdom and United States Responses to the Regulatory*

holding companies. The Federal Reserve's role as primary regulator for state member banks gives it hands-on responsibility for only a small percentage of deposit institutions.²⁸ Conversely, the Federal Reserve's authority over bank holding companies gives it, at least, indirect access to most banks and certainly the most important ones. Bank holding companies continue to control the vast majority of U.S. bank assets. In 2001, 6,318 bank holding companies operated in the U.S. and controlled 6,420 insured commercial banks.²⁹ Commercial banks controlled by bank holding companies held 94.2% of all insured commercial bank assets.³⁰

Because of the restrictions the GLBA places on the activities of bank subsidiaries,³¹ the Federal Reserve retained a meaningful role in supervision as the primary regulator of bank holding companies (including financial holding companies).³² Nonetheless, Congress demonstrated a clear preference for direct regulation by the functional regulators rather than the Federal Reserve. For example, the GLBA provides that the Federal Reserve may require reports³³ from bank holding companies and their subsidiaries, but that "the Board shall, to the fullest extent possible, accept" reports that the bank holding company or

Challenges of Modern Financial Markets, 38 TEX. INT'L L.J. 317 (2003) [hereinafter Schooner & Taylor, *U.K. and U.S. Responses*].

28. In 2001, the Federal Reserve Banks examined 534 of the 970 state member banks. State member banks accounted for 12.1% of all insured commercial banks and held 25.9% of all U.S. commercial bank assets. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, EIGHTY-EIGHTH ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM 143 (2001), available at <http://www.federalreserve.gov/boarddocs/rptcongress/annual01/ar01.pdf> [hereinafter 2001 ANNUAL REPORT OF THE FEDERAL RESERVE].

29. *Id.*

30. *Id.*

31. See Schooner & Taylor, *U.K. and U.S. Responses*, *supra* note 27, at 325.

32. In the absence of significant restrictions on the activities of bank subsidiaries, banking firms could choose to forego the bank holding company structure and thereby avoid Federal Reserve supervision entirely.

33. Such required report must relate to "(i) [the bank holding company's or subsidiary's] financial condition, systems for monitoring and controlling financial and operating risks, and transactions with depository institution subsidiaries of the bank holding company; and (ii) compliance by the company or subsidiary with applicable provisions of [the GLBA] or any other Federal law that the Federal Reserve has specific jurisdiction to enforce against such company or subsidiary." 12 U.S.C. § 1844(c)(1)(A) (2000).

subsidiary has provided to other state or federal regulators.³⁴ Moreover, in a case in which the Federal Reserve requests a report from a functionally regulated subsidiary³⁵ of a bank holding company that is not already required by another federal or state regulator, the Federal Reserve “shall first request that the appropriate regulatory authority or self-regulatory organization obtain such report.”³⁶

Similarly, the GLBA vests the Federal Reserve with authority to examine bank holding companies and their subsidiaries. Yet the Federal Reserve may examine a functionally regulated subsidiary of a bank holding company only if:

34. 12 U.S.C. § 1844(c)(1)(B)(i)(I) (2000).

35. A functionally regulated subsidiary is:

any company —

(A) that is not a bank holding company or a depository institution; and

(B) that is —

(i) a broker or dealer that is registered under the Securities Exchange Act of 1934;

(ii) a registered investment adviser, properly registered by or on behalf of either the Securities and Exchange Commission or any State, with respect to the investment advisory activities of such investment adviser and activities incidental to such investment advisory activities;

(iii) an investment company that is registered under the Investment Company Act of 1940;

(iv) an insurance company, with respect to insurance activities of the insurance company and activities incidental to such insurance activities, that is subject to supervision by a State insurance regulator; or

(v) an entity that is subject to regulation by the Commodities Futures Trading Commission, with respect to the commodities activities of such entity and activities incidental to such commodities activities.

12 U.S.C. § 1844(c)(5) (2000).

36. 12 U.S.C. § 1844(c)(1)(B)(iii)(I) (2000). If the Federal Reserve does not receive such a report and the report is “necessary to assess a material risk to the bank holding company or any of its depository institution subsidiaries” then the Federal Reserve may require the report from the functionally regulated subsidiary. 12 U.S.C. § 1844(c)(1)(B)(iii)(II) (2000).

- (i) the Board has reasonable cause to believe that such subsidiary is engaged in activities that pose a material risk to an affiliated depository institution,
- (ii) the Board reasonably determines, after reviewing relevant reports, that examination of the subsidiary is necessary to adequately inform the Board of [the systems for monitoring and controlling financial and operational risks], or
- (iii) based on reports and other available information, the Board has reasonable cause to believe that a subsidiary is not in compliance with this Act or any other Federal law that the Board has specific jurisdiction to enforce against such subsidiary . . . and the Board cannot make such determination through examination of the affiliated depository institution or bank holding company.³⁷

Therefore, following the passage of the GLBA, the Federal Reserve ceased annual examination of subsidiaries conducting securities activities (formerly known as "Section 20 subsidiaries").³⁸ Even with regard to the Federal Reserve's examination of depository institutions, the GLBA instructs the Federal Reserve to defer "to the fullest extent possible" to the appropriate federal or state banking regulator.³⁹

The Federal Reserve has limited authority to set capital standards for bank holding company subsidiaries that are not depository institutions.⁴⁰ Furthermore, unless the Federal Reserve possesses specific jurisdiction to do so, the Federal Reserve may not prescribe regulations or impose administrative restrictions on any functionally regulated subsidiary unless:

- (1) the action is necessary to prevent or redress an unsafe or unsound practice or breach of fiduciary duty by such subsidiary that poses a material risk to –
 - (A) the financial safety, soundness, or stability of an affiliated depository institution; or
 - (B) the domestic or international payment system; and

37. 12 U.S.C. § 1844(c)(2)(B) (2000). The Federal Reserve conducted no special examinations of this kind in 2001. See 2001 ANNUAL REPORT OF THE FEDERAL RESERVE, *supra* note 28, at 146.

