

HISTORICAL REVIEW OF “UMBRELLA SUPERVISION”
BY THE BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

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I. Introduction

The Board of Governors of the Federal Reserve System (“Board”) acts as an “umbrella supervisor” under the Gramm-Leach-Bliley Act (“GLB Act”). Depending on the context, the GLB Act might be described as retaining, preserving, keeping, confirming, continuing, acknowledging, blessing, endorsing, expanding, appointing, assigning, choosing, granting, or establishing the Board in its role as umbrella supervisor, consolidated supervisor, comprehensive regulator, overall supervisor, super-regulator, or regulatory czar. The broad array of descriptive terms used reflects the ongoing debate over the appropriate role of the Board in financial institution supervision. Moving beyond the Board’s status as “umbrella supervisor” to its specific functions as umbrella supervisor raises even more questions. As Comptroller Eugene Ludwig has observed, “[t]he metaphor of the umbrella has obvious appeal. It evokes safety and security. But we need to move beyond imagery to specifics. What exactly do we mean by umbrella supervision?”¹

This article reviews legislative history and supervisory practices related to bank holding companies and their subsidiaries with a view toward understanding what Congress meant when it referred to the Board as an “umbrella supervisor” in the GLB Act. Part II of this article reviews the historical development of bank holding company law and regulation which laid the foundation for the practice of umbrella supervision.² And Part III provides answers to

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¹ Eugene A. Ludwig, Comptroller of the Currency, Remarks Before the American Enterprise Institute (Oct. 9, 1997), *available at* <http://www.occ.treas.gov/ftp/release/97-91.txt>.

² *See generally*, CARTER H. GOLEMBE ASSOCIATES, THE BANK HOLDING COMPANY ACT AMENDMENTS OF 1970: A LEGISLATIVE HISTORY 1-5 (1971); CHARLES G. BLAINE, FEDERAL REGULATION OF BANK HOLDING

questions regarding the Board’s role as umbrella supervisor: What does “umbrella supervision” mean? Is “consolidated supervision” different? How does the GLB Act limit the Board’s authority and practice? When did the Board obtain all of the legal authority to allow it to practice umbrella supervision? When did “umbrella supervision” come to commonly refer to a set of supervisory practices? What is the relationship between the umbrella and other supervisors? Part IV sums up the answers to these questions. Umbrella supervision is a set of supervisory practices conducted within the scope of the Board’s legal authority. “Umbrella supervision” is used as a synonym for “consolidated supervision” and as a distinct term referring to another set of supervisory practices. The Board possessed all the powers necessary for it to practice umbrella supervision in 1983, although its authority expanded to functionally regulated subsidiaries in 1999. The Board’s authority over functionally regulated subsidiaries is limited regarding capital, reports, examinations, and enforcement. The phrase “umbrella supervision” came into common usage in the late 1980s and early 1990s. The relationship between the umbrella and other supervisors is defined by primary and secondary roles, statutory responsibilities, and supervisory cooperation.

II. Historical Developments

A. The Banking Act of 1933 and Other Pre-Gramm-Leach-Bliley Legislation

1. Banking Act of 1933

Bank holding company supervision by the Board began with the Banking Act of 1933 (“Banking Act”). The Banking Act, among other matters, created the Federal Deposit Insurance Corporation (“FDIC”),³ prohibited affiliations between banking and securities underwriting firms, and otherwise separated banking and commerce.⁴

COMPANIES 1-1 to 1-4, 2-1, and 4-1 to 4-2 (1973); PAULINE B. HELLER, HANDBOOK OF FEDERAL BANK HOLDING COMPANY LAW xvii-xix and 349 n.172 (1976); and STAFF OF THE BOARD OF GOVERNORS, THE BANK HOLDING COMPANY MOVEMENT TO 1978: A COMPENDIUM (1978) at 21-68 [hereinafter *Compendium*].

³ Banking Act of 1933, Pub. L. No. 73-66, § 8, 48 Stat. 162, 168 (1933) (codified as amended in scattered sections of 12 U.S.C.).

⁴ *Id.* at §§ 16, 20, 21, 32, 48 Stat. at 184, 188, 189, 194.

It also added section 23A to the Federal Reserve Act of 1913 (“FR Act”), which limited transactions between a member bank and its affiliates,⁵ while leaving in place many advantages of Federal Reserve membership, such as obtaining loans and services from Federal Reserve Banks.

The Banking Act authorized the Board to gather information on affiliates of member banks.⁶ First, the Banking Act required each member bank to obtain information from each of its affiliates, other than member banks, and to furnish to the Board reports containing such information as “shall be necessary to disclose fully the relations between such affiliate and such bank and to enable the Board to inform itself as to the effect of such relations upon the affairs of such bank.”⁷ Second, the Banking Act allowed the Board to obtain directly from affiliates “additional reports as may be necessary in order to obtain a full and complete knowledge of the condition of the affiliated member bank.”⁸ Finally, the Banking Act required a “holding company affiliate” to obtain a voting permit from the Board before it voted any member bank stock that it owned or controlled.⁹ In applying for a voting permit, the affiliate had to agree to certain conditions, including the maintenance of certain reserves, the requirement that dividends paid by the holding company be paid only out of actual net earnings, submission of reports, and consent to “such examinations of such holding company affiliate as shall be necessary to disclose fully the relations between such banks and such holding company affiliate and the effect of such relations upon the affairs of such banks.”¹⁰ The applicable definition of “holding company affiliate” included any corporation owning or controlling 50% or more of the voting shares of a member bank.¹¹ Thus, while one-bank

⁵ *Id.* at § 13, 48 Stat. at 183 (“No member bank shall (1) make any loan . . . from, any of its affiliates.”).

⁶ *Id.* at § 5(c), 48 Stat. at 165 (“Each bank . . . shall obtain from each of its affiliates . . . not less than three reports during each year . . . [and] such additional reports as . . . may be necessary.”).

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* at §§ 5(c), 19, 48 Stat. at 164, 186 (“Any such holding company affiliate may make application to the Federal Reserve Board for a voting permit entitling it to . . . [vote].”).

¹⁰ *Id.* at § 5(c), 48 Stat. at 164.

¹¹ *Id.* at § 2(c), 48 Stat. at 163. (“The term ‘holding company affiliate’ shall include any corporation . . . [w]hich owns or controls . . . either a majority of shares . . . or more than 50 per centum of the number of shares . . .”).

holding companies were subject to the voting permit provisions of the Banking Act if they owned or controlled the requisite percentage of member bank stock, bank holding companies that only owned or controlled the stock of nonmember banks were not subject to the voting permit requirement.

The Board issued Regulation P to implement the voting permit provisions of the Banking Act.¹² The regulation required applicants to submit detailed information with a request for a voting permit, including their last audit by an independent auditor, a statement regarding management, a list of all subsidiaries, a statement of financial condition, and a copy of the last report of examination of each subsidiary of the applicant.¹³ It also set forth conditions with respect to the issuance of a voting permit, such as the holding company's agreement to: (1) permit examinations of its affairs, and those of each banking or other organization owned or controlled by the holding company; (2) publish individual or consolidated statements of condition of the subsidiaries of the holding company; (3) declare dividends only out of actual net earnings; (4) maintain required reserves of readily marketable assets; (5) furnish information required by the Board; and (6) divest any interest in a securities company within 5 years.¹⁴ In 1934, the Board's annual report to Congress included the following statement about its examination of holding company affiliates:

In connection with the consideration of applications of holding company affiliates for voting permits, arrangements were completed, wherever practicable, to have the various banks controlled by the same holding company affiliate examined as nearly as practicable as of the same date in order that a *comprehensive picture of the entire group* might be obtained and information concerning various relationships within the group be developed. Such arrangements were worked out in cooperation with the chief national bank examiners in the various districts and the State banking authorities, the national banks being examined by the national bank

¹² *Regulation P, Series of 1933, Holding Company Affiliates—Voting Permits*, 19 Fed. Res. Bull. 505 (1933).

¹³ *Id.* at 509.

¹⁴ *Id.* at 511.

examiners and the State banks by the State authorities and examiners for the Federal Reserve banks.¹⁵

In 1935, Congress added a provision to the Banking Act that resulted in the Board granting exemptions from the voting permit requirement for most one-bank holding companies.¹⁶

2. Legislative Proposals from 1938 to 1955

Beginning in 1938, Congress considered a number of bills providing for the regulation of bank holding companies.¹⁷ Indeed, such bills were introduced in Congress in 1938, 1941, 1945, 1947, 1949, 1950, and 1953.¹⁸ Some of these bills were referred to committee, some led to hearings, and several were reported out of committee. Yet no action was taken on them by either the full House or Senate.¹⁹ While none of these bills became law, they illustrate the perceived weaknesses in banking law and proposed responses in the period preceding the enactment of the Bank Holding Company Act of 1956. Among the perceived weaknesses in banking law were the confusion and delay caused by overlapping regulatory authorities and the ability of bank holding companies to exercise control over banks

¹⁵ 1934 FED. RES. BD. ANN. REP. 54 (emphasis added).

¹⁶ Banking Act of 1935, Pub. L. No. 74-305, § 301, 49 Stat. 707 (1935). The Board adopted amendments to Regulation P to reflect this change. 21 Fed. Res. Bull. 857 (1935). (“The term ‘holding company affiliate’ shall have the meaning given to it by section 2(c) of the Banking Act of 1933.”). The Board also adopted a standard agreement for applications for voting permits consistent with these changes. 1935 FED. RES. BD. ANN. REP. 217 (1936) (“Standard provisions of agreement required as condition precedent to granting general voting permits”); *see generally*, *Compendium*, *supra* note 2, at 35, 38, 39 (“Two years later, the Banking Act of 1935 included a provision that resulted in exemptions from the 1933 Act for most one-bank holding companies.”).

¹⁷ *See e.g.*, S. REP. NO. 84-1095, at 3-5 (“Defin[ing] ‘banking holding companies,’ control[ling] their future expansion, and require[ing] divestment of their nonbanking interests . . .”).

¹⁸ S. 76, 83d Cong. (1953); S. 3547, 81st Cong. (1950); S. 2318, 81st Cong. (1949); S. 829, 80th Cong. (1947); H.R. 3351, 80th Cong. (1947); S. 792, 79th Cong. (1945); H.R. 2776, 79th Cong. (1945); S. 310, 77th Cong. (1941); S. 3575, 75th Cong. (1938).

¹⁹ S. REP. NO. 84-1095, at 3-5 (1955).

while avoiding supervision. Proposed responses ranged from registering and supervising bank holding companies to eliminating them altogether.

In 1943, the Board’s report to Congress described its regulation of bank holding companies:

Regulation of bank holding companies by the Board is effected through the specific statutory powers to grant, withhold, or revoke voting permits, and through agreements predicated upon the general statutory powers and responsibilities of the Board and required to be executed by holding companies before obtaining voting permits from the Board. The purpose of those statutes and agreements is that the holding companies and their subsidiaries, including member banks and nonmember banks, whether insured or uninsured, shall maintain sound financial condition and proper management policies and operating practices, including those involving intercompany transactions and relationships.²⁰

The Board’s report went on to recommend legislation “preventing further expansion of existing bank holding companies or the creation of new bank holding companies” to prevent the circumvention of sound banking principles, existing statutes, and public policy.²¹

²⁰ 1943 FED. RES. BD. ANN. REP. 44.

