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BANK AND THRIFT REGULATION

Concerns About Credit Availability and Regulatory Burden

Statement of
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BANKS AND THRIFT REGULATION

Concerns About Credit Availability and Regulatory Burden

Summary of Statement by Charles A. Bowsher
Comptroller General of the United States

GAO's testimony discusses two concerns of the Subcommittee: the availability of bank credit to small and medium-sized businesses and the amount of regulatory burden placed on our banking institutions. Congress enacted the landmark FDIC Improvement Act (FDICIA) in December 1991 to strengthen the nation's banking system. The passage of FDICIA also heightened concerns of the banking industry about the continuing increase in regulatory burden and its potential impact on banking activities, particularly on lending to small and medium-sized businesses.

There are four main points that GAO makes about these issues today. First, while it is true that FDICIA increased the amount of regulation, GAO urges Congress to recognize the importance of maintaining the key safety and soundness reforms in FDICIA that are critical to preventing further losses to the insurance funds and the taxpayers. Second, GAO recognized that access to bank credit is essential to the viability of small and medium-sized businesses that are a principal source of new jobs in this country. Banks should be encouraged to lend to creditworthy borrowers, and GAO believes that steps should be taken administratively to streamline the paperwork burden and regulations that may be unnecessarily hindering certain types of business loans. Third, GAO believes that some of the regulatory burden placed on banks can be reduced by eliminating the inconsistency and duplication involved with bank examinations. Fourth, before Congress enacts any legislative remedies, GAO advises that it needs sound analyses to determine whether the root causes of unnecessary burden are in the statutes, the implementing regulations, the behavior of the regulators, or some combination of all three factors. Such analyses have not been done.

GAO also applauds the general direction of the President's regulatory initiative directed at problems of credit availability that he announced last week. However, GAO urges the regulators, in conducting their regulatory reviews, to be mindful of the importance of retaining safety and soundness provisions, particularly regarding the accounting treatment for real estate loans.

Finally, GAO discusses two studies it is doing at the request of the Senate and House Banking Committees--one on small business lending and the other on regulatory burden. Preliminary results of these studies are expected in May 1993, with the more extensive study on regulatory burden expected to take considerably more time and resources.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss two concerns of the Subcommittee: the availability of bank credit to small and medium-sized businesses and the amount of regulatory burden placed on our banking institutions. As you are aware, Mr. Chairman, Congress enacted the landmark FDIC Improvement Act (FDICIA) in December 1991 to strengthen the nation's banking system. The passage of FDICIA also heightened concerns of the banking industry about the continuing increase in regulatory burden and its potential impact on banking activities, particularly on lending to small and medium-sized businesses.

There are four main points that we wish to make about these issues today. First, while it is true that FDICIA increased the amount of regulation, Congress must recognize the importance of maintaining the key safety and soundness reforms in FDICIA that are critical to preventing further losses to the insurance funds and the taxpayers. Second, access to bank credit is essential to the viability of small and medium-sized businesses that are a principal source of new jobs in this country. Banks should be encouraged to lend to creditworthy borrowers, and we believe that steps should be taken administratively to streamline the paperwork burden and regulations that may be unnecessarily hindering certain types of business loans. Third, some of the regulatory burden placed on banks can be reduced by eliminating the inconsistency and duplication involved with bank examinations. Fourth, before enacting any legislative remedies, Congress needs sound analyses to determine whether the root causes of unnecessary burden are in the statutes, the implementing regulations, the behavior of the regulators, or some combination of all three factors. Such analyses have not been done.

Before I discuss each of these points in greater detail, I would like to applaud the general direction of the President's regulatory initiative directed at problems of credit availability that he announced last week. However, we urge the regulators, in conducting their regulatory reviews, to be mindful of the importance of retaining safety and soundness provisions, particularly regarding the accounting treatment for real estate loans.