38. 2001 ANNUAL REPORT OF THE FEDERAL RESERVE, *supra* note 28, at 145.

39. 12 U.S.C. § 1844(c)(2)(D) (2000).

40. 12 U.S.C. § 1844(c)(3) (2000).

(2) the Board finds that it is not reasonably possible to protect effectively against the material risk at issue through action directed at or against the affiliated depository institution or against depository institutions generally.⁴¹

Consistent with the framework envisioned by Congress, the Federal Reserve describes its supervisory role with regard to financial holding companies (“FHCs”) as distinct from supervision over traditional banking holding companies (“BHCs”):

The Federal Reserve’s supervisory oversight role is that of an umbrella supervisor concentrating on a consolidated or group-wide analysis of an organization. Umbrella supervision is not viewed as an extension of more traditional bank-like supervision throughout an FHC. The FHC framework [of supervision] is consistent with and incorporates principles that are well established for BHCs.⁴²

While the Federal Reserve’s role as umbrella supervisor is not intended to duplicate the role of the banking agencies, its regulatory role remains focused on safety and soundness and not on other goals of financial regulation, such as consumer protection. In describing the objectives of financial holding company supervision, the Federal Reserve states:

The Federal Reserve, as umbrella supervisor, will seek to determine that FHCs are operated in a safe and sound manner so that their financial condition does not threaten the viability of affiliated depository institutions. Oversight of FHCs (particularly those engaged in a broad range of financial activities) at the consolidated level is important because the risks associated with those activities can cut across legal entities and business lines. The purpose of FHC supervision is to identify and evaluate, on a consolidated or group-wide basis, the significant risks that exist in a diversified holding company in order to assess how these risks might affect the safety and soundness of depository institution subsidiaries.⁴³

41. 12 U.S.C. § 1848a (2000).

42. Framework for Financial Holding Company Supervision, Letter from the Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, to the Officer in Charge of Supervision and Appropriate Supervisory Staff at Each Federal Reserve Bank and to Financial Holding Companies (Aug. 15, 2000), *available at* <http://www.federalreserve.gov/boarddocs/SRLETTERS/2000/SR0013.htm>.

43. *Id.*

B. Bank of England

Pursuant to the Bank of England Act of 1998, responsibility for regulating depository institutions was transferred from the Bank of England ("the Bank") to the Securities and Investments Board (later, the FSA).⁴⁴ Under the FSMA, the FSA was established as regulator for banking, securities, and insurance firms. Despite the divorce of the Bank from the formal supervision of banks, there is little doubt that this institution will continue to play an important role in bank supervision.

The Bank has three core purposes,⁴⁵ two of which have strong ties to bank supervision. First, the Bank is charged with "maintaining the integrity and value of the currency."⁴⁶ Second, the Bank must promote the stability of the financial system.⁴⁷ Third, the Bank must promote the effectiveness of the financial system.⁴⁸ The second core purpose relates directly to bank supervision and, according to the Bank, translates into three main areas of work:

- 1/ analysing, and promoting initiatives to strengthen, the financial system's capacity to withstand shocks;
- 2/ surveillance, that is monitoring developments in the financial system to try to identify potential threats to financial stability at an early stage; and
- 3/ reinforcing arrangements for handling financial crises should they occur.⁴⁹

Further recognition of the Bank's role in supervision is found in the Memorandum of Understanding between HM Treasury, the Bank of England, and the FSA ("MoU"), which provides that "[t]he Bank will be responsible for the overall stability of the

44. Heidi Mandanis Schooner & Michael Taylor, *Convergence and Competition: The Case of Bank Regulation in Britain and the United States*, 20 MICH. J. INT'L L. 595, 646-47 (1999) [hereinafter Schooner & Taylor, *Convergence and Competition*].

45. BANK OF ENGLAND, BANK OF ENGLAND 2002 ANNUAL REPORT 16 (2002), available at <http://www.bankofengland.co.uk/annualreport/2002report.pdf> [hereinafter BANK OF ENGLAND 2002 ANNUAL REPORT].