²¹ *Id.* at 37. The Board also sought to limit the expansion of bank holding companies through administrative action. In 1948, the Board initiated proceedings against Transamerica under section 7 of the Clayton Act based on the anti-competitive effect of its acquisitions of stock in 48 banks in five Western states. In 1952, the Board ordered Transamerica to dispose of the stock of its majority-owned banks. *Transamerica Corp.*, 38 Fed. Res. Bull. 368 (1952). Transamerica sought relief in the Third Circuit Court of Appeals. In 1953, the appeals court reversed the divestiture order of the Board on the grounds that the Board failed to prove that the acquisitions of these banks either substantially lessened competition or tended to create a monopoly. *Transamerica Corp. v. Bd. of Governors*, 206 F.2d 163 (3d Cir. 1953) (“Order of the Board was set aside because it did not make any findings regarding the tendency of the acquisitions to lessen competition or create monopoly in the local communities where the acquired commercial banks operated.”). *See generally*, GERALD C. FISCHER, *BANK HOLDING COMPANIES* 66-68 (Columbia Univ. Press 1961). (Discussing *Trans-*

In 1955, several bills were introduced in the House and Senate to regulate bank holding companies.²² The Board’s Chairman, William M. Martin, Jr., supported the regulation of one-bank holding companies in testimony before the House Banking and Currency Committee on February 28, 1955, where he observed that “potential abuses resulting from combination under single control of both banking and nonbanking interests could easily exist in a case in which only one bank is involved,” and, as a result, the Board would urge that “the definition should be related to control of a single bank.”²³ This statement embodied a shift in Board posture toward bank holding companies. Although the Board had recommended legislation preventing further expansion by existing bank holding companies and the creation of new bank holding companies in its 1943 Annual Report to Congress, it sought more expansive authority to supervise one-bank holding companies in 1955.

3. Bank Holding Company Act of 1956

In 1956, Congress enacted the Bank Holding Company Act of 1956 (“BHC Act”),²⁴ which required registration of companies controlling two or more banks. The BHC Act defined a bank holding company, controlled the formation and expansion of bank holding companies, limited bank holding companies to the business of banking or managing and controlling banks, and required divestiture of nonbanking interests unless they met one of many exceptions. The principal determinant of status as a bank holding company was control of two or more banks.²⁵ The primary criterion for determining control was ownership or control of 25% or more of the voting shares of a bank.²⁶ The BHC Act included many exemptions from registration as a bank holding company for agricultural, educational, religious,

america.). The Supreme Court declined to hear the case on petition for review. *Transamerica Corp. v. Bd. of Governors*, *cert. denied*, 346 U.S. 901 (1953).

²² *See, e.g.*, S. 880, 84th Cong. (1955); H.R. 2674, 84th Cong. (1955); H.R. 6227, 84th Cong. (1955).

²³ *Control and Regulation of Bank Holding Companies: Hearing on H.R. 2674 Before the H. Comm. on Banking and Currency*, 84th Cong. 15 (1955).

²⁴ Bank Holding Company Act of 1956, Pub. L. No. 84-511, 70 Stat. 133.

²⁵ *Id.* at § 2(a), 70 Stat. at 133.

²⁶ *Id.*

charitable, and other organizations. Furthermore, it did not regulate individuals or partnerships owning or controlling banks.

The BHC Act included the following provision related to supervision and examination by the Board:

The Board from time to time may require reports under oath to keep it informed as to whether the provisions of this Act and such regulations and orders issued thereunder have been complied with; and the Board may make examinations of each bank holding company and each subsidiary thereof, the cost of which shall be assessed against, and paid by, such holding company. The Board shall, as far as possible, use the reports of examinations made by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the appropriate State bank supervisory authority for the purpose of this section.²⁷

The BHC Act did not subject one-bank holding companies to Board regulation and supervision. Rather, one-bank holding companies became subject to the Board’s jurisdiction under the FR Act only if they applied for a permit to vote the stock of a member bank. In its report submitted to Congress pursuant to section 5(d) of the BHC Act, however, the Board began to recommend repeal of the voting stock permit requirement.²⁸ At the same time, the Board advocated extension of the BHC Act to one-bank holding companies.²⁹

4. Supervision of One-Bank Holding Companies

In 1966, Congress once again considered requiring the registration of one-bank holding companies when it passed amendments to the BHC Act (“1966 Amendments”).³⁰ While the

²⁷ *Id.* at § 5(c), 70 Stat. at 137. This language was identical to §4(c) of H.R. 2674, as introduced in the House on January 20, 1955, and §4(c) of S. 880 as introduced in the Senate on February 1, 1955.

²⁸ 44 Fed. Res. Bull. 794-95 (1958); *see also Compendium, supra* note 2, at 41, 42.

²⁹ 44 Fed. Res. Bull. 781 (1958).

³⁰ Pub. L. No. 89-485, 80 Stat. 236 (1966).

1966 Amendments repealed registration exemptions for certain organizations³¹ and expanded the definition of a bank holding company to include long-term, non-business trusts, the 1966 Amendments did not require the registration of one-bank holding companies. At the same time, the Financial Institutions Supervisory Act of 1966 (“FIS Act”) repealed the voting permit requirement of the FR Act.³² Therefore, one-bank holding companies not only remained outside the coverage of the BHC Act, they were also relieved of supervision by the Board attendant when obtaining a voting permit for member bank stock.

From 1967 to 1969, the number of bank holding companies grew dramatically. At the end of 1968, existing or proposed one-bank holding companies controlled over 27% of the commercial bank deposits in FDIC-insured banks.³³ A Congressional staff report entitled *The Growth of Unregistered Bank Holding Companies—Problems and Prospects* provided a detailed account of the growing number of one-bank holding companies:

[A] comparison can be made of the number and size of bank holding companies now under regulation of the Federal Reserve Board as against the number and size of existing and proposed one bank holding companies which under existing law would not come under regulation of the Federal Reserve Board. The contrast here is startling. The latest figures show that as of June 1968, 106 bank holding companies with \$48.9 billion in bank deposits were registered with the Federal Reserve Board. In comparison, there were 783 existing and proposed one bank holding companies with total commercial bank deposits of about \$108.2 billion as of December 31, 1968, which would come under no regulation comparable to that imposed upon registered bank holding companies. In

³¹ *Id.* § 13(b), 80 Stat. at 242 (1966); *see also* 52 Fed. Res. Bull. 963 (1955).

³² Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, § 207, 80 Stat. 1055 (1966); *see also* 52 Fed. Res. Bull. 966 (1955) (repealing “the provisions . . . of the Federal Reserve Act, [and] requiring holding company affiliates to obtain permits to vote the stock of member banks”).

³³ STAFF OF H. COMM. ON BANKING AND CURRENCY, 91ST CONG., FINANCIAL INSTITUTIONS: REFORM AND THE PUBLIC INTEREST 1 (Comm. Print 1969).

other words, more than 7 times as many bank holding companies, existing and proposed, with more than double the commercial bank deposits would evade Federal Reserve Bank regulation under existing law than are now regulated.³⁴

So long as a company owned only one bank, it was not subject to supervision by the Board.

In 1969, legislation was introduced to expand the BHC Act definition of “bank holding company” to include one-bank holding companies.³⁵ On December 31, 1970, amendments to the BHC Act became law (“1970 Amendments”).³⁶ The 1970 Amendments required the registration of one-bank holding companies, eliminated the exemption for partnerships, and narrowed the exemptions for ownership in a fiduciary capacity, all of which increased the number of bank holding companies to which the BHC Act applied.

5. Termination of Nonbank Activities or Ownership

In 1975, Senator William Proxmire introduced legislation to strengthen the supervisory authority of the federal banking agencies over domestic financial institutions.³⁷ In the Board’s letter recommending the legislation, Chairman Arthur Burns noted that the proposed bill included a “provision designed to aid the Board . . . in handling a problem bank situation where adverse effects have arisen from the relationship between the banking and nonbanking subsidiaries of the parent holding company” where the “problems and unfavorable publicity connected with a nonbanking subsidiary of a bank holding company” negatively impact banks within the bank holding company.³⁸ Chairman Burns observed that this may lead to

³⁴ *Id.* at 7.

³⁵ H.R. 6778, 91st Cong. (1969); H.R. 9385, 91st Cong. (1969) (“‘Bank holding company’ means any company that has control over any bank or over any company that is or becomes a bank holding company.”).

³⁶ Bank Holding Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat. 1760.

³⁷ S. 2304, 94th Cong. (1975).

³⁸ *Bill to Strengthen Supervisory Authority of Banking Agencies Introduced in Senate*, [1973-1978 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,641 (Sept. 26, 1975).

serious difficulties for such banks, which runs counter to the Board’s belief “that a bank holding company should be a source of financial strength for its subsidiary banks.”³⁹ Indeed, “nonbanking subsidiaries within a bank holding company structure should augment rather than detract from that strength.”⁴⁰ Thus, Chairman Burns stated that it was the Board’s belief that “it should have the power to order divestiture of a bank holding company subsidiary or termination of a nonbanking activity by a bank holding company whenever it has reasonable cause to believe that the continuation of such activity or ownership constitutes a serious risk to the financial safety, soundness, or stability of a bank holding company’s subsidiary bank[s].”⁴¹ Nevertheless, the Board recognized that the “power to order divestiture represents a drastic remedy and [the Board] contemplates that it would be exercised only in very rare instances. However, the Board’s experience to date leads it to believe that in some instances this remedy should be available in order effectively to protect the interests of a banking subsidiary of the bank holding company, its depositors, and customers.”⁴²

In 1978, Congress authorized the Board to order the cessation of activities and divestiture of nonbank subsidiaries of a bank holding company under certain conditions through enactment of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (“FIRIRCA”).⁴³ FIRIRCA added section 5(e) to the BHC Act, thus giving the Board the power to order a bank holding company to terminate any activity, ownership or control of any nonbank subsidiary (other than a nonbank subsidiary of a bank) if the Board has reasonable cause to believe that continuation of the activity, ownership or control constitutes a serious risk to the financial safety, soundness or stability of a bank subsidiary of the bank holding company.⁴⁴ Such an order could be issued after due notice and

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (codified as amended in scattered sections of 12 U.S.C.). In a study released during 1978, Board staff analyzed the financial and economic implications for the growth of bank holding companies. *Compendium, supra* note 2.

⁴⁴ *E.g.*, Financial Institutions Regulatory and Interest Rate Control Act § 105(a); H.R. REP. No. 95-1383, at 19 (1978) (“If the Federal Reserve . . . has cause to believe that the operation of a nondepository subsidiary is a

opportunity for hearing, and after considering the views of the bank’s primary supervisor.⁴⁵ In addition, FIRIRCA gave the Board the power to issue a cease-and-desist order against a bank holding company or subsidiary thereof in connection with violations of law, regulation, agreement in writing and unsafe and unsound practices.⁴⁶

6. BHC Ratings and Capital

In the late 1970s, federal banking regulators developed new systems for rating banks and bank holding companies. The CAMEL rating system was adopted for banks in 1978.⁴⁷ In 1979, the Board adopted the BOPEC/F-M rating system for bank holding companies.⁴⁸ In the BOPEC/F-M system, the components were defined as follows: “B” stood for “Bank Subsidiaries,” “O” stood for Other (Nonbank) Subsidiaries, “P” stood for “Parent Company,” “E” stood for “Earnings-Consolidated,” “C” stood for “Capital adequacy—Consolidated,” “F” stood for “Financial Composite Rating,” and “M” stood for “Management Composite Rating.”⁴⁹ In adopting the BOPEC/F-M rating system, the Board noted that its concern was with the “risk characteristics of the entire organization,”⁵⁰ as well as the

serious risk . . . [it] can order the holding company to divest within 120 days such nondepository subsidiary.”).

⁴⁵ *Id.*

⁴⁶ Financial Institutions Regulatory and Interest Rate Control Act § 107(b).

⁴⁷ *Banking Agencies Adopt Uniform Interagency Bank Soundness Rating System*, [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 97,451 (May 10, 1978) (stating that, in the CAMEL system “C” stands for “Capital,” “A” stands for “Asset quality,” “M” stands for “Management,” “E” stands for “Earnings,” and “L” stands for “Liquidity”).

