Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

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Reforming the Financial Regulators: An Incremental Approach*

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April, 2014

Last week, the Bipartisan Policy Center (BPC) released a report entitled "Dodd-Frank's Missed Opportunity: A Road Map for a More Effective Regulatory Architecture." This report is co-authored by Mark Olson, a former member of the Federal Reserve Board, and Richard Neiman, a former superintendent of banking for the State of New York.

Over the years, there have been numerous reports and proposals for reforming the fragmented U.S. financial regulatory system. It is universally recognized that the current system developed in response to different crises at different times, and could benefit from some consolidation that eliminates the potential for regulatory conflict and gaps. Yet, proposals for broad reform have floundered because of resistance from regulated firms, which tend to favor the known structure over a new, and untested structure; from sitting regulators, which naturally favor maintaining their authority; and from Congressional committees, which also favor retaining jurisdiction over one agency or another.

What makes this latest BPC report distinctive is that it recommends incremental reforms that would improve the operations of the financial regulatory system while avoiding the practical and political hurtles that have stalled other proposals. While, the report does envision an end-state regulatory structure that is materially different from the current one, it proposes an immediate step that the federal banking agencies could take to improve the current system that does not require Congressional action.

The key incremental step proposed in the BPC report is the creation of a consolidated examination force for the three prudential banking agencies, the OCC, FDIC, and Federal Reserve. The rationale for this proposal is two-fold: these agencies share a common safety and soundness mission, and they could each benefit from coordinated training and deployment of examiners and other resources. The public policy benefit is better sharing of data through a single examination report for each bank that is based upon the combined expertise of the agencies.

This proposed consolidated examination force should be minimally disruptive to existing agency authorities. The consolidated examination force would be overseen by a subcommittee of the Federal Financial

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Institutions Examination Council that would be composed of the heads of supervision from the three agencies and the Council's state banking regulator. The lead examiner on each team would be an employee of the agency that has the primary responsibility for the bank, and state banking departments would be free to join and leverage the expertise and resources of the teams.

To refine and validate this recommendation, the report calls upon the three banking agencies to conduct a short-term pilot test that is geographically limited, yet involves banks of different sizes and charters. This is a test that deserves to be conducted.

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