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

financial system as a whole⁵⁰ Apart from its specific monetary policy and payments systems responsibilities, the Bank is responsible for the:

broad overview of the system as a whole. The Bank will be uniquely placed to do this: it will be responsible for monetary stability, and will have high level representation at the institution responsible for financial regulation (through the Deputy Governor (financial stability), who will be a member of the Financial Services Authority Board). Through its involvement in the payments systems it may be the first to spot potential problems. The Bank will be able to advise on the implications for financial stability of developments in the domestic and international markets and payments systems; and it will assess the impact on monetary conditions of events in the financial sector⁵¹

Further, the MoU contemplates “official financial operations” by the Bank in exceptional circumstances to prevent systemic breakdown.⁵² Finally, the Bank is charged with “the efficiency and effectiveness of the financial sector, with particular regard to international competitiveness.”⁵³ Many of these responsibilities will dovetail with bank supervision. One specific recent example of the Bank’s continued involvement in bank regulation is the Bank’s representation, along with the FSA, of the U.K. in negotiations regarding the new Basel Capital Accord.⁵⁴

IV. SHOULD CENTRAL BANKS SUPERVISE?

Driven in part by the question of bank supervision in euro-area countries,⁵⁵ a growing body of literature addresses whether central banking and bank supervision should be combined.⁵⁶

50. Memorandum of Understanding between HM Treasury, the Bank of England and the FSA ¶ 2 (Oct. 28, 1997), available at <http://www.bankofengland.co.uk/legislation/mou.pdf>.

51. *Id.* ¶ 2(iii).

52. *Id.* ¶ 2(iv).

53. *Id.* ¶ 2(v).

54. BANK OF ENGLAND 2002 ANNUAL REPORT, *supra* note 45, at 22.

55. *See supra* Part II.

56. *See, e.g.,* Di Noia & Di Giorgio, *supra* note 11; Charles Goodhart & Dirk Schoenmaker, *Should the Functions of Monetary Policy and Banking Supervision Be Separated?*, 47 OXFORD ECON. PAPERS 539 (1995) [hereinafter Goodhart & Schoenmaker, *Monetary Policy and Banking Supervision*]; Charles Goodhart & Dirk Schoenmaker, *Institutional Separation Between Supervisory*

This Part summarizes both theoretical and empirical arguments for and against the separation of central banking and bank supervision. These arguments are presented in three categories: (1) the combination of macroeconomic and microeconomic goals; (2) the concentration of power; and (3) independence and other institutional considerations.

A. *Combination of Macroeconomic and Microeconomic Goals*

Reluctance to task central bankers with bank supervision most often focuses on the ways in which the macroeconomic goals (price stability)⁵⁷ and microeconomic goals (safety and soundness) can conflict. A central bank may be more willing to lend to banks it supervises and this may conflict with monetary policy goals.⁵⁸ Moreover, the central bank might be tempted to manipulate policy instruments, e.g., interest rates, to benefit

and Monetary Agencies, 51 *GIORNALE DEGLI ECONOMISTI E ANNALI DI ECONOMIA* 353 (1993) [hereinafter Goodhart & Schoenmaker, *Institutional Separation*]; Joseph G. Haubrich, *Combining Bank Supervision and Monetary Policy*, *ECON. COMMENT. SERIES* (Nov. 1996), at <http://www.clev.frb.org/research/com/1196.htm>; H. Robert Heller, *Prudential Supervision and Monetary Policy*, in *THE EVOLVING ROLE OF CENTRAL BANKS* 57 (Patrick Downes & Reza Vaez-Zadeh eds., 1991); EDUARDO LUNDBERG, *MONETARY POLICY AND BANKING SUPERVISION FUNCTIONS ON THE CENTRAL BANK (Banco Central Do Brasil, Working Paper Series 2, 2002)*, at <http://www.bcb.gov.br/ingles/public/wps/wps02.pdf>; Joe Peek et al., *Is Bank Supervision Central to Central Banking?*, 114 *Q. J. ECON.* 629 (1999); José Tuya & Lorena Zamalloa, *Issues on Placing Banking Supervision in the Central Bank*, in *FRAMEWORKS FOR MONETARY STABILITY: POLICY ISSUES AND COUNTRY EXPERIENCES* 663 (Tomás J.T. Baliño & Carlo Cottarelli eds., 1994).

57. The term "price stability" is used here as a generalized label for the monetary policy goal of central banks. Of course, the specific goals of individual central banks may vary. The Federal Reserve's statutory mandate with regard to monetary policy is as follows:

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.

Federal Reserve Act of 1913, 12 U.S.C. § 225a (2000).

58. The significance of this conflict is questionable given the central bank's ability to off-set the effect of lending to an individual bank through its open market operations. See Goodhart & Schoenmaker, *Institutional Separation*, *supra* note 56, at 361.

banks under its supervision.⁵⁹ This line of reasoning draws on a regulatory capture premise, i.e., that the central bank will ignore its monetary objectives in favor of furthering the interests of its regulated constituents.⁶⁰

Similar to the conflict-oriented analysis is the preference for a single purpose. The principle is that a central bank performs better when it is focused on a single goal (i.e., price stability) as opposed to two (i.e., price stability and safety and soundness). In support of these arguments, Carmine Di Noia and Giorgio Di Giorgio found that central banks achieve better price stability when they are not required to juggle price stability with sole responsibility for bank supervision.⁶¹

The conflict of interest arguments may underestimate the trade-offs faced by central banks. As a practical matter, central banks can face multiple, and sometimes conflicting, macroeconomic objectives. For example, the Federal Reserve, by statute, is bound by the goals of "maximum employment, stable prices, and moderate long-term interest rates."⁶² It may be true that any conflict created by the combination of macro- and microeco-

59. As Goodhart and Schoemaker explain:

[T]he conflict of interest may arise between the monetary authorities, who wish for higher rates (e.g. to maintain an exchange rate peg, to bear down on inflation, or to reduce the pace of monetary growth), and the regulatory authorities who are frightened about the adverse effects such higher rates may have upon the bad debts, profitability, capital adequacy, and solvency of the banking system. It is in this guise that the conflict has, indeed, from time to time occurred.