⁴⁸ *Federal Reserve Board Adopts System for Appraising and Rating Performance and Financial Condition of Bank Holding Companies*, [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 97,708 (Feb. 7, 1979) (evaluating bank holding companies by examining “Bank Subsidiaries; Other (Nonbank) Subsidiaries; Parent Company; Earnings—Consolidated; Capital Adequacy—Consolidated”).

⁴⁹ The first five elements are rated on a scale of one through five in descending order of performance quality. The financial composite rating denotes an overall evaluation ratings based on the first five elements. The managerial composite reflects a comprehensive evaluation of holding company management as indicated by the assignment of “S”, “F”, or “U” for, respectively, management that is found to be satisfactory, fair or unsatisfactory. *Id.* at 2.

⁵⁰ *Id.*

need for “capital on a consolidated basis that must serve as the ultimate source of support and strength to the entire corporation.”⁵¹

Before the 1980s, bank regulators enforced capital requirements informally.⁵² In 1981, the Office of the Comptroller of the Currency (“OCC”) and Board issued formal capital standards.⁵³ In 1983, the Fifth Circuit Court of Appeals overturned an OCC capital directive related to the unsafe and unsound capital level at a national bank.⁵⁴ Congress reacted to the decision by enacting the International Lending Supervision Act (“ILS Act”).⁵⁵ The ILS Act directed federal banking agencies to “cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions.”⁵⁶ The ILS Act clearly established the authority of regulators to issue capital directives and to utilize capital ratios as a determinant of safety and soundness. Specifically, the ILS Act stated that the “failure of a banking institution to maintain capital at or above its minimum level . . . may be deemed . . . to constitute an unsafe and unsound practice.”⁵⁷ Furthermore, the ILS Act provided the Board with authority to establish capital standards for affiliates, including bank holding companies and their nonbank subsidiaries.⁵⁸

⁵¹ *Id.* at 10.

⁵² *See, e.g.*, Kenneth J. Gordon, *Risk-Based Capital Requirements: The Proper Approach to Safe and Sound Banking?*, 10 ANN. REV. BANKING LAW 491, 493 (1991); Joseph J. Norton, *Capital Adequacy Standards: A Legitimate Regulatory Concern for Prudential Supervision of Banking Activities?*, 49 OHIO ST. L.J. 1299, 1321 (1989) (“The various regulatory positions were largely separate internal examination tools for helping to assess overall bank soundness and to coax informally management (where needed) to do better.”).

⁵³ *E.g.*, Statement of Policy on Capital Adequacy, 46 Fed. Reg. 62,693 (FDIC 1981); *Capital Adequacy Guidelines*, Fed. Banking L. Rep. (CCH) ¶ 47-255, at 9 (Dec. 17, 1981).

⁵⁴ *First Nat’l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 685 (5th Cir. 1983).

⁵⁵ International Lending Supervision Act, Pub. L. No. 98-181, 97 Stat. 1278 (1983); *see also* 12 U.S.C. § 3907 (1983).

⁵⁶ International Lending Supervision Act, § 908, 97 Stat. at 1280 (1983).

⁵⁷ *Id.*

⁵⁸ S. REP. NO. 98-122, at 17 (1983) (“[A]ny of the provisions of the bill may be applied by the appropriate federal banking agency to any affiliate of any insured bank, including any bank holding company individually or on a consolidated basis for its nonbank subsidiaries”); *see also* S. REP. NO.

Regulatory capital requirements continued to evolve after the ILS Act. In 1985, the federal banking regulators adopted uniform capital adequacy standards.⁵⁹ In January 1989, the Board adopted risk-based capital guidelines.⁶⁰ These guidelines reinforced the existing policy that organizations undertaking significant expansion, either through internal growth or acquisitions, maintain strong capital positions substantially above minimum levels. In August 1989, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989⁶¹ mandated penalties for failure to satisfy capital standards on a timely basis. In December 1991, the Federal Deposit Insurance Improvement Act of 1991 required bank regulators to monitor capital levels and take prompt corrective action when insured depository institutions failed to meet them, basing the required actions upon five delineated capital categories.⁶²

7. Proposals to Reform the Regulatory Structure

Proposals to reform the regulatory structure for financial institutions are an almost perennial feature of political debate.⁶³ During the late 1980s and early 1990s, many reform proposals advocated simplifying the regulatory structure for financial institutions. In 1987, Senator Wirth co-sponsored legislation to establish a Financial Services Oversight Commission⁶⁴ with

100-19, at 36 (1987); 50 Fed. Reg. 16,057, 16,064 (Federal Reserve Bd. Apr. 24, 1985); *Wake Bancorp, Inc.*, 73 Fed. Res. Bull. 925 (1987).

⁵⁹ See, e.g., 50 Fed. Reg. 16,057, 16,066 (Federal Reserve Bd. Apr. 24, 1985); 50 Fed. Reg. 11,128, 11,136 (FDIC Mar. 19, 1985); 50 Fed. Reg. 10,207, 10,216 (OCC Mar. 14, 1985).

⁶⁰ 54 Fed. Reg. 4186 (Federal Reserve Bd. Jan. 27, 1989).

⁶¹ Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183.

⁶² See Federal Deposit Insurance Improvement Act of 1991, Pub. L. No. 102-242, § 131, 105 Stat. 2236, 2253 (1991).

⁶³ For an overview of 24 proposals for regulatory restructuring going back to the 1930s, see the Appendix to Rose Marie Kushmeider, *The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation*, 17 FDIC BANKING REVIEW 1, 25-29 (2005); see also, DEPT. OF THE TREASURY, BLUEPRINT FOR MODERNIZED FINANCIAL REGULATORY STRUCTURE (2008).

⁶⁴ S. 1891, 100th Cong. (1987). The bill was based in large part on a proposal by E. Gerald Corrigan, president of the Federal Reserve Bank of

responsibility for consolidated supervision of domestic financial institutions by function rather than type of institution. Senator Wirth stated that the proposed Commission “would provide an *umbrella supervisory structure*,” and would have powers to “regulate activities of banking, financial and commercial holding companies and establish minimum standards of capital adequacy for financial holding companies.”⁶⁵

In the first quarter of 1991, Representative Gonzalez introduced two separate banking bills, House Bill 6⁶⁶ and House Bill 1505.⁶⁷ These bills included provisions reforming the deposit insurance system, mandating prompt corrective action, regulating foreign banks operating in the United States, amending consumer protection laws and modernizing financial services regulation and supervision. House Bill 6 would have reorganized the supervisory structure for banks and thrifts, splitting federal supervision and regulation of bank holding companies, banks, and thrifts between the Board and a new Office of Depository Institutions Supervision.⁶⁸ House Bill 1505 would have created one federal regulator for bank holding companies, banks, and thrifts by transferring the supervisory powers of the OCC, Board, FDIC, and Office of Thrift Supervision (“OTS”) to a new Federal Depository Institutions Regulatory Agency.⁶⁹

In February 1991, the Treasury advanced a proposal to restructure the regulatory system for financial institutions that would have allocated bank and bank holding company “umbrella oversight” to a new federal banking agency or the Board, depending upon the national or state charter of the lead bank within the organization.⁷⁰ The Treasury report addressed “umbrella oversight” of a financial services holding company (“FSHC”), observing that “bank regulation should be focused on protecting the bank, which has access to the

New York. E. GERALD CORRIGAN, *FINANCIAL MARKET STRUCTURE: A LONGER VIEW* (Fed. Reserve Bank of N.Y.1987).

⁶⁵ S. 2433, 101st Cong. (1990); S. 1891, 100th Cong. (1987) (emphasis added); 136 CONG. REC. S4246 (1990); 133 CONG. REC. S16675 (1987).

⁶⁶ H.R. 6, 102d Cong. (1991).

⁶⁷ H.R. 1505, 102d Cong. (1991).

⁶⁸ See H.R. 6, Title X, 102d Cong. (1991).

⁶⁹ See H.R. 1505, Title III, 102d Cong. (1991).

⁷⁰ See DEPT. OF THE TREASURY, *MODERNIZING THE FINANCIAL SYSTEM: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS* (1991) [hereinafter *Financial System*].

federal safety net, not on protecting its holding company or financial affiliates.”⁷¹ But some umbrella oversight is necessary:⁷² “Umbrella oversight is designed to identify problems in the holding company of affiliates that are likely to cause difficulties for the insured bank, and to apply remedial action. *The sole, guiding principle of umbrella oversight is to protect the insured bank.*”⁷³ Such oversight includes:

[A] The ability to examine the FSHC and bank, and also to examine any nonbank affiliate which poses a risk to the bank. (The regulator, if any, of the nonbank affiliate would have reciprocal examination rights.) [B] The ability to require sale of a nonbank affiliate if such affiliate poses a clear threat to the bank. [C] For banks that fall below minimum capital standards, the ability to require that the parent company either: (1) bring bank capital back to minimum standards; (2) sell or otherwise divest the bank; or (3) become subject to bank capital standards and other holding company regulations to be applied to the entire organization on a consolidated basis.⁷⁴

As reported by the House Committee on Banking, Finance and Urban Affairs, House Bill 6 required diversified holding companies to register with the Board, and gave the Board the power to require reports from diversified holding companies and their subsidiaries, as well as authority to conduct examinations of the holding companies and their financial affiliates.⁷⁵ This bill gave the Board supervisory authority over holding companies rather than distributing supervision of holding companies between two regulators as proposed by the Treasury Department.

In October 1991, Representative Dingell used the term “umbrella regulator” to describe the Board’s role in the system of regulation envisioned by House Bill 6—a system of functional regulation for banking and securities activities, which preserved the

⁷¹ *Id.* at 61.

⁷² *Id.* (“At the same time, certain ‘umbrella oversight’ of the FSHC by the bank regulator is necessary to protect the insured depository from affiliate risk.”)

⁷³ *Id.* (emphasis added).

⁷⁴ *Id.*

⁷⁵ H.R. 6, § 405, 102d Cong. (1991); H.R. REP. No. 102-157, at 69 (1991).

Federal Reserve’s role as “umbrella regulator” of domestic bank holding companies.⁷⁶ Representative Dingell stated that such a system “requires tough, functional regulation of new securities powers by giving the securities regulators control over the securities activities of banks, and it preserves to the Federal Reserve Board its current role of an umbrella regulator of the holding company.”⁷⁷

While House Bill 6 did not pass the House, several of the matters addressed by the bill appeared in the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”).⁷⁸ FDICIA made a number of changes related to deposit insurance, supervision of foreign banks, prompt corrective action when institutions fell below certain capital thresholds, audit committees, and accounting standards. However, FDICIA did not include provisions related to financial modernization or reform of the supervisory structure.⁷⁹

8. Risk-Based Supervisory Practices

In the late 1980s, the supervisory practices of international and domestic regulators became increasingly risk-focused. In January 1987, the United States and United Kingdom reached a nonbinding accord on capital adequacy standards, which sought to promote uniformity and a risk-based approach to capital adequacy.⁸⁰ In 1988, the Basel Committee issued its final capital adequacy report (“Basel Capital Accord”).⁸¹ In 1989, federal banking regulators adopted risk-based capital standards based on the Basel Capital Accord.⁸² The Board’s risk-based capital requirements classified capital as core capital and supplementary capital, requiring at least 50% of capital to

⁷⁶ See 137 CONG. REC. H8899 (1991); *see also* Financial Institutions Safety and Consumer Choice Act of 1991, H.R. 6 §§ 404, 405, 102d Cong. (1991) (proposed registration, reporting, examination, and enforcement powers of the Board).

⁷⁷ 137 CONG. REC. H8899 (1991).

⁷⁸ See Federal Deposit Insurance Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (1991).

⁷⁹ *See id.*

⁸⁰ See 52 Fed. Reg. 5119, 5135 (Feb. 19, 1987).

⁸¹ BASLE COMM. ON BANKING SUPERVISION, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS (July 1988).

