



New Oversight Role Tests FDIC Relationship with Fed

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By [Joe Adler](#)

WASHINGTON — The Federal Reserve Board, the sole bank holding company regulator for decades, is about to experience a pretty new concept: a teammate.

The Federal Deposit Insurance Corp., after the reform law gave it backup supervisory power over large companies directly overseen by the central bank, is not taking the role lightly. Last week, it announced plans to form a unit devoted to financial giants, doing "continuous review and oversight" of such firms.

The provision — as well as the FDIC's announcement — has been met with curiosity and some skepticism about how the two agencies, which have at times been at loggerheads, will work together.

"I could see a rocky road ahead because this is territory that the Fed has manned solo since 1956," said Douglas Landy, a partner in Allen & Overy and a former lawyer at the Federal Reserve Bank of New York. "It's difficult to then bring in people whose agenda is not exactly the same as yours."

Just as the Dodd-Frank bill gave the FDIC power to resolve systemically important companies, it also gave the agency a supporting role in supervising such firms, much like its traditional backup role for non-FDIC-supervised banks.

Under the law, the FDIC can carry out special exams of systemically important nonbanks and bank holding companies with more than \$50 billion of assets to help prepare for a seizure of a troubled firm.

The FDIC also gained backup enforcement authority over any bank holding company in cases where its "conduct or threatened conduct (including any acts or omissions) ... poses a risk to the Deposit Insurance Fund." (The agency cannot examine or bring sanctions against "generally sound" companies.)

The FDIC has wasted no time in asserting its new role. Three weeks after the bill was signed, the agency announced on Aug. 10 the creation of an Office of Complex Financial Institutions. This entity is to focus not only on new resolution duties but also on oversight of bank holding companies with more than \$100 billion of assets and nonbanks deemed systemically important. (The FDIC's existing supervision division will handle smaller companies).

"From the FDIC's perspective, it makes great sense to put a unit like this together. You want people there to have experience evaluating the complexities of these large institutions," said Mark Olson, a former Fed governor and now a co-chairman of Corporate Risk Advisors LLC.

But some also see a potential for conflict.

"The legislation most definitely provides the FDIC with backup authority, but it's also important to clarify that the primary federal regulator for all holding companies remains the Federal Reserve," said Diane Casey-Landry, the chief operating officer and senior executive vice president of the American Bankers Association. "The important part here will be to understand what does 'backup' mean, and not to create inefficiencies or redundancies in the process."

Veterans of the agencies said that, though the Fed and the FDIC have generally coalesced on issues relevant to both, their relationship has at times been strained.

"It was clear that the Fed came with a different set of perspectives," said John Douglas, a partner in Davis Polk & Wardwell and a former FDIC general counsel. "They were worried about systemic risk and the impact on, say, the commercial paper market and the broader debt markets — things the FDIC didn't focus on. The FDIC was focused on dealing with the particular failure at hand."

He said he "would never describe it as rocky. I would say there were disagreements. I sort of view that as part of having two agencies deal with a problem."

Nicholas Ketcha Jr., a former FDIC supervision director, said the agencies would typically speak to a bank with one voice but not before intense, high-level conversations behind closed doors. "I just see history repeating itself," said Ketcha, a managing director at the bank consulting firm FinPro. "It's going to force them to work more together. There will be some behind-the-scenes gnashing of teeth. But on the surface the orders will be done together, and there will be cooperation."

Olson said tension between the two agencies is inevitable but this does not preclude them from working well together. "When there is overlapping jurisdiction, as there is here, that all by itself creates a natural tension. The agencies work best when they recognize that natural tension exists but that there is a congressional mandate for them to work together," he said. "You have the leadership find ways to work together so that, No. 1, you are each fulfilling your statutory mandate while at the same time not either duplicating to an unnecessary extent or having the bank itself have to accommodate multiple regulators, if that's not necessary."

He added that the Fed has had a positive experience working alongside other agencies, for example, as holding company supervisor to the Office of the Comptroller of the Currency's oversight of national banks. "It will not be a new circumstance for the Fed to work jointly with another entity," Olson said.

The FDIC has had conflicts with primary regulators over the status of troubled banks. The agency, concerned about DIF losses, has wanted to move more aggressively against some troubled banks or thrifts than the primary regulator did. Most notably, the Office of Thrift Supervision resisted FDIC interference with Washington Mutual Bank, which failed in 2008 in the largest banking collapse in U.S. history. The FDIC sought to downgrade Wamu's supervisory rating, which would have tightened restrictions on it, but the OTS insisted the thrift was in better shape and a downgrade could backfire.

After Wamu's collapse, the agencies revised a memorandum of understanding designed to strengthen the FDIC's ability to intervene with a faltering bank.

The most public clash between the FDIC and Fed has related to policy, not a bank failure. For several years the Fed sought to eliminate the leverage ratio in the United States as part of the Basel II process, only to be rebuffed by the FDIC and, eventually, Congress. Ultimately, the Fed changed its view, and Basel III is to create a leverage ratio for European banks.

Observers said it is crucial for the Fed and the FDIC to be on the same page for the new regulatory regime to succeed.

"The last thing anybody wants is to have two regulators give conflicting views about how to operate these businesses," said Douglas. "You don't want one regulator who says 'Do A,' and the other who says 'Do B.' What you want is two regulators ... coming to a common conclusion."

The FDIC has had substantial experience with large institutions simply through its longstanding backup powers; it currently sends resident examiners to each of the eight largest banks. But agency officials said a new apparatus was still needed to manage the expanded responsibilities.

"We already have a presence in these institutions, but that presence is going to be enhanced. We thought our current structure wasn't exactly right for this change," said Paul Nash, the deputy to the FDIC chairman for external affairs. (Fed officials declined to comment for this story.)

Nash said the regulatory reform has already stimulated dialogue between the two agencies on enforcing the law. Dodd-Frank requires the Fed and the FDIC in 17 months to develop joint standards for large companies to draft so-called "living wills" — road maps regulators could use in a hypothetical resolution of the company.

"We have already had substantive discussions about living wills. That is the first thing we need to get out. That is already underway," Nash said. "We are optimistic that we will work with the Fed to produce good and clear guidelines for those institutions."

He added that the current memorandum of understanding covering backup authority over banks "may serve as a template for discussions with the Fed in terms of our backup authority" for holding companies.

Some observers said that they expect the FDIC and Fed to be good partners. "It's always been a concern in the past that the primary regulator hasn't been tough enough or quick enough to impose formal sanctions on the institution," said Gil Schwartz, a former Fed attorney now a partner in Schwartz & Ballen LLP.

"I'm not aware that there have been situations in which the FDIC and the Fed have had disagreements as to what the appropriate remedy should be," he said. "Cases with the OTS have been the ones featured prominently in the press.

"With the Fed, the FDIC's view was" that the central bank was "not looking to preserve the franchise of the agency," said the former central bank lawyer.

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