Id.

60. For a recent study showing "that the separation of powers in regulation may act as a commitment against the threat of regulatory capture," see Jean-Jacques Laffont & David Martimort, *Separation of Regulators Against Collusive Behavior*, 30 RAND J. ECON. 232 (1999). This provides further support for arguments in favor of regulatory competition. See *infra* Part IV.B.

61. Di Noia and Di Giorgio conclude:

We find that the inflation rate is considerably higher and more volatile in countries where the central bank acts as a monopolist in banking supervision than in countries where this responsibility is assigned either to another agency or to more than one agency (possibly including the central bank).

Di Noia & Di Giorgio, *supra* note 11, at 361.

62. 12 U.S.C. § 225a (2000).

conomic goals is less troublesome than the conflicts within the macroeconomic goals.⁶³

Support for combining central banking with bank supervision focuses on the positive synergies between the macroeconomic and microeconomic goals. This is especially true in countries with bank-centered capital raising markets.⁶⁴ Empirical research suggests that confidential supervisory information can assist central banks in achieving monetary goals.⁶⁵ Close relationships with banks will assist the central bank in anticipating the direction of the economy and in addressing financial crises. Intimate knowledge of banks will avoid inappropriate access to lender of last resort lending. Bank supervision enables the central bank to protect the payments system from the risk of contagion.

A recent U.S. study found that the Federal Reserve's "monetary policy responsibilities do alter its bank supervisory role . . . In particular, the stance of monetary policy, as captured by the federal funds rate, affects the supervisory behavior of the FED, but does not affect the behavior of the [FDIC and OCC]."⁶⁶

63. In 1995, Goodhart and Schoenmaker observed regarding the experience of the Bank of England:

In any case, the experience of the UK, an example of a country with a politically subservient central bank, suggests that such conflicts of interest between regulatory and monetary objectives are an order of magnitude less important than conflicts between purely monetary objectives and political imperatives.

Goodhart & Schoenmaker, *Monetary Policy and Banking Supervision*, *supra* note 56, at 546.

64. See Peek et al., *supra* note 56, at 651.

65. See *id.* (study on the use of confidential supervisory information by the Federal Reserve). Importantly, this study notes that the Federal Reserve could obtain confidential supervisory information without actually being a bank supervisor. *Id.* at 647. However, the authors conclude that "hands-on' supervisory experience may be necessary to identify the nuances of changes in bank health that contribute to the effective conduct of monetary policy." *Id.* at 652.

66. Vasso P. Ioannidou, *Does Monetary Policy Affect the Central Bank's Role in Bank Supervision?*, Tilburg University Center Discussion Paper 2002-54, at 23 (unpublished manuscript, on file with author). Ioannidou found that:

[W]hen the FED increases the federal funds rate, it becomes less strict with respect to its bank supervisory role. One explanation is that the FED compensates banks for the extra pressure it puts on

This finding does not necessarily favor the separation or the combination of the two functions. It does, however, highlight the fact that the safety and soundness of banks is linked strongly to the performance of the overall economy. All other things being equal, strength in monetary policy should lead to easier bank supervision.

B. Concentration of Power

Opposition to the combination of monetary and supervisory tasks is sometimes premised on an aversion to concentration of power. Particularly in the U.S., the public remains suspicious of big government; this sentiment prevails in popular press coverage of the Federal Reserve.⁶⁷ In addition to the public's suspicions, concentration of power in a single agency can pose particular problems for the regulated. Some of the normal checks against the abuse of regulatory power might be chilled when the regulatory function is combined with other power. For example, a bank might be reluctant to challenge regulatory actions (anything from proposed rulemaking to an enforcement action) for fear that the central bank might retaliate by imposing higher reserves and limiting access to other services.

When the central bank is the sole bank supervisor, the benefits of regulatory competition⁶⁸ are also lost. This observation favors separation of the monetary and supervisory functions but also suggests that supervisory functions should be divided

them when it increases the funds rate, either because it views them as its constituency or because it is concerned about the micro-stability of the financial sector.

Id. The study relied on formal enforcement actions as a measurement of bank supervision.

67. Popular books about the Federal Reserve include: MURRAY N. ROTHBARD, *THE CASE AGAINST THE FED* (1994); EUSTACE MULLINS, *THE SECRETS OF THE FEDERAL RESERVE: THE LONDON CONNECTION* (1983); WILLIAM GREIDER, *SECRETS OF THE TEMPLE: HOW THE FEDERAL RESERVE RUNS THE COUNTRY* (1987).

68. For a discussion of regulatory competition in the context of financial institutions, see Edward J. Kane, *Competitive Financial Regulation: An International Perspective*, in *THREATS TO INTERNATIONAL FINANCIAL STABILITY* 111 (Richard Portes & Alexander K. Swoboda eds., 1987). See also Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 *STAN. L. REV.* 1 (1977) (exploring the issue of domestic regulatory competition in detail).

among multiple regulatory agencies. In the U.S., three federal government agencies — the Federal Reserve, Office of the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”) — and individual state agencies, share supervisory responsibility.