⁸² *See, e.g.*, 54 Fed. Reg. 4186, 4191 (Fed. Reserve Jan. 27, 1989); 53 Fed. Reg. 8550, 8558 (Fed. Reserve Mar. 15, 1988).

consist of core capital. The risk-based requirements also categorized assets and off-balance sheet risk to arrive at a weighed risk figure. Capital was then divided by the weighted risk figure to yield a risk-based capital ratio. The risk-based system required a certain percentage of capital to be set aside depending upon the level of risk involved with particular assets.

Supervisory focus on risk impacted other areas of supervisory practice. In 1996, Federal Reserve examiners began to assign a formal supervisory rating to the adequacy of an institution’s risk-management processes, including its internal controls.⁸³ Large institutions were expected to have comprehensive reporting and monitoring systems that allowed for “the aggregation of risks on a fully consolidated basis across all business lines and activities.”⁸⁴ In 1997, Board staff issued an SR letter entitled *Risk-Focused Framework for Supervision of Large Complex Institutions*.⁸⁵ This guidance focused on activities that pose the greatest risks to the soundness of a banking organization and assessment of an organization’s management systems to identify, measure, monitor and control risks. This guidance also referred to the umbrella supervision responsibilities of the Board, stating that, when the Board carries out its “umbrella supervision responsibilities for bank holding companies and the U.S. operations of foreign banking organizations, the Federal Reserve should continue, as appropriate, to incorporate the findings and conclusions of other supervisors into its overall assessment of the consolidated banking organization or banking group.”⁸⁶ The Board’s role as an umbrella supervisor was supported by its risk-based practices related to consolidated capital

⁸³ See Fed. Reserve Bd., SR 95-51, Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies (Nov. 14, 1995).

⁸⁴ *Id.* at 9.

⁸⁵ See Fed. Reserve Bd., SR 97-24, Risk-Focused Framework for Supervision of Large Complex Institutions (Oct. 27, 1997).

⁸⁶ *Id.* at 2 (emphasis added). Board staff also referred to the Board’s “umbrella authority” in connection with guidance issued in 1995 regarding supervision of foreign banks with U.S. operations: “The Federal Reserve, in its statutory role as *umbrella authority* with responsibility for overall U.S. operations, will confer with the examining agencies to determine if its participation in any of the examiner closeout meetings is warranted.” Fed. Reserve Bd., SR 95-22, Enhanced Framework for Supervising the U.S. Operations of Foreign Banking Organizations (March 31, 1995) (emphasis added).

and risk-management processes, which cut across legal entities under ownership or control of a bank holding company.

9. Legislative Proposals During the Late 1990s

On February 27, 1995, Representative Leach introduced House Bill 1062, which expand permissible affiliations between banks and securities firms.⁸⁷ In testimony on this legislation, Chairman Greenspan discussed the Board’s supervisory role over domestic institutions in Congressional testimony, stating, “[W]e must not lose sight, and the Leach bill does not, that the *umbrella supervisor* must still be permitted to monitor both the financial condition of the organization and the potential transfer of risks to the insured depository affiliates.”⁸⁸ Subsequent congressional witnesses also addressed the importance of umbrella, comprehensive, and consolidated supervision of domestic financial institutions.⁸⁹ Nevertheless, the 104th Congress ended without action on this legislation by the full House. On January 7, 1997, Representative Leach introduced House Bill 10. It authorized financial services holding companies and affiliations between banking, securities, and insurance firms. The bill also authorized the Board to gather information on the financial services holding companies and any subsidiary through reports and examinations.⁹⁰ On July 3, 1997, the

⁸⁷ H.R. 1062, 104th Cong. (1995).

⁸⁸ *Modernization of the Financial Services Regulatory Systems: Hearing Before the H. Comm. on Banking & Fin. Servs.*, 104th Cong. 10 (1995) (testimony of Alan Greenspan, Chairman, Fed. Reserve Bd.) (emphasis added).

⁸⁹ See, e.g., *Modernization of the Financial Services Regulatory Systems: Hearing Before the H. Comm. on Banking & Fin. Servs.*, 104th Cong. (1995) (testimony of Matthew P. Fink, President, Investment Company Institute); *Modernization of the Financial Services Regulatory Systems: Hearing Before the H. Comm. on Banking & Fin. Servs.*, 104th Cong. (1995) (testimony of James L. Bothwell, Dir., Fin. Inst. And Mkt. Issues, U.S. Gen. Accounting Office); *Modernization of the Financial Services Regulatory Systems: Hearing Before the H. Comm. on Banking & Fin. Servs.*, 104th Cong. (1995) (testimony of Paul A. Volcker, Chairman, James D. Wolfensohn, Inc. and Frederick H. Schultz Professor of International Economic Policy of Princeton University.); *Modernization of the Financial Services Regulatory Systems: Hearing Before the H. Comm. on Banking & Fin. Servs.*, 104th Cong. (1995) (testimony of E. Gerald Corrigan).

⁹⁰ H.R. 10, 105th Cong. §§ 101, 102, 123 (1997).

House Committee on Banking and Financial Services voted favorably on House Bill 10 and issued a report that addressed umbrella supervision, noting that “[a]n important aspect of this new framework is that it would incorporate functional regulation with the Federal Reserve serving as an umbrella regulator to oversee the new financial holding company structure.”⁹¹ On October 30, 1997, the House Commerce Committee adopted an amendment to House Bill 10 that reduced the Board’s oversight authority.⁹² On November 3, 1997, a report by the House Committee on Banking and Financial Services, in discussing provisions designed to streamline Board supervision of bank holding companies, stated that such provisions make “significant changes in the role of the Federal Reserve Board in overseeing holding companies.”⁹³ Specifically, “Section 111 provides that the Federal Reserve Board may not examine the non-bank subsidiaries of financial services holding companies, absent exigent circumstances. The Committee determined that although it was appropriate for the Federal Reserve Board to have supervisory authority over holding companies, the authority over affiliates should be confined to the functional regulators. . . .”⁹⁴

As amended, the bill required the Board to use reports of primary bank regulators, functional regulators, and self-regulatory organizations to the fullest extent possible, limited the Board’s authority to examine functionally regulated subsidiaries, and prohibited the Board from imposing capital requirements on functionally regulated holding company subsidiaries.

On May 13, 1998, Representative Gillmor made the following statement on the floor of the House regarding these provisions:

Earlier versions of this legislation would have created an umbrella-like regulatory framework subjecting many financial entities to excessive and conflicting regulatory requirements. No clear argument had been made to authorize Federal Reserve umbrella regulation over securities and

⁹¹ H.R. REP. No. 105-164, pt. 1, at 90 (1997).

⁹² See Press Release, Conference of State Bank Supervisors, Financial Modernization Legislation Passes House Commerce Committee (Oct. 31, 1997).

⁹³ H.R. REP. No. 105-164, pt. 3, at 117 (1997).

⁹⁴ *Id.*

insurance entities that had functioned effectively without Federal Reserve supervision. That is why I offered an amendment in the Committee on Commerce to scale back this broad expansion of unwarranted regulatory authority and emphasize true functional regulation. My amendment, which was passed unanimously in the Committee on Commerce, is commonly known as Fed Lite because it scales back much of the unnecessary authority of the Federal Reserve to require reports and conduct examinations in nonbank subsidiaries of a holding company. Essentially, Fed Lite eliminates most duplicative and burdensome regulations.⁹⁵

While the Fed Lite provisions minimized burden and reduced duplication, they affirmed the Board’s capital adequacy practices and strengthened the Board’s authority to set capital standards for affiliates, albeit with limitations related to functionally regulated insurance, securities, and commodities affiliates.⁹⁶

As passed by the House on May 13, 1998, the bill referred to the Board as the “umbrella supervisor” of financial holding companies in a purpose section related to interagency coordination, consultation, and information sharing. The language in that section stated that Congress’s intent was “that the Board of Governors of the Federal Reserve System, as the umbrella supervisor for financial holding companies, and the State insurance regulators, as the functional regulators of companies engaged in insurance activities, coordinate efforts to supervise companies that control both a depository institution and a company engaged in insurance activities regulated under State law.”⁹⁷ This was the first use of the term “umbrella” in the text of proposed legislation to refer to the Board’s supervisory role.

On September 18, 1998, the bill reported out of the Senate Committee on Banking, Housing, and Urban Affairs included similar provisions regarding streamlined supervision of financial holding

⁹⁵ 144 CONG. REC. H3130 (daily ed. May 13, 1998) (statement of Rep. Gillmor).

⁹⁶ H.R. REP. No. 105-164, pt. 3, at 13 (1997).

⁹⁷ H.R. 10, 105th Cong. § 117 (1998).

companies.⁹⁸ However, the 105th Congress ended without further action on this banking legislation in large part because of objection to its expansion of the Community Reinvestment Act.⁹⁹ On January 6, 1999, House Bill 10 was reintroduced in the House. It included provisions similar to the Senate bill worked on during the previous year.¹⁰⁰ Committee Chairman James Leach stated that “last fall we came close to achieving consensus and the bill before us reflects compromises hammered out over four years of consideration.”¹⁰¹

On March 4, 1999, the Senate Banking Committee completed its mark-up of the Senate’s version of financial services modernization, Senate Bill 900. Prior to the committee vote, Senator Sarbanes and Representative Leach resolved a number of issues, including differences over the Community Reinvestment Act.¹⁰² The report of the committee commented on the supervision of financial holding companies, stating that the bill “seeks to provide regulation of BHCs that is sufficient to protect the safety and soundness of the financial system and the integrity of the Federal deposit insurance funds without imposing unnecessary regulatory burdens.”¹⁰³ The report further observed that “[w]hile functional regulators are supervising various holding company subsidiaries, the Committee believes there is a need for oversight of the organization as a whole as well as subsidiaries not subject to functional regulation. The need for holding company regulation was stressed by witnesses before the Committee as well.”¹⁰⁴ The report thus concluded that “the Board has authority to examine the holding company and, under certain circumstances, any holding company subsidiary that poses a material

⁹⁸ S. 2590, 105th Cong. § 117 (1998); S. REP. NO. 105-336, at 12 (1998).

⁹⁹ *Financial Modernization Runs Out of Stream*, 17 BANKING POL’Y REP. 2 (1998).

¹⁰⁰ H.R. 10, 106th Cong. §§ 111, 117 (1999).

¹⁰¹ *Modernization of the Financial Services Regulatory Systems: Hearing Before the H. Comm. on Banking & Fin. Servs.*, 104th Cong. 1 (1995) (statement of Rep. Leach, Chairman, House Comm. on Banking & Fin. Servs.).

¹⁰² *Financial Modernization: Just Before March 4 Vote, Lawmakers Compromise on Controversial Issues*, 18 BANKING POL’Y REP. 3, (1999).

¹⁰³ S. REP. NO. 106-44, at 16 (1999).

¹⁰⁴ *Id.* (“For example, William McQuillan, President of City National Bank of Greeley, N.E., testified, ‘the IBAA strongly supports the establishment of an umbrella regulator for diversified financial services firms and feels the only Federal regulator equipped for this job is the Federal Reserve.’”).

risk to an affiliated bank.” Nevertheless, such umbrella regulation had its limits:

The Committee does not intend for holding company regulation to override functional regulation of holding company subsidiaries. For functionally regulated subsidiaries, the Board is required, to the greatest extent possible, to rely on reports required by and examinations conducted by the functional regulator.¹⁰⁵

The Senate passed Senate Bill 900 on March 6, 1999.