FDICIA REFORMS

While we support efforts to reduce regulatory burden, we are concerned about proposals to eliminate FDICIA safety and soundness provisions. Since 1980, approximately 2,700 banks and thrifts have failed, costing roughly $200 billion to date. FDICIA reforms are essential for protecting healthy banks and the taxpayers from rising deposit insurance costs. Through several key provisions that complement each other, the act provides incentives for market participants and the regulators to bring their systems for identifying and controlling risk in line with the increased riskiness and complexity of today's financial marketplace. Our reports on bank and thrift failures have shown that many failed institutions had serious internal control problems, including violations of laws and regulations, which regulators cited as contributing significantly to their failures.[1] Had these problems been corrected, the institutions might not have failed or their failure might have been less expensive to the insurance funds.

The key FDICIA safety and soundness provisions are (1) prompt corrective action to close institutions before their capital runs out; (2) management and auditing reforms for institutions with assets of $150 million or more that highlight private sector responsibility for protecting taxpayers from losses; (3) accounting reforms to provide accurate information to management, regulators, and the public; (4) annual, on-site examinations for most banks to detect problems on a more timely basis; and (5) changes in the way banks are closed so that uninsured depositors and general creditors will be more likely to share in the losses if a bank fails. Congressional oversight of each of these areas will be crucial in the years ahead.

SMALL AND MEDIUM-SIZED BUSINESS LENDING

Although FDICIA should be effective in reducing insurance fund losses, concerns have been raised that it is having the undesirable side effects of restricting bank lending and of adding to the costly burden of regulation on the industry. There is substantial anecdotal evidence that some borrowers have difficulties in obtaining loans, which is not surprising, given the number of bank failures that have occurred, the number of problem banks that still exist, and the state of the economy. There have also been extensive reports in the press and elsewhere of a nationwide shortage of business credit, often referred to as a "credit crunch."

Recent evidence, however, suggests that problems with lending restrictions, particularly relating to commercial and industrial loans, vary by geographic regions and by banks' financial condition. CBO recently reported that the availability of bank loans in any region of the country is likely to be associated with the number and size of weak banks in that region.[2] Thus, the New England, Mid-Atlantic, and Southwest regions have

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[1]Failed Banks: Accounting and Auditing Reforms Urgently Needed (GAO/AFMD-91-43, April 22, 1991).

[2]CBO Staff Memorandum: Regional Analysis of Bank Lending, Congressional Budget Office (Feb. 1993).

suffered the most from the financial problems of the banking industry, while regions with a proportionally large number of strong banks, such as the Central and Midwest regions, have been less affected by reduced bank lending. Overall, CBO reported that lending by strong banks increased annually from 1990 through 1992 by approximately 3.1 percent, while lending by weak banks decreased by 3.6 percent.

Similar evidence has been presented relative to small business lending by the National Federation of Independent Business from its survey of thousands of small businesses in 1992. It had analyzed small business credit conditions over the prior 19 years and reported that recent credit conditions for small businesses were not unique. The availability of credit was not ranked highly as a problem for a great majority of small businesses, which was not significantly different from what was reported in earlier surveys. On the other hand, credit availability was considered a critically important problem for about 12 percent of the respondents. The survey identified some disparities by region and firm size. Problems were concentrated in New England and Texas and in "larger small businesses"--defined as employing 40 or more people. The study further suggested that small businesses' ability to obtain loans will probably become more difficult as the economy recovers and leads to increased loan demand and greater competition for capital.

We have initiated a review for the Senate Banking Committee to better understand the concerns unique to this type of lending. On the basis of our work thus far, we do believe there are ways to streamline paperwork burden and regulations affecting some types of loans to small and medium-sized businesses. We currently are visiting regulators, banks, and other suppliers of small business credit to better understand the effects of market forces, laws, regulations, and supervisory processes on this type of lending. By May 1993, we hope to have some preliminary results from this review.

IMPROVEMENT OF EXAMINATION PROCESS

We believe that improving the regulatory examination process also holds promise for eliminating much undue burden placed on the industry. Last month we testified on the results of our recently completed review of the bank and thrift regulators' safety and soundness examinations. We identified inconsistencies and overlap among the four regulators in their examination policies and practices. These inconsistencies included differences in examination scope, frequency, documentation, and assessment of critical areas, such as loan loss reserves. Such differences could result in disparate conclusions regarding the safety and soundness of an institution, depending on which regulator does the assessment.