Most observations regarding concentration of power are negative, but for some, particularly developing, countries, such concentration may prove beneficial. In some countries, the stature of the central bank may be a necessary force behind a nascent supervisory regime. Centralized power may be necessary to compel a change in the culture of regulation.

With power comes responsibility. A central bank that performs poorly as a bank supervisor may suffer from lost credibility, which could seriously compromise its effectiveness in implementing monetary policy.⁶⁹ On the other hand, a central bank or other supervisor without clear regulatory responsibility can escape blame for poor performance.

C. Independence and Other Institutional Considerations

Recent support for central bank independence is strong and has translated into an international trend.⁷⁰ The need for independence in the implementation of monetary policy, however, does not necessarily commute to bank supervision. On the one hand, bank supervisors might be more effective when they are insulated from political pressures.⁷¹ On the other hand, to the extent that bank supervision involves the activities and interests of individuals and firms, bank supervision should be sub-

69. For an interesting discussion on why credibility is so important to central bankers, see ALAN S. BLINDER, *CENTRAL BANKING IN THEORY AND PRACTICE* 62–66 (1998).

70. See generally Michael Taylor, *Central Bank Independence: The Policy Background*, in BLACKSTONE'S GUIDE TO THE BANK OF ENGLAND ACT 10 (1998); Geoffrey Miller, *An Interest-group Theory of Central Bank Independence*, 27 J. LEGAL STUD. 433 (1998); BLINDER, *supra* note 69, at 53–76.

71. Lastra advocates for some degree of independence for bank supervisors and contends “that the US Savings and Loan Associations’ debacle might have been prevented or at least mitigated had non-political considerations more firmly prevailed in their supervision.” ROSA MARIA LASTRA, *CENTRAL BANKING AND BANKING REGULATION* 55 (1996).

ject to the kinds of checks and balances provided by judicial review and political accountability.⁷²

Independence in monetary policy is achieved in several ways. One way is to ensure that the policymaker has freedom in the means for achieving goals proscribed by the legislator. For example, the Federal Reserve is mandated to pursue the goals of "maximum employment, stable prices, and moderate long-term interest rates,"⁷³ but the decisions of the Federal Open Market Committee on how to achieve those goals are practically irreversible.⁷⁴ Another way to achieve independence is through independent funding. For example, the Federal Reserve's operations are funded not through appropriations, but through assessment on the Reserve Banks.⁷⁵

Consideration of the source of funding is important to the question of separation of monetary policy and supervision. When a bank rescue is funded privately, the public's desire for oversight is less than when a bank rescue is funded through the taxpayer. In this regard, Charles Goodhart and Dirk Schoemaker observe:

When the government has been providing the funds, either directly to rescue the banks, or indirectly via institutions established to support the banking system, it is likely to wish to have a final oversight in the operation of the regulatory system. He who pays the piper calls the tune. As the rescues are increasingly being financed by the tax-payer, so the responsi-

72. In fact, the Federal Reserve does not enjoy the same independence when acting as a bank supervisor as it does when implementing monetary policy. For example, when the Federal Reserve initiates an enforcement action against a bank or bank manager, the Federal Reserve is subject to the same judicial review as the other federal banking agencies. In bringing formal enforcement proceedings such as cease and desist orders, civil money penalties, and removal and prohibition orders, the Federal Reserve is the "appropriate Federal banking agency" ("AFB") for state member banks. The OCC is the AFB for national banks; the FDIC for state nonmember banks; and the Office of Thrift Supervision ("OTS") for savings institutions. 12 U.S.C. § 1813(q) (1996). Judicial review for enforcement actions brought by any of the AFBs is set forth in 12 U.S.C. § 1818(8)(D) (2000).

73. 12 U.S.C. § 225a (2000).

74. See BLINDER, *supra* note 69, at 55. Taylor argues that the true source of the Federal Reserve's independence is political. See Taylor, *supra* note 70, at 14-15.

75. Schooner & Taylor, *Convergence and Competition*, *supra* note 44, at n.62.

bility for supervision and regulation of the system — in order to avoid excessive calls on such tax-payers' funding — has been passing more and more from central banks to separate agencies established under the aegis of the authorities.⁷⁶

While the observations regarding funding of bailouts may justify the separation of macro and micro economic functions, other institutional observations suggest the benefits of a central bank's involvement in supervision. Recently, Charles Goodhart, Dirk Schoenmaker, and Paolo Dasgupta studied the skills of central bank supervisors versus non-central bank supervisors.⁷⁷ They found that "central banks employ more economists and fewer lawyers in their supervisory/financial stability wing than non-central bank supervisory agencies."⁷⁸ Staffing with relatively more economists would seem to provide a better macro-economic perspective on supervision.⁷⁹

V. THE FSMA AND GLBA MODELS: ELEGANT ALTERNATIVES OR UNTESTED GUESSES?

The U.K. and the U.S. clearly diverge with regard to the role of the central bank in supervision.⁸⁰ The Bank of England, previously the primary supervisor of banks, lost its role entirely. It retains some involvement in bank supervision, but not in a hands-on sense. The Federal Reserve was and remains one of three primary federal bank supervisors.⁸¹ With the passage of the GLBA, the supervisory responsibilities of the Federal Reserve arguably increased and certainly did not diminish. With regard to the question of the central bank's role in supervision, both the British and American approaches could be described as elegant. Britain scores high marks for its direct and consoli-

76. Goodhart & Schoenmaker, *Monetary Policy and Banking Supervision*, *supra* note 56, at 543–44.

77. Charles Goodhart et al., *The Skill Profile of Central Bankers and Supervisors*, 6 EUR. FIN. REV. 397 (2002).

78. *Id.*

79. *Id.* The authors note that when consumer protection is the regulatory goal, legal skills are more appropriate. *Id.*

80. For a discussion of the reasons for such divergence, see Schooner & Taylor, *U.K. and U.S. Responses*, *supra* note 27.