On March 11, 1999, the House Committee on Banking and Financial Services completed its mark-up of House Bill 10. The Committee version of the bill continued to state congressional intention regarding coordination, consultation, and information sharing between the Board as umbrella supervisor and state insurance regulators.¹⁰⁶ The Committee’s report provided further explanation of the supervisory approach of the bill:

The framework for permitting new financial affiliations incorporates functional regulation with the Federal Reserve serving as an umbrella supervisor to oversee the new financial holding company structure. The Federal Reserve would be required to defer to the Securities and Exchange Commission [SEC] and state regulators on interpretation of state securities laws and to state insurance regulators on interpretation of state insurance law as it relates to functionally-regulated nonbank affiliates.¹⁰⁷

These provisions remained in the bill as reported by the House Commerce Committee on June 15, 1999.¹⁰⁸ The Committee report provided the following explanation of the supervision of financial holding companies by the Board, the SEC, and state insurance regulators:

¹⁰⁵ *Id.*

¹⁰⁶ H. REP. NO. 106-74, pt. 1, at 26 (1999).

¹⁰⁷ *Id.* at 98.

¹⁰⁸ H. REP. NO. 106-74, pt. 3, at 19, 77 (1999).

[Section 111] clarifies and limits the role of the Federal Reserve Board in overseeing holding companies Section 111 provides that the Federal Reserve Board may examine the non-bank subsidiaries of financial services holding companies only under specified and limited circumstances. . . .

Section 111 also provides that the Federal Reserve Board may not impose any capital adequacy rules, guidelines or other actions on a non-depository subsidiary of a bank holding company that is in compliance with the applicable capital requirements of another Federal regulatory authority or State insurance authority. . . .

This section also requires the Federal Reserve Board to defer to the SEC regarding the interpretation and enforcement of applicable Federal securities laws . . . [and] to the relevant State insurance authorities regarding the interpretation and enforcement of applicable State insurance laws relating to the activities of insurance companies and agents.¹⁰⁹

The House passed House Bill 10 on July 1, 1999.

Although there were significant differences in the bills passed by the House and Senate, both bills acknowledged the Board as the umbrella supervisor for financial holding companies engaged in bank, insurance, and securities activities. The differences between the two bills was worked out by the Conference Committee, which issued its report on November 2, 1999.¹¹⁰ The Conference Report stated:

Reflected in the legislation is the determination made by both Houses to preserve the role of the

¹⁰⁹ *Id.* at 143-45.

¹¹⁰ Resolution of the differences between the bills was facilitated by an agreement between the Federal Reserve Board and the Treasury on the activities of operating subsidiaries. Letter from Alan Greenspan, Chairman of the Fed. Res. Bd. and Lawrence H. Summers, Sec’y of the Treasury, to Jim Leach, Representative, Chairman of the House Comm. on Banking & Fin. Servs. (Oct. 14, 1999).

Board of Governors of the Federal Reserve System . . . as the umbrella supervisor for holding companies, but to incorporate a system of functional regulation designed to utilize the strengths of the various Federal and State financial supervisors. . . .

In keeping with the Board’s role as an umbrella supervisor, the legislation provides that the Board may require any bank holding company or subsidiary thereof to submit reports regarding its financial condition, systems for monitoring and controlling financial and operating risks, transactions with depository institutions, and compliance with the BHCA or other Federal laws that the Board has specific jurisdiction to enforce. The Board is directed to use existing examination reports prepared by other regulators, publicly reported information, and reports filed with other agencies, to the fullest extent possible.¹¹¹

On November 4, 1999, Representative Gillmor made the following statements about umbrella supervision in Congressional debate related to acceptance of the Conference Report:

While the Federal Reserve serves an umbrella regulator over Financial Holding Companies, I was concerned about the Fed getting into the jurisdiction of the already effective insurance and securities regulators My amendment in the Commerce Committee two years ago, which was included in the current bill, created the functional regulatory framework for financial holding companies. The purpose of this “Fed Lite” framework is to parallel the financial services affiliate structure envisioned under this legislation. This parallel regulatory structure eliminates the duplicative and burdensome regulations on businesses not engaged in banking activities, and importantly, preserves the role of the Federal Reserve as the prudential supervisor over

¹¹¹ H. REP. NO. 106-434, at 151-57 (1999).

businesses that have access to taxpayer guarantees and the federal safety net.¹¹²

On November 4, 1999, the Senate and House agreed to the Conference Report.¹¹³

B. Gramm-Leach-Bliley Act

1. Major Provisions

On November 12, 1999, President Clinton signed the Gramm-Leach-Bliley Act (GLB Act) into law.¹¹⁴ The GLB Act repealed restrictions on affiliations among banks, securities firms, insurance companies, and other financial services providers contained in the Banking Act and BHC Act.¹¹⁵ It also authorized affiliations among such entities through the creation of a new financial holding company structure.

Functional and Entity Regulation. The GLB Act accepted functional regulation—regulation of banking activities by bank regulators, regulation of securities activities by the SEC, regulation of insurance activities by state insurance commissions, and regulation of commodities activities by the Commodities Futures Trading Commission. The GLB Act supplemented functional regulation with entity regulation, however, leaving intact the Board’s general power to supervise the parent entity over subsidiaries offering banking, securities, insurance, and other financial services, subject to certain limitations.

FHC Status. The GLB Act authorized a bank holding company that files an effective election with the Board certifying that all of its depository institution subsidiaries are well capitalized and well managed to become a financial holding company (“FHC”).

¹¹² 145 CONG. REC. H11547-11548 (daily ed. Nov. 4, 1999) (statement of Rep. Gillmor); *see also* 145 CONG. REC. S13877 (daily ed. Nov. 4, 1999) (statement of Sen. Allard); 145 CONG. REC. S4616 (daily ed. May 4, 1999) (statement of Sen. Gramm).

¹¹³ 145 CONG. REC. D1257 (daily ed. Nov. 4, 1999).

¹¹⁴ Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified at scattered sections of 12 U.S.C.); *see also*, President Bill Clinton, Remarks at the Signing of the Financial Modernization Act (Nov. 12, 1999), *in* 35 WEEKLY COMP. PRES. DOC. 2363 (Nov. 12, 1999).

¹¹⁵ Gramm-Leach-Bliley Act §§ 101, 102.

FHCs may engage in a broad range of activities that are financial in nature, including securities underwriting and dealing, insurance agency and underwriting, and merchant banking, as well as activities deemed to be incidental or complementary to such financial activities.¹¹⁶

Supervisory Authority. Under the GLB Act, the Board continued to have the power to examine and require reports from any bank holding company or any subsidiary, adopt consolidated capital adequacy guidelines for bank holding companies, and take enforcement action against bank holding companies and their nonbank subsidiaries. Furthermore, the GLB Act acknowledged the Board as the “umbrella supervisor” in connection with the Board’s relationship with functional regulators of insurance companies:

It is the intention of the Congress that the Board of Governors of the Federal Reserve System, as the umbrella supervisor for financial holding companies, and the State insurance regulators, as the functional regulators of companies engaged in insurance activities, coordinate efforts to supervise companies that control both a depository institution and a company engaged in insurance activities regulated under State law.¹¹⁷

The GLB Act also addressed information sharing by the Board, other federal banking agencies, and state insurance regulators. But the GLB Act placed limits on the Board’s supervisory powers, especially for functionally regulated subsidiaries of a bank holding company.¹¹⁸

Reports. The GLB Act required the Board to rely on publicly available information, externally audited financial statements and reports that a holding company or subsidiary is required to provide to

¹¹⁶ 12 U.S.C. § 1843(k) (2008); Gramm-Leach-Bliley Act § 103.

¹¹⁷ Gramm-Leach-Bliley Act § 307. This is the only statutory use of the term “umbrella supervisor.”

¹¹⁸ A “functionally regulated subsidiary” is defined to mean any subsidiary of a bank holding company (other than an insured depository institution) that is a broker, dealer, or investment company registered with the SEC; insurance company, insurance agent supervised by a state insurance regulator, investment adviser supervised by the SEC or state securities supervisor; or entity regulated by the Commodities Futures Trading Commission. 12 U.S.C. § 1844(c)(5); Gramm-Leach-Bliley Act § 111.

other federal or state supervisors or self-regulatory organizations to the fullest extent possible.¹¹⁹ Before the Board may seek a special report from a functionally regulated subsidiary, the Board must first request that the subsidiary’s functional regulator obtain the special report.¹²⁰ If the report is not made available to the Board, the Board may obtain the report directly from the subsidiary only if the report is necessary to assess: (a) a material risk to the holding company or an affiliated depository institution; (b) compliance with the BHC Act or any other federal law that the Board has specific jurisdiction to enforce against the company or subsidiary; or (c) the holding company’s systems for managing and controlling financial or operational risks that may pose a threat to a subsidiary insured depository institution.¹²¹

Examinations. The Board may examine a bank holding company or any subsidiary only for specified purposes, and must focus its examinations on the holding company and any subsidiary that, for specified reasons, may have a material adverse effect on affiliated depository institutions.¹²² The Board must, to the fullest extent possible, rely on reports of examination done by the functional regulator of an insurance company, a securities broker or dealer, or any other functionally regulated subsidiary.¹²³ In addition, the Board may examine a functionally regulated subsidiary only if the Board: (1) reasonably believes that the subsidiary is engaged in activities that pose a material risk to an affiliated depository institution; (2) reasonably determines that examination of the subsidiary is necessary to adequately inform the Board concerning the holding company’s systems for monitoring and controlling financial and operational risks that could threaten a subsidiary depository institution; or (3) has reasonable cause to believe that the subsidiary is not in compliance with the BHC Act or any other federal law that the Board has specific jurisdiction to enforce against the subsidiary (including applicable limitations on transactions between a depository institution and its affiliates) and the Board cannot otherwise determine such compliance through the examination of the holding company or its subsidiary depository institutions.¹²⁴

¹¹⁹ 12 U.S.C. § 1844(c)(1)(B)(i); Gramm-Leach-Bliley Act § 111.

¹²⁰ 12 U.S.C. § 1844(c)(1)(B)(iii)(I); Gramm-Leach-Bliley Act § 111.

¹²¹ 12 U.S.C. § 1844(c)(1)(B)(iii)(II); Gramm-Leach-Bliley Act § 111.

¹²² 12 U.S.C. § 1844(c)(2); Gramm-Leach-Bliley Act § 111.

¹²³ 12 U.S.C. § 1844(c)(2)(E); Gramm-Leach-Bliley Act § 111.

¹²⁴ 12 U.S.C. § 1844(c)(2)(B); Gramm-Leach-Bliley Act § 111.

Capital. The Board retained its authority to adopt consolidated capital adequacy guidelines for bank holding companies,¹²⁵ but the Board may not impose capital requirements on: (a) any securities broker-dealer or insurance company subsidiary in compliance with the capital requirements of the Securities Exchange Commission or relevant state insurance authority; (b) any other subsidiary in compliance with the applicable capital requirements of its federal regulator; or (c) any registered investment adviser or licensed insurance agent subsidiary.¹²⁶

Source of Strength. Under existing regulation, the Board requires a bank holding company to serve as a source of strength to its subsidiary banks.¹²⁷ But Congress limited this policy by

¹²⁵ 12 U.S.C. § 3907.

¹²⁶ Gramm-Leach-Bliley Act § 111(5)(c)(3)(A). In establishing capital adequacy guidelines, the Board may not take into account the operations or investments of any investment company that is registered under the Investment Company Act of 1940, unless (i) the investment company is a bank holding company, or (ii) a bank holding company owns at least 25 percent of the investment company and such investment has a market value of at least \$1 million. *Id.* § 111(5)(c)(3)(C). The Conference Report indicates that the Board should be flexible in its application of holding company consolidated capital standards to FHCs of which the predominant regulated subsidiary is a broker-dealer. 145 CONG. REC. H11295 (daily ed. Nov. 2, 1999).