Although we did not study the efficiency and effectiveness of the regulatory structure as a whole, we believe the examination problems and inconsistencies we found are symptomatic of the difficulty of efficiently and effectively regulating the banking and thrift industries with four separate federal regulators. The current regulatory structure has evolved over decades of legislative efforts to address specific problems, resulting in a fragmented system that may no longer be capable of handling the complexities of today's banking and thrift industries. We believe that inconsistent examination practices and the inherent overlap and duplication resulting from four separate regulatory agencies to carry out essentially the same function results in the potential for inequitable regulation of banks and thrifts, as well as unnecessary burden placed on the industry.

REGULATORY BURDEN STUDIES

Before Congress enacts any legislative remedies, it needs sound analyses to determine whether the root causes of undue regulatory burdens are in the laws, the regulations, or in how the laws and regulations are administered by the regulators. While existing studies reflect an increasing concern that the cumulative effect of regulation may be placing too great a burden on the industry, they provide little information about how specifically to ease the burden without adversely affecting key safety and soundness and consumer protection goals.

The industry studies we have reviewed were, for the most part, based upon opinion surveys of their members and provided extensive lists of issues causing concern among bankers. Among the major concerns reflected in the studies were the following:

-- safety and soundness requirements relating to appraisals, examinations, and formal written policies;

-- consumer protections reflected in the Community Reinvestment Act (CRA), Truth-in-Lending Act, the Real Estate Settlement Procedures Act (RESPA), the Expedited Funds Availability Act, and the Home Mortgage Disclosure Act (HMDA); and

-- reporting and record-keeping issues relating to Call Reports, geocoding, holding company reports, and the Bank Secrecy Act.

We have found serious methodological problems with these studies. Because they were, for the most part, based on industry perspectives or opinions, the aggregate cost estimates were imprecise and unreliable. Furthermore, the studies did not attempt to weigh regulatory costs against the safety and soundness and consumer protection benefits of bank regulations. The benefit side of the equation was, for the most part, ignored in these studies.

The agency studies we have reviewed identified changes that the agencies could make internally to reduce unnecessary burden without compromising safety and soundness or consumer protection goals. Some examples of actions taken include streamlining the applications process for chartering, branching, or merging; clarifying CRA examination procedures; coordinating examinations schedules; and simplifying report forms. A regulatory burden study recently completed by the Federal Financial Institutions Examination Council (FFIEC) provided a summary of the agencies' administrative efforts and reported that the FFIEC would continue meeting to identify and recommend possible statutory changes to further reduce regulatory burden. Even though agency officials indicated that they did not expect their administrative changes would significantly reduce the cumulative burden on banks, their efforts should be applauded and encouraged.

Because of the deficiencies we have found in the existing studies, we believe further analyses targeted to specific regulatory burden issues are needed to identify what appropriate legislative actions, if any, Congress needs to take. We are, therefore, using our review of the existing studies to design and pilot a more in-depth study of some of the industry's concerns. This study will seek to better define and understand these concerns, their magnitude, root causes, and relevance to bank operations. Additionally, our design will take into consideration work we are doing for the House Banking Committee in which we are reviewing the regulators' examination processes and other program initiatives to assess banks' compliance with consumer protection and community reinvestment laws. Our study will involve our going into banks, with their consent and cooperation, to identify activities related to compliance with the safety and soundness, consumer protection, and record-keeping requirements of greatest concern to the industry. This study will require considerable time and resources, but we consider it an important investment for understanding the industry's concerns and identifying how best to address them. With the industry's and the regulators' cooperation, we hope to identify additional ways to reduce regulatory burden without jeopardizing key safety and soundness or consumer protection goals.

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Mr. Chairman, this concludes my prepared statement. My colleagues and I will be pleased to answer questions.

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