81. For the purposes of discussion of the U.S. system of regulation, the term "bank" shall be used to refer to commercial banks and not savings associations.

dated approach to supervision and for its bold move with regard to the Bank of England. Quite simply, the FSA is the bank supervisor and the Bank of England is not. While some may wish to see the MoU⁸² as a hedge against a total severing of ties with the central bank, it remains clear that the prudential responsibility rests with the FSA.

In contrast, the GLBA approach may prove exquisite for its opposite tack. The complex division of supervision combined with Federal Reserve umbrella oversight potentially achieves a delicate balance of the pros and cons detailed in Part III. This Part examines whether, given the arguments for and against separation, the American or British system represents a superior solution in the current debate on the role of central banks in bank supervision. This Part will again consider the issues defined in Part IV: (1) combination of macro and microeconomic goals; (2) concentration of power; and (3) independence and other institutional considerations.

A. Combination of Macroeconomic and Microeconomic Goals

In a sense, Britain's approach to bank supervision provides the ultimate answer to the conflict between macro and microeconomic goals. Divorcing the Bank of England from direct supervision preserves a single macroeconomic focus⁸³ for the Bank and eliminates the conflict incentive. The question remains whether the Bank's continued limited role in supervision provides the Bank with sufficient tools to promote the stability of the financial system.⁸⁴ While few would quarrel with the appropriateness of the Bank's continued involvement in safety and soundness issues, the question remains whether, particularly in a crisis, this involvement will give the Bank sufficient competence with regard to individual financial institutions to do its job.

Given the dichotomous approaches, one might conclude that the Federal Reserve's role in supervision would leave it prey to conflicts, yet, at the same time, provide the synergistic benefits

82. See *supra* Part III.B.

83. Of course, the same cannot be said for the FSA. The FSA as an integrated supervisor is responsible for implementing diverse legal regimes, i.e., safety and soundness versus consumer protection.

84. This is one of the Bank's three core purposes. See *supra* Part III.B.

of close supervision of individual institutions. The reality is far more complex.

The Federal Reserve lacks the single focus granted to the Bank of England. The Federal Reserve is tasked with both monetary policy and bank supervision, and its role as a bank supervisor is further complicated by the fact that supervisory responsibility in the U.S. is dispersed among several regulators. The Federal Reserve is the primary supervisor for state-chartered member banks, but not for state-chartered non-member or national banks.⁸⁵ Of course, any bank that is part of a bank holding company or financial holding company is subject to Federal Reserve supervision, including examinations and reports. Still, the clear expectation is that the Federal Reserve will rely on the work of the FDIC and OCC with regard to the banks they supervise.⁸⁶ Under this scenario, the Federal Reserve is responsible for directly supervising 955 of the 8,005 commercial banks.⁸⁷ Those institutions hold \$1,706,559 million of the \$6,504,593 million total assets held by commercial banks. Of the 955 banks the Federal Reserve supervises, only 26 hold assets of \$10 billion or more, and the other 929 have assets under \$1 billion.

This means that the Federal Reserve is involved in the direct examination of many small banks. These examinations are conducted by the Reserve Banks and thus are physically separated from the policymakers in Washington, D.C. The benefit is that policymakers in Washington are less likely to be influenced by the needs of individual banks, with which the field offices have the direct contact. The downside is that policymakers may lack the intimate knowledge of the banks that the Federal Reserve supervises — keeping in mind that these are, for the most part, small banks.

This brings the focus back to the Federal Reserve's role as umbrella supervisor. The Federal Reserve retains the legal authority to supervise banks. Under certain circumstances, the Federal Reserve can conduct back-up examinations and demand

85. 12 U.S.C. § 1813q (2000). The FDIC is the primary federal regulator for state-chartered, non-member banks and the OCC is the primary federal regulator for national banks. *Id.*

86. *See supra* Part III.

87. These numbers are as of March 31, 2002. *See* FDIC Statistics on Banking, at <http://www.fdic.gov/bank/statistical/statistics/sectionc.html>.

reports of any bank and any non-bank subsidiary of a bank holding company.⁸⁸ In addition, the Federal Reserve conducts annual inspections of large bank holding companies. It conducted 1,212 such inspections (1,118 on site; 94 off site) in 2001.⁸⁹

Unlike the Bank of England, the Federal Reserve bears direct responsibility for the safety and soundness of bank holding companies and financial holding companies,⁹⁰ and thus has much greater incentive to exercise its secondary supervisory powers. Perhaps this provides both the incentive and legal access that will result in the Federal Reserve having sufficient intimacy of banks to achieve desired synergies. Balanced against this is Congress' clear intent for the Federal Reserve's role in supervision to be derivative — thereby leaving an unclear picture as to whether the Federal Reserve's role achieves an elegant balance of the evils of conflicts and the benefits of synergies.