¹²⁷ 12 C.F.R. § 225.4(a)(1) (2008); 52 Fed. Reg. 15,707 (Apr. 30, 1987). *But see* MCorp Fin., Inc. v. Bd. of Governors Fed. Reserve Sys., 900 F.2d 852, 863 (5th Cir. 1990) (holding that the BHC Act does not require a holding company to transfer its funds to its troubled subsidiary). But the U.S. Supreme Court reversed the Fifth Circuit, holding that the court of appeals did not have the jurisdiction to set aside the Board’s order. *Bd. of Governors Fed. Reserve Sys. v. MCorp Fin., Inc.*, 502 U.S. 32, 44 (1991). While the Supreme Court did not rule on the issue, the Board argued that the ILS Act authorizes the Board to establish capital standards for bank holding companies and ensure that capital reserves are used to protect the safety of subsidiary banks. Brief of Petitioner-Appellant at 19 n.23, *Board of Governors*, 502 U.S. 32 (1991) (Nos. 90-913 and 90-914). Subsequently, Congress enacted FDICIA, which granted federal regulators the ability to require a capital restoration plan guaranteed by the bank’s parent bank holding company. Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 131, 105 Stat. 2256; *see also* Kieran H. Fallon, *Source of Strength or Source of Weakness?: A Critique of the “Source of Strength” Doctrine in Banking Reform*, 66 N.Y.U. L. REV. 1344 (1991).

prohibiting the Board from requiring a subsidiary of a bank holding company that is a insurance company, registered broker-dealer, investment company, or investment adviser to provide funds or assets to an affiliated depository institution if the state insurance authority or the SEC, as appropriate, determine that the transfer would have a material adverse effect on the financial condition of such subsidiary.¹²⁸ In such circumstances, however, the Board could order the bank holding company to divest the relevant depository institution.¹²⁹

Enforcement. The GLB Act impacted the Board’s enforcement authority in several ways. First, the Board can order the divestiture of a depository institution by a broker-dealer or insurance company under the conditions stated immediately above. Second, the GLB Act authorized the Board to order the divestiture of depository institution subsidiaries of a FHC if the FHC does not cause any depository institution subsidiary of the FHC not in compliance with applicable FHC capital and management requirements to cure such deficiencies within specified time frames.¹³⁰ Finally, the GLB Act limited the Board’s enforcement authority regarding functionally regulated subsidiaries. The Board may take enforcement action against such functionally regulated subsidiaries only: (a) to enforce compliance with any federal law that the Board has specific jurisdiction to enforce (e.g., the BHC Act), or (b) to prevent or redress an unsafe or unsound practice or breach of fiduciary duty that poses a material risk to the financial safety, soundness, or stability of an affiliated depository institution or the domestic or international payments system, where the Board finds that it cannot effectively address the problem by taking action against only affiliated depository institutions.¹³¹

Consultation. The GLB Act requires the Board to consult with the appropriate state insurance authorities prior to authorizing a

¹²⁸Gramm-Leach-Bliley Act § 112 (codified at 12 U.S.C. §§ 1831v and 1844(g)).

¹²⁹*Id.*

¹³⁰A noncompliant financial holding company may, however, avoid such a divestiture order by ceasing to engage in all activities that are not permissible for a bank holding company under section 4(c)(8) of the BHC Act. Gramm-Leach-Bliley Act, § 103 (codified at 12 U.S.C. § 1844(m)).

¹³¹*Id.* § 113.

financial holding company or insured depository institution to affiliate with a company engaged in insurance activities.¹³²

Information Sharing. The GLB Act authorizes the Board to provide information to the appropriate state insurance authority where necessary or appropriate to permit the state authority to administer and enforce state insurance laws.¹³³ It also authorizes the Board to provide any examination reports or other confidential supervisory information about any entities the Board has examined to any federal or state agency with supervisory or regulatory authority over that entity.¹³⁴ This authority allows the Board to share information with functional regulators who possess supervisory or regulatory authority over a holding company subsidiary or other such examined entities.

2. Commentary on GLB Act

After enactment of the GLB Act, various bank regulators commented on the Board’s role as umbrella supervisor in public speeches. For instance, former Chairman Greenspan made the following statement a few days after the GLB Act became law:

[T]he Federal Reserve retains the overall responsibility for financial services holding companies with bank subsidiaries. In exercising that responsibility, however, the Board is required by the act to rely, to the fullest extent possible, on public information and reports from, as well as examinations conducted by, the functional regulator. . . .

It is clear from the letter and the spirit of the Gramm-Leach-Bliley Act that bank regulators and the holding company supervisor are to give great deference to the functional regulators and to interject themselves only in critical circumstances. . . .

[T]he new act does not change the key, dominant, and major responsibility of both the bank and the holding company regulators: to contribute to the

¹³² *Id.* § 307(c).

¹³³ *Id.* § 307(b).

¹³⁴ *Id.* § 727 (codified at 12 U.S.C. § 326).

safety and soundness of the insured depository institution. . . .

In order to protect the bank, umbrella supervision must extend its oversight to the consolidated organization. The need for the Federal Reserve to take a consolidated view of entities with bank affiliates represents the reality that current and future bank holding companies are not passive portfolio investors in their component parts, but rather managers of a consolidated financial enterprise directed from the center--the holding company. Thus, some authority must focus on the entire--the consolidated--entity so that each of the component regulators is aware of risks that may be unfolding elsewhere in the organization that could affect the unit for which it is responsible. This oversight is focused on implications for the bank but provides information that will also be shared with regulators of nonbank affiliates as well. . . .

As umbrella supervisor, our major emphasis will be on protecting the bank subsidiary and on the risk management of the consolidated entity, but the information we generate may also be helpful to functional regulators.¹³⁵

Comptroller John D. Hawke, Jr., gave a speech in which he provided his assessment of the impact of the GLB Act on the regulation of financial institutions:

¹³⁵ Alan Greenspan, Chairman, Fed. Reserve Bd., Address Regarding Insurance Companies and Banks under the New Regulatory Law (Nov. 15, 1999); *see also*, Roger W. Ferguson, Jr., Vice Chairman, Fed. Reserve Bd., Umbrella Supervision Address, National Association of Urban Bankers (May 26, 2000) (“The activities of the Federal Reserve as the umbrella supervisor fall into three broad categories: information gathering and assessment, ongoing supervision, and promotion of sound practices and improved disclosure.”) [hereinafter *Ferguson Address*]; Laurence H. Meyer, Address on the Challenges of Global Financial Institution Supervision (May 31, 2000) (“As umbrella supervisor, the Federal Reserve seeks to gain an overview of the organization’s activities and to detect potential threats to affiliated U.S. depository institutions.”).

[A]s far reaching as the new law is, it left entirely unchanged the structure of financial regulation The decision in Gramm-Leach-Bliley not to address fundamental issues of supervisory structure struck some as particularly curious in light of developments in financial regulation in other countries. . . . [T]hey are increasingly rejecting the confusing structural model of U.S. supervision in favor of a unified agency approach

Of course, the idea of consolidating the federal banking agencies in this country is not a new one. . .

Proposals to rearrange the responsibilities of the federal financial agencies have been a perennial of public policy for many years. . . .

. . . .

Yet none of the proposals for consolidation of bank supervision in a single agency came to fruition

. . . .

In Gramm-Leach-Bliley, the unique structure of U.S. bank supervision has again received strong affirmation. As in the past, Congress has dispersed many new supervisory responsibilities in parallel across the federal banking agencies. . . . [The Gramm-Leach-Bliley Act] preserved the Federal Reserve’s role as the regulator of bank holding companies, with the mission of supplementing the work of the primary bank regulators by focussing [sic] on risks arising outside the bank

. . . .

Viewed in perspective, I believe the new law simply extends the existing multi-agency concept of financial supervision that we’ve been refining for nearly a century. . . .¹³⁶

3. Implementation of the GLB Act

¹³⁶ John D. Hawke, Jr., Comptroller of the Currency, Statement before the New York Bankers Ass’n (April 6, 2000).

The Board also began to formally implement the GLB Act through promulgation of regulations, action on applications, information gathering, and supervisory guidance. It provided general parameters for supervisory practice as umbrella supervisor and specific guidance related to reliance on primary and functional regulators of banks, securities firms, and insurance firms.

Reliance on Primary and Functional Regulators. On March 17, 2000, the Board issued an interim rule regarding the securities activities of bank holding companies, which made the following statement about umbrella supervision:

The Gramm-Leach-Bliley Act also relies on functional regulation of the securities firm by the SEC, full supervision of the depository institution by the appropriate federal banking agency, and umbrella supervision of the overall organization by the Board to identify and address potential risks to the depository institution associated with the securities and other activities in the organization.¹³⁷

In connection with its approval of Charles Schwab’s bank holding company application on May 1, 2000, the Board made the following statement about its reliance on the SEC’s functional regulation of Schwab’s securities activities:

In view of the fact that, on a *pro forma* basis, a large majority of Schwab’s activities are conducted in subsidiaries that are functionally regulated by the Securities and Exchange Commission, [so] the Board expects, in carrying out its responsibilities as umbrella supervisor, to rely heavily on the Securities and Exchange Commission for examination and other supervisory information.¹³⁸

On June 22, 2000, the Board’s staff acknowledged its obligation to utilize the findings of primary bank supervisors and

¹³⁷ Bank Holding Companies and Change in Bank Control; Securities Underwriting, Dealing, and Market-Making Activities of Financial Holding Companies, 65 Fed. Reg. 14,440, 14,441 (Mar. 17, 2000).

¹³⁸ *The Charles Schwab Corporation*, 86 Fed. Res. Bull. 494, 495 (2000) (italics added).

functional regulators in supervisory guidance on equity investments and merchant banking: “Consistent with the Federal Reserve’s role as umbrella supervisor of FHCs and BHCs, supervisors should, where appropriate and available, utilize fully the findings of primary bank supervisors and functional regulators of holding company affiliates in reviewing the potential risks of equity investment activities.”¹³⁹

In connection with its responsibilities as umbrella supervisor of financial holding companies engaged in insurance activities, the Board began to collect insurance-related information.¹⁴⁰ In November 2000, the Board’s notice of the proposed information collection offered the following explanation:

As an umbrella supervisor, it is essential for the Federal Reserve to evaluate the volume and nature of insurance activities conducted by an FHC on a fully consolidated basis. A few basic indicators of the nature and volume of the FHC’s insurance business that cut across legal entities and business lines will be critical, especially since the number of entities and related functional regulators involved with such activities can be substantial and impractical for the Federal Reserve to aggregate on its own. Moreover, with hundreds of BHCs now qualified as FHCs, monitoring those that have begun to engage in insurance activities, and how rapidly they are growing that business, will be extremely challenging. Regulatory disclosures will be particularly important for smaller FHCs that do not regularly publish statements to the marketplace. By adopting some modest reporting supplements to the FR Y9-C, the Federal Reserve will be better prepared to tailor and calibrate its supervisory and coordination efforts with functional supervisors on an as needed and risk-focused basis.

¹³⁹ Fed. Reserve Bd., Letter from Federal Reserve Board to federal bank examiners and supervisors, SR 00-09, (June 22, 2000).

¹⁴⁰ Fed. Reserve Bd., Consolidated Financial Statements for Bank Holding Companies, New Schedule HC-I to Form Y-9C for reports beginning with March 31, 2001.

