American Banker

March 17, 2010 Wednesday

Cutoff Would Undercut Fed District Banks

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SECTION: WASHINGTON; Pg. 1 Vol. 175 No. 41

LENGTH: 944 words

WASHINGTON - Far from being the big winner under Senate Banking Committee Chairman Chris Dodd's regulatory reform bill, the Federal Reserve System would undergo radical changes - including a likely consolidation of its 12 district banks - if the legislation were enacted.

Currently, 4,974 holding companies and 844 individual state-chartered banks are supervised by the Fed, but the Dodd bill would narrow that scope to 55 holding companies - those with more than $50 billion of assets.

The Federal Reserve banks of New York and Chicago would have jurisdiction over most of these companies; two Fed districts - St. Louis and Kansas City - would no longer regulate any institution, and the Atlanta, Richmond, Minneapolis and Dallas banks would oversee three or fewer.

Such a scenario could precipitate a reworking of the entire system, former Fed officials said.

"If this is enacted in this way regarding bank supervision, it raises questions about the structure of the system and the structure of the Federal Reserve banks, including the number of reserve banks needed," said Ernie Patrikis, a lawyer at White & Case LLP who spent 30 years at the New York Fed.

Some districts' banks would be hit harder than others, but all would lose the vast majority of institutions currently under their purview to oversight by the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corp.

One of the hardest-hit would be the Federal Reserve Bank of Kansas City, which supervises 810 bank holding companies and 172 state banks. Under the Dodd bill, it would regulate none. (For a list of what district would regulate which institutions under the bill, please go to americanbanker.com).

The implications extend beyond bank supervision to monetary policy.

When the Fed system was designed in 1913, the 12 district banks were spread geographically, based on population, and the Federal Open Market Committee included five regional presidents on a rotating basis. The move was partly an effort to ensure that monetary policy was not dominated by policymakers in Washington.

But the FOMC structure would probably have to be reworked if there were fewer district banks, and questions would inevitably arise over which districts would survive. "A reduced supervisory purview would likely have major implications for the structure of the regional Federal Reserve Bank System and, therefore, the making of monetary policy," said John Dearie, the executive vice president of the Financial Services Forum and a former New York Fed official. "The FOMC would likely have to be restructured to preserve the representation of the various regions of the country and their economic interests in the setting of interest rate policy."

The issue could arise when Fed Chairman Ben Bernanke testifies alongside former Fed chairman Paul Volcker at a House Financial Services Committee hearing today on bank supervision.

Though the House regulatory reform bill would add to, not take away from, the Fed's supervisory power, Bernanke has become increasingly forceful about defending central bank oversight of all holding companies and state banks in recent weeks as the Senate debates its version.

To be sure, Dodd's bill takes a softer approach toward the Fed than the version he released in November, which would have stripped all supervisory duties from the Fed.

But many observers at the time argued such a bill faced long odds, in part because the Obama administration and the banking industry insisted the Fed needed to have some role in bank oversight.

The revised Dodd bill would preserve a role but focus it exclusively on the parent companies of banks with more than $50 billion of assets, making the Fed the de facto systemic-risk regulator.

Though the banking industry is already fighting to expand the Fed's role further, Dodd's new version may have enough political support to prevail.

Alan Blinder, a former Fed vice chairman and now vice chairman of Promontory Interfinancial Network, was supportive of Dodd's revised draft. He said the bill would give the Fed more power to impose higher capital and leverage requirements and more effectively guard against systemic risk. That may be worth the tradeoff of fewer banks to oversee.

"In terms of pure body count - how many banks report to it - all 12 of the reserve banks will have fewer customers," said Blinder. "Understandably, a lot of them don't like that idea. On the other hand, for the large institutions, over the $50 billion threshold, they will have a lot more to do because they've added a lot more authority."

But other observers were also debating a provision in the Dodd bill that would require the New York Fed president to be appointed by the president and confirmed by the Senate.

Dodd singled out the New York Fed because it has a permanent seat on the FOMC and critics have raised questions about its corporate governance. District bank presidents are picked by the banks' boards, which include officials from institutions they oversee.

Some consumer groups welcomed the change. Requiring a White House appointment would mean the New York Fed president would "no longer be selected by the bankers on his or her board," a change that would help to "democratize the Fed," said Ed Mierzwinski, the consumer program director of the U.S. Public Interest Research Group at a **Cato Institute** panel discussion Tuesday.

But Allan Meltzer, an economist and professor at Carnegie Mellon University's Tepper School of Business, said making the job a political appointment would be a mistake.

"This is just another step in a long process by which they politicize the Federal Reserve," he said.

Chris Dieterich contributed to this story.