Despite Congress' somewhat contradictory "give with one hand and take away with the other" approach to the Federal Reserve's role as umbrella supervisor, it remains clear that the Federal Reserve retains greater formal supervisory authority with regard to prudential matters than does the Bank of England. Still, the practical effect of this difference remains to be seen. The Bank of England had no formal authority for bank supervision until 1979. Before and after that time, the Bank often used an informal style of supervision that stands in contrast to the more formal, legalistic style employed in the U.S.⁹¹ Therefore, while the Bank of England has lost its formal authority to supervise banks, it may continue to exercise a significant level of informal control, drawing its role in supervision a bit closer to the formal role of the Federal Reserve. This is apt to be true in the short term, i.e., when many of the current FSA staff are former Bank of England employees. Over time, as this personnel connection dissipates, there may be less opportunity for informal influence by the Bank.

88. See *supra* notes 42–43 and accompanying text.

89. 2001 ANNUAL REPORT OF THE FEDERAL RESERVE, *supra* note 28, at 144.

90. See *supra* note 43 and accompanying text.

91. See generally, Schooner & Taylor, *Convergence and Competition*, *supra* note 44, at 621 (discussing the British style of moral suasion versus the formal style of supervision in the U.S.).

B. Concentration of Power

While the FSMA concentrates supervisory power in a single agency, it does not consolidate that supervisory power with the monetary authority. This is a consistent international experience. As discussed in Part I, among OECD countries, only Ireland has an integrated regulator that is also the central bank. This is also consistent with the current approach in euro-area countries. While monetary authority has been consolidated at the ECB, bank supervision has not.⁹² It is possible that bank supervision may eventually be consolidated into a central authority in Europe.⁹³ It seems unlikely, however, that such power will be vested in the European Central Bank given international trends.

The U.S. remains distant from the international trend toward integrated supervision. Banking, securities, and insurance regulators remain separate. Moreover, even within each of these traditional regimes, there are multiple regulators, i.e., multiple bank regulators, multiple securities regulators, and multiple insurance regulators. The GLBA retains the balkanized regulatory regime that has been a distinguishing mark of the U.S. system since the advent of the dual banking system. If there are advantages to this system, they lie in the potential benefits of regulatory competition. The disadvantages lurk in costly overlap and less than clear accountability. Moreover, it is important to highlight the fact that the U.S. has no integrated supervisor. The Federal Reserve's umbrella authority differs from the type of integrated supervision that has captured international attention. Such umbrella authority is prudential and only applies to the safety and soundness of banks, and not, for example, insurance companies. Therefore, the U.S. system does not capture the benefits, if any exist, of an integrated system of financial regulation.

While the GLBA avoids creating what might be seen as excessive concentration of power in an already very powerful Federal Reserve, it also disperses power in a way that allows accountability to be evaded in a crisis. In other words, if the Federal Reserve misreads or misreacts in the next crisis of banking

92. See *supra* Part III.

93. For discussion of the potential alternatives for European financial supervision, see Jeroen Kremers et al., *supra* note 20.

industry, it is quite possible that it could shift the blame to the primary bank regulators and other functional regulators, despite the Federal Reserve's role as umbrella supervisor.⁹⁴

C. Independence and Other Institutional Considerations

Recent U.S. history confirms the responsibility of taxpayers for financial institution failures. The savings and loan crisis of the 1980s cost taxpayers \$132.1 billion.⁹⁵ The extensive nature of deposit insurance in the U.S. led to an extensive role for the FDIC in bank supervision.⁹⁶ This reality is unlikely to change, especially given recent legislative efforts to increase deposit insurance coverage.⁹⁷

With the extensive and necessary involvement of the FDIC in bank supervision in the U.S.,⁹⁸ one can question the necessity of the Federal Reserve's involvement (or the OCC's involvement for that matter) in direct bank supervision. If the FDIC is ultimately financially responsible for bank failures, then the FDIC, and not other agencies, seems the most logical situs for bank supervision.⁹⁹

94. Of course, the converse is also true, i.e., functional regulators could attempt to shift blame to the Federal Reserve, claiming that the Federal Reserve failed in its capacity as umbrella supervisor.

95. FEDERAL DEPOSIT INSURANCE CORPORATION, 1 HISTORY OF THE EIGHTIES: LESSONS FOR THE FUTURE 39 (1997).

96. That is not to say that the Federal Reserve has not also been financially involved in bank rescues. For example, the Federal Reserve provided liquidity support to Continental Illinois Bank (1984), Bank of New York (1985), and Bank of England (1991). See Goodhart & Schoenmaker, *Institutional Separation*, *supra* note 56, at 435–37.

97. The House of Representatives recently passed a bill that would increase the already extensive deposit insurance coverage from \$100,000 to \$130,000. The Federal Deposit Insurance Reform Act of 2002, H.R. 3717, 107th Cong. § 3(a) (2002).