Simply stated, these data would serve to identify whether the organization has engaged in agency business (sales), underwriting and reinsurance activities and indicate the approximate size of its reserve positions (which constitute the largest liability for an insurance company and the most prominent source of insurer insolvency). These “identifiers” will serve as a tool for identifying when the Federal Reserve will need to contact and coordinate with functional regulators to get additional information without duplicative or onerous burden on the FHC’s functionally-regulated [sic] entities.¹⁴¹

On April 5, 2004, the Board approved the application of Manulife Financial Corporation to become a bank holding company and acquire all the voting shares of John Hancock Financial Services, Inc. In approving the application, the Board stated that it contacted and considered information provided by various federal and state agencies, including state insurance commissioners. The Board also observed that “a substantial portion of the U.S. activities of Manulife and John Hancock are subject to functional regulation by state insurance commissioners or the SEC.”¹⁴² Because of this, the Board stated that it would “consistent with the provisions of section 5 of the BHC Act as amended by the Gramm-Leach-Bliley Act, rely on the appropriate state insurance regulators and the SEC for examination and other supervisory information in fulfilling the Board’s responsibilities as a holding company supervisor.”¹⁴³

Supervisory Practice as Umbrella Supervisor. On August 15, 2000, the Board’s staff issued supervisory guidance entitled “Framework for Financial Holding Company Supervision” (“SR 00-13”) which addressed umbrella supervision as follows:

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

¹⁴¹ 65 Fed. Reg. 69,525, 69,533 (Nov. 17, 2000).

¹⁴² *Manulife Financial Corporation*, 90 Fed. Res. Bull. 373, 375 (2004).

¹⁴³ *Id.*

an extension of more traditional bank-like supervision throughout an FHC. . . .

The Federal Reserve is responsible for the consolidated supervision of FHCs. In this regard, the Federal Reserve will assess the holding company on a consolidated or group-wide basis with the objective of ensuring that the holding company does not threaten the viability of its depository institution subsidiaries. . . .

Depository institution subsidiaries of FHCs are supervised by their appropriate primary bank or thrift supervisor (federal and state). The GLB Act did not alter the role of the Federal Reserve, as holding company supervisor, *vis-a-vis* the primary supervisors of FHC-associated bank and thrift subsidiaries because the Federal Reserve has traditionally relied to the fullest extent possible on those supervisors.

Nonbank (or nonthrift) subsidiaries engaged in securities, commodities or insurance activities are supervised by their appropriate functional regulators

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.

Accordingly, the Federal Reserve will focus on the financial strength and stability of FHCs, their consolidated risk-management processes, and overall capital adequacy. The Federal Reserve will review and assess the internal policies, reports, and procedures and effectiveness of the FHC consolidated risk management process. The appropriate bank, thrift, or functional regulator will continue to have primary responsibility for evaluating risks, hedging, and risk management at the legal-entity level for the entity or entities that it supervises¹⁴⁴

SR 00-13 went on to describe the broad parameters of financial holding company supervision in practice: “The supervisory activities of the Federal Reserve fall into three broad categories: [1] information gathering, assessments and supervisory cooperation; [2] ongoing supervision; and [3] promotion of sound practices and improved disclosure”¹⁴⁵ While some aspects of the description related to umbrella supervision, the SR letter covered many aspects of the Board’s supervisory activities, including consideration of applications, reports and examinations, safety and soundness, capital adequacy, intra-group exposures, risk concentrations, enforcement powers, promotion of sound practices, and improved transparency and public disclosure.

On December 6, 2004, the Board adopted a new bank holding company examination ratings system, effective January 1, 2005. Under the new system, each bank holding company is assigned component and composite ratings—R F I/C (D).¹⁴⁶ The Board’s SR letter announcing the change stated:

¹⁴⁴ Fed. Reserve Bd., Letter from Federal Reserve Board to federal bank examiners and supervisors and financial holding companies, SR 00-13 (Aug. 15, 2000); *see also Ferguson Address*, *supra* note 135.

¹⁴⁵ SR 00-13, *supra* note 144.

¹⁴⁶ Fed. Res. Bd., Letter from Federal Reserve Board to federal bank examiners and supervisors and regulated banking organizations, SR 04-18 (Dec. 6, 2004) (“In this system, ‘R’ stands for risk management, ‘F’ stands for financial condition, ‘I’ stands for potential impact of the parent company, ‘C’ stands for composite rating based on an evaluation and rating of its managerial and financial condition and an assessment of future potential risk to its subsidiary depository institution(s), and ‘D’ usually

The revised BHC rating system was developed to align the BHC rating process with the Federal Reserve’s current supervisory practices in carrying out consolidated or umbrella supervision of BHCs. As such, the revised rating system and the accompanying implementation guidance is not intended to signal a shift in the Federal Reserve’s supervisory practices of coordinating with and relying to the greatest extent possible on the work of primary bank and other functional nonbank regulators.¹⁴⁷

C. Corporate Governance Developments

Outside of the realm of bank regulators, corporate governance developments began to raise concerns about financial reporting, business ethics, and internal controls similar to those addressed by the Board as umbrella supervisor related to financial soundness and risk management. The Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) developed standards to improve the quality of financial reporting through business ethics, effective internal controls, and corporate governance.¹⁴⁸ Furthermore, disclosures of accounting fraud and irregularities by large public companies starting in late 2001 led to the enactment of the Sarbanes-Oxley Act (“S-Ox”).¹⁴⁹ S-Ox created the Public Accounting Board and established standards and prohibitions related to auditors, audit committees, financial disclosures, internal controls, and conflicts of interest. On October 29, 2002, Federal Reserve Board staff issued guidance on the applicability of S-Ox to supervised institutions.¹⁵⁰ In

mirrors the primary regulator’s assessment of the subsidiary depository institution[s].”).

¹⁴⁷ *Id.*

¹⁴⁸ COMM. OF SPONSORING ORG. OF THE TREADWAY COMM’N, REPORT OF THE NATIONAL COMMISSION ON FRAUDULENT FINANCIAL REPORTING (1987); *see also*, COMM. OF SPONSORING ORG. OF THE TREADWAY COMM’N, INTERNAL CONTROL—INTEGRATED FRAMEWORK (1992).

¹⁴⁹ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

¹⁵⁰ Fed. Reserve Bd., Letter from Federal Reserve Board to federal bank examiners and supervisors and regulated banking organizations, SR 02-20 (Oct. 29, 2002); *see also*, Fed. Reserve Bd., SR 03-8, Letter from Federal Reserve Board to federal bank examiners and supervisors and regulated banking organizations (May 5, 2003).

July 2003, COSO issued draft guidance on enterprise risk management.¹⁵¹ In this context, Governor Bies gave a speech about enterprise-wide risk management and its relationship to umbrella supervision:

One of the challenges the Federal Reserve System has as the umbrella supervisor of financial holding companies is to encourage the evolution of corporate governance within organizations that keeps pace with changing business strategies. . . .

. . . .

Financial institutions are being encouraged to establish enterprise-wide risk management functions to ensure that risks of all types, including conflicts of interest, are identified; risk appetites are defined; appropriate mitigating controls are effective; and exceptions are rigorously reviewed at a high level within the organization.¹⁵²

This speech promoted sound practices consistent with views expressed by other Board governors and Board staff regarding the Board’s role as umbrella supervisor.

III. The Board’s Role as Umbrella Supervisor

The preceding historical overview provides the basis for analyzing the previously posed questions: (A) What does “umbrella supervision” mean? (B) Is “consolidated supervision” different? (C) How does the GLB Act limit the Board’s authority and practice? (D) When did the Board obtain the legal authority to allow it to practice

¹⁵¹ COMM. OF SPONSORING ORG. OF THE TREADWAY COMM’N, EXPOSURE DRAFT, ENTERPRISE RISK MANAGEMENT FRAMEWORK (2003); *see also* COMM. OF SPONSORING ORG. OF THE TREADWAY COMM’N, ENTERPRISE RISK MANAGEMENT—INTEGRATED FRAMEWORK 2 (2004) (“This final document defines enterprise risk management as a process “applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”).

¹⁵² Susan Schmidt Bies, Governor, Fed. Reserve Bd, Address for the Financial Markets and Corporate Governance (Feb. 19, 2004).

umbrella supervision? (E) When did “umbrella supervision” commonly come to refer to a set of supervisory practices? (F) What is the relationship between the umbrella supervisor and other supervisors?

A. What Does “Umbrella Supervision” Mean?

The phrase “umbrella supervision” refers to a set of supervisory practices developed by the Board. Umbrella supervision is conducted within the parameters of the Board’s legal authority,¹⁵³ but is not defined by law or regulation; while the GLB Act acknowledged the Board as “umbrella supervisor,” it did not define the phrase.¹⁵⁴ However, the statutory acknowledgement of the Board as umbrella supervisor is embedded in the statutory scheme as well as in a legislative history which provides guidance for understanding the Board’s practices as umbrella supervisor.

Congressional debate leading up to the enactment of the GLB Act affirmed several things related to the regulation and supervision of financial institutions. First, Congress preserved the existing multi-agency structure for regulation and supervision of banking, securities, insurance, and other financial institutions.¹⁵⁵ Second, Congress affirmed functional regulation within a financial holding company’s structure, meaning that the SEC should regulate securities activities, state insurance commissioners should regulate insurance activities, and the primary federal banking regulators should regulate banking activities.¹⁵⁶ Third, Congress saw a need for an “umbrella supervisor” to oversee a financial holding company with a depository institution affiliate “as a whole,” “in its entirety,” or on a “consolidated” or

¹⁵³ Umbrella supervision does not encompass all the Board’s legal supervisory authority. For instance, it is not used to describe the Board’s authority to examine national banks under section 11(a)(1) of the Federal Reserve Act. 12 U.S.C. § 248(a)(1) (2008).

¹⁵⁴ Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 307, 113 Stat. 1415 (1999).

¹⁵⁵ Jose de Luna Martinez & Thomas A. Rose, *International Survey of Integrated Financial Sector Supervision* (World Bank, Policy Research Working Paper No. 3096, 2003) (observing that Congress did not adopt an integrated model of supervision with one supervisor for all financial institutions operating in the banking, securities, and insurance sectors, although this approach has been adopted in many countries).

¹⁵⁶ Gramm-Leach-Bliley Act, Titles II, III, 113 Stat. 1385, 1407 (1999).

“comprehensive” basis.¹⁵⁷ Fourth, Congress preferred the Board in the role of supervisor for all bank holding companies rather than assign this responsibility to the primary bank regulator of the lead bank in a holding company group.¹⁵⁸ Finally, Congress limited the Board’s oversight role by adding the so-called “Fed Lite” provisions to proposed legislation.¹⁵⁹

Turning to the GLB Act itself, Congress acknowledged the Board as umbrella supervisor in section 307:

It is the intention of the Congress that the Board of Governors of the Federal Reserve System, as the umbrella supervisor for financial holding companies, and the State insurance regulators, as the functional regulators of companies engaged in insurance activities, coordinate efforts to supervise companies that control both a depository institution and a company engaged in insurance activities regulated under State law.¹⁶⁰

This acknowledgement of the Board as “umbrella supervisor” can be viewed in several ways. First, this section resides within a scheme of functional regulation where the primary regulator is determined by the activity or product rather than the type of entity. Therefore, the acknowledgement of the Board as “umbrella supervisor” implies a supplemental role for the Board to play in relation to functionally regulated entities. Second, this section expresses congressional intent that the “umbrella supervisor” coordinate supervision and share information with insurance regulators. Thus, the closest connection between the term “umbrella supervisor”

¹⁵⁷ See, e.g., S. REP. No. 106-44, at 16 (1999) (“[T]here is a need for oversight of the organization as a whole as well as subsidiaries not subject to functional regulation.”); *Bank Modernization Legislation: Hearing Before H. Comm. on Banking and Fin. Servs.*, 106th Cong. 3 (1997) (statement of James L. Bothwell, Chief Economist, GAO) (advocating regulation of financial services holding companies on a “consolidated, comprehensive basis” with the SEC, OCC, or Board being “responsible and accountable as the umbrella supervisor for operations of the holding company in its entirety.”).

¹⁵⁸ See e.g., Ludwig, *supra* note 1, Financial System, *supra* note 70.

¹⁵⁹ Gramm-Leach-Bliley Act, § 111.

¹⁶⁰ Gramm-Leach-Bliley Act § 307.

and a supervisory function is one of coordination, cooperation, and sharing of information with state insurance regulators. Finally, the acknowledgement of the Board as “umbrella supervisor” can be taken to affirm the Board’s existing supervisory practices as “umbrella supervisor.”