98. The FDIC has the authority to examine all banks holding FDIC-insured deposits and has the authority to bring enforcement actions against all such banks. The FDIC can also, under certain circumstances, provide open bank assistance. See generally The Banking Act of 1933, ch. 89, 48 Stat. 162 (1933) (codified as amended in scattered sections of 12 U.S.C.).

99. For further discussion on this point, see Heidi Mandanis Schooner, *Regulating Risk Not Function*, 66 U. CIN. L. REV. 441, 485 (1998).

Deposit insurance coverage is not nearly as extensive in Britain¹⁰⁰ and thus may not justify extensive involvement of the insurer in bank supervision. Moreover, the Bank of England's — and other central banks' — ability and willingness to coordinate and fund bank rescues may have diminished.¹⁰¹ Again, this supports the separation of functions in Britain.

Notwithstanding the above, a central bank's interest in systemic failures implicates its involvement, at some level, in bank supervision. This brings the discussion back to the question of whether a central bank's indirect involvement, like that of the Bank of England or the Federal Reserve's umbrella authority, is sufficient in a time of crisis.¹⁰²

Finally, fundamental differences in the style of regulation in the U.S. and the U.K. may also affect the question of separation. Historically, the U.S. has relied on an increasingly formal style of bank regulation, under which specific statutory controls, e.g., capital regulations and prompt corrective action, are the means of supervision. While the U.K.'s system of regulation has also become increasingly formal, it remains less reliant on specific statutory provisions and more on agency discretion.¹⁰³ These differences may implicate different skills on the part of the supervisory staff. It may be the case that the U.S. system of bank supervision is implemented effectively by the legal staffs

100. The Financial Services Compensation Scheme compensates for the first £2,000 in deposits and then 90% of the next £33,000 in deposits. See FSCS, *Compensation Limits*, at http://www.fscs.org.uk/about_us/compensation_limits/ (last visited March 5, 2003).

101. Goodhart and Schoenmaker conclude:

But central banks *are* tending to retreat from their previous primary role [in bank rescues] for two related reasons. First the banking system is becoming less clearly defined, fuzzier; consequently it is more difficult to persuade the members of the banking club to agree to cooperate in financing rescues. So, the second reason is that the central bank is less able to organize co-operation on a self-regulatory basis. There is more need to turn to the Government both for statutory measures, and for ultimate financial support. This latter means that the regulatory/supervisory function is tending to shift away from central bank control to an independent body more directly under political control.

Goodhart & Schoenmaker, *Institutional Separation*, *supra* note 56, at 384.

102. See *supra* Part IV.A.

103. For a full discussion of these differences in style, see Schooner & Taylor, *Convergence and Competition*, *supra* note 44, at 647.

that are typically employed when bank supervision is separate from the central bank.¹⁰⁴ On the other hand, a system that relies on a more informal system of control may require the skills of economists, such as those on the staffs of a central bank.

VI. CONCLUSION

The GLBA might be justified as a complex but elegant solution to the many advantages and disadvantages of combining macro- and microeconomic goals.¹⁰⁵ Through its umbrella authority, the Federal Reserve has access to bank confidential information that could improve its macroeconomic performance. Yet, it remains unclear whether Congress' affinity for functional regulation means that the Federal Reserve will be rendered somewhat detached and therefore unable to take advantage of the synergies available when monetary policy and bank supervisory functions are combined.

The Federal Reserve's continued role as primary supervisor of state member banks lacks justification. If the Federal Reserve is to remain one of the primary bank supervisors, it would make more sense for the Federal Reserve to be responsible for examination of the largest banks, for which issues of systemic stability are salient.¹⁰⁶ Alternatively, given the FDIC's extensive involvement in bank supervision, one might question the necessity of any central bank involvement in direct supervision.

In the absence of proven success of integrated supervisors,¹⁰⁷ it is doubtful that the U.S. will adopt an integrated model. One of the reasons is that it appears that a precondition to the integrated model is the separation of the central bank from the integrated supervisor.¹⁰⁸ The stature of the Federal Reserve,

104. See *supra* notes 71–72 and accompanying text.

105. Of course, the fact that GLBA might be justified on these grounds does not equate to an explanation of the passage of the statute. More likely, the statute was enacted as a result of various special interest group pressures aimed at retaining or increasing their market share.

106. For example, the Federal Reserve's role as direct bank supervisor could be reserved for the five to ten largest institutions. While this author is not advocating this change, it seems to make more sense than the current division of supervisory responsibility.

107. For discussion of the initial success or failure of the single regulator, see *Costs and Benefits of the Single Regulator*, 6 FIN. REGULATOR 6 (2001).

108. See *supra* Part II.

while not completely unshakable, is very secure. Therefore, as a practical matter, it is unlikely that the Federal Reserve will lose bank supervisory authority to another agency — unless it wants to.¹⁰⁹

Of course, the fate of the Bank of England's remaining limited role as bank supervisor is probably less a function of the success or failure of the FSA and more a product of the future of bank supervision in Europe. In other words, whether or not the integrated model proves successful, the implementation of that model by European countries on a national level may eventually cede to development of a federal regulator. It is even possible that a dual banking system, not unlike that in the U.S., may emerge as a possible scenario in Europe.

109. It is interesting to note that one of the possible explanations for the Bank of England's loss of bank supervisory authority was its relative ambivalence to that role. See Schooner & Taylor, *Convergence and Competition*, *supra* note 44, at 635, 638.