After enactment of the GLB Act, the Board and its staff used the phrase “umbrella supervision” as a synonym for “consolidated supervision,” describing the following set of supervisory practices: (a) requiring reports of a bank holding company and any subsidiary; (b) conducting examinations of a bank holding company and any subsidiary; (c) setting capital requirements for bank holding companies and all subsidiaries; and (d) taking enforcement actions against a bank holding company and its nonbank subsidiaries.¹⁶¹

The Board and its staff also used “umbrella supervision” to describe the following practices: (a) assessing consolidated risk for banking organizations as a whole;¹⁶² (b) taking remedial action to address threats to depository institution subsidiaries of bank holding companies from outside of depository institutions themselves;¹⁶³ and (c) sharing information with functional regulators and primary federal banking regulators.¹⁶⁴ This set of supervisory practices usually

¹⁶¹ See, e.g., *Letter from Alan Greenspan, Chairman, Fed. Reserve Bd., to Senator Tim Johnson (June 25, 2003) [hereinafter Greenspan Letter] (provided as additional material for Hearing Before H. Committee on Banking, Housing, and Urban Affairs, 108th Cong. 90-91 (2003)); Industrial Loan Companies: Hearing Before H. Subcomm. on Fin. Institutions and Consumer Credit, 109th Cong. 4 (2006) [hereinafter Alvarez Testimony 1] (statement of Scott G. Alvarez, General Counsel, Federal Reserve Board); Industrial Loan Companies: Hearing Before S. Comm. on Banking, Housing, and Urban Affairs, 110th Cong. 4-5 (2007) [hereinafter Alvarez Testimony 2] (statement of Scott G. Alvarez, General Counsel, Federal Reserve Board).*

¹⁶² See, e.g., Fed. Res. Bd. Letter, SR 00-13 *supra* note 144 (“The Federal Reserve’s supervisory oversight role is that of an umbrella supervisor concentrating on a consolidated or group-wide analysis of an organization.”).

¹⁶³ See, e.g., *Ferguson Address, supra* note 135 (“In conducting our oversight, our specific goal will be to assess how a company’s activities might affect the safety and soundness of its affiliated depository institutions.”).

¹⁶⁴ Section 307 of the GLB Act expresses congressional intention that the Board share information and coordinate supervision with state insurance regulators. See Gramm-Leach-Bliley Act § 307.

focuses on the Board’s supervision of functionally regulated subsidiaries, such as securities, insurance, and commodities firms; however, they can relate to bank subsidiaries of a bank holding company.

B. Is “Consolidated Supervision” Different?

The Board and its staff use the term “consolidated supervision” as a shorthand description for a set of supervisory practices: the requiring of reports, conducting of examinations, setting capital requirements, and taking enforcement actions against bank holding companies and their subsidiaries.¹⁶⁵ The term “consolidated supervision” also appears frequently in Basel Committee issuances.¹⁶⁶ Although similar phrases appear in the laws and regulations applicable to financial institutions, the specific term “consolidated supervision” does not appear in the laws or regulations governing financial institutions in the United States.¹⁶⁷

Is consolidated supervision different from umbrella supervision? It depends on the context. Sometimes the terms “umbrella supervision” and “consolidated supervision” are used in close proximity. For instance, guidance from the Board’s staff on financial holding company supervision used the terms “umbrella supervisor” and “consolidated supervision” in the topic sentences of sequential paragraphs.¹⁶⁸ Sometimes the terms are combined, as in Chairman Greenspan’s use of the phrase “consolidated umbrella supervision” in testimony on banking supervision before a House

¹⁶⁵ See e.g., Greenspan Letter, *supra* note 161; Alvarez Testimony 1, *supra* note 161; Alvarez Testimony 2, *supra* note 161.

¹⁶⁶ See e.g., Frederick R. Dahl, *Committee on Banking Regulations and Supervisory Practices: Revised Basel Concordat on Principles for the Supervision of Banks’ Foreign Establishments*, 22 INT’L LEGAL MATERIALS 900 (1983); BASEL COMM. ON BANKING SUPERVISION, MINIMUM STANDARDS FOR SUPERVISION OF INTERNATIONAL BANKING GROUPS AND THEIR CROSS-BORDER ESTABLISHMENTS (1992); BASEL COMM. ON BANKING SUPERVISION, THE SUPERVISION OF CROSS-BORDER BANKING, ANNEX B (1996).

¹⁶⁷ For similar but not identical phrases, see 12 U.S.C. § 3105(d)(2)(A) (2000) (“comprehensive supervision or regulation on a consolidated basis”); 12 C.F.R. § 211.24(c)(1)(ii) (2007) (“comprehensive consolidated supervision”); 17 C.F.R. § 240.15c3-1(c)(13)(ii)(B) (2007) (“consolidated, comprehensive supervision”).

¹⁶⁸ SR 00-13, *supra* note 144.

subcommittee.¹⁶⁹ Sometimes the terms “consolidated supervision” and “umbrella supervision” are used interchangeably, as in the Board staff’s statement that its “revised rating system was developed to align the BHC rating process with the Federal Reserve’s current supervisory practices in carrying out consolidated or umbrella supervision.”¹⁷⁰

Thus, the terms “umbrella supervision” and “consolidated supervision” sometimes refer to the same group of practices—requiring reports, conducting examinations, setting capital requirements, and the taking of enforcement action against bank holding companies and their subsidiaries. At other times, umbrella supervision refers to a different group of practices—the assessing of risk for a banking organization as a whole, the taking of remedial action to address outside threats to depository institution subsidiaries, and the sharing of information with functional regulators and primary federal banking regulators. These varying usages of the term “umbrella supervision” reflect different ways of thinking about supervision; namely, rules-based and risk-based approaches to supervision.

C. How Does the GLB Act Limit the Board’s Authority and Practice?

The GLB Act did not alter the Board’s general authority over bank subsidiaries of bank holding companies. The Board may still require reports from and conduct examinations of all bank holding company subsidiaries, but the Board must rely on reports and

¹⁶⁹ *Hearing Before H. Subcomm. on Capital Markets, Securities and Government Sponsored Enterprises*, 105th Cong. 333 (1997) [hereinafter Greenspan Testimony] (statement of Alan Greenspan, Chairman, Fed. Reserve Bd.).

¹⁷⁰ Fed. Res. Bd., Bank Holding Company Rating System, SR 04-18 (Dec. 6, 2004). “The revised BHC rating system was developed to align the BHC rating process with the Federal Reserve’s current supervisory practices in carrying out *consolidated or umbrella supervision* of BHCs.” *Id.* (emphasis added); Meyer, *supra* note 135 (“The *consolidated, or umbrella, supervisor* aims to keep the relevant regulators informed about overall risk-taking and to identify and evaluate the myriad risks that extend throughout such diversified bank and financial holding companies in order to judge how the parts and the whole affect, or may affect, affiliated banks.”) (emphasis added).

examinations of other regulators to the fullest extent possible.¹⁷¹ The Board may only obtain reports or conduct examinations of functionally regulated subsidiaries of bank holding companies in specified instances related to material risks, threats to depository institution subsidiaries, or compliance with laws within the Board’s specific jurisdiction.¹⁷² The Board retains its authority to adopt consolidated capital adequacy guidelines for bank holding companies, but the Board may not impose capital requirements directly on broker-dealers, insurance companies, or other subsidiaries in compliance with requirements of their functional regulators.¹⁷³ The Board can take enforcement action against a functionally regulated subsidiary only to address a material risk to a depository institution or the payment system that cannot be effectively addressed by taking action against an affiliated depository institution or against depository institutions generally.¹⁷⁴

D. When Did the Board Obtain the Legal Authority to Allow It to Practice Umbrella Supervision?

The Board obtained the legal authority within to practice umbrella supervision over domestic institutions when it obtained explicit authority to require reports, conduct examinations, set capital requirements, and take enforcement action against bank holding companies and their subsidiaries. This occurred incrementally. In 1933, the Board possessed supervisory authority over companies controlling a member bank that wished to vote shares of those member banks.¹⁷⁵ In 1956, the Board obtained the power to require reports from and conduct examinations of multi-bank holding companies.¹⁷⁶ In 1970, the Board obtained the authority to require reports and conduct examinations of one-bank holding companies.¹⁷⁷ In 1978, Congress granted the Board the explicit authority to order a bank holding company to divest a nonbank subsidiary or cease

¹⁷¹ Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 111, 113 Stat. 1362 (1999).

¹⁷² *Id.* § 111, 113 Stat. at 1362-63.

¹⁷³ *Id.* § 111, 113 Stat. at 1365.

¹⁷⁴ *Id.* § 111, 113 Stat. at 1369.

¹⁷⁵ Banking Act of 1933, Pub. L. No. 73-66, § 5(c), 48 Stat. 165.

¹⁷⁶ Bank Holding Company Act of 1956, Pub. L. No. 84-511, 70 Stat. 137.

¹⁷⁷ Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat. 176.

activity and the power to issue cease-and-desist orders against bank holding companies in connection with the violation of law, regulation, or agreement in writing, or to stop unsafe and unsound practices.¹⁷⁸ In 1983, Congress gave the Board explicit authority to set capital requirements.¹⁷⁹ By 1983, therefore, the Board had accumulated all the powers to allow it to practice umbrella supervision.

In 1999, the GLB Act gave the Board jurisdiction over securities and insurance subsidiaries of FHCs through the repeal of prohibitions on affiliations between bank, securities, and insurance firms. This extended the supervisory authority and enforcement power of the Board over securities firms and insurance companies under the umbrella of a parent company that also owned or controlled a bank. With regard to depository institution subsidiaries of bank holding companies, the Board already possessed the authority to assess risk on a consolidated basis and share information with banking regulators, but the GLB Act gave the Board the authority for the first time to require divestiture of depository institution subsidiaries.¹⁸⁰ Therefore, in 1999, the Board possessed the authority, albeit subject to some limitations, to assess risk on a groupwide basis, take remedial action to address threats from outside of the depository institution subsidiary, and share information with primary bank and functional regulators.

E. When Did “Umbrella Supervision” Commonly Come to Refer to a Set of Supervisory Practices?

In the late 1980s and early 1990s, the phrase “umbrella supervision” was adopted by federal legislators and bank regulators to refer to supervisory practices engaged in by the Board and other existing or proposed regulators. In 1987, legislators and commentators began to refer to “umbrella supervision” when a Congressional proposal to establish a new framework for supervision of domestic financial institutions emerged. In November 1987, Senator Wirth co-sponsored legislation to establish a Financial Services Oversight

¹⁷⁸ Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, § 105(a), 92 Stat. 3646.

¹⁷⁹ International Lending Supervision Act of 1983, Pub. L. No. 98-181, § 908, 97 Stat. 1280.

¹⁸⁰ Previously, the Board could only issue a cease-and-desist order against a depository institution subsidiary, or order the divestiture of a nonbank subsidiary. *See* Pub. L. No. 95-630, § 105(a), 92 Stat. 3646 (1978); H.R. REP. NO. 95-1383, at 19 (1978).

Commission¹⁸¹ with responsibility for consolidated supervision of domestic financial institutions by function rather than type of institution.¹⁸²

Shortly thereafter, articles appeared in the press describing the Financial Services Oversight Commission as an “umbrella agency.”¹⁸³ In 1990, a member of Board staff characterized the Board’s authority over foreign banks with U.S. operations as “umbrella supervisory authority” in congressional testimony.¹⁸⁴ In 1991, Treasury issued a report recommending “umbrella oversight” of financial services holding companies by either the Board or primary regulator of its lead bank.¹⁸⁵ In 1992, a journal article referred to “expanding the

¹⁸¹ S. 1891, 100th Cong. (1987). The bill was based in large part on a proposal by E. Gerald Corrigan, president of the Federal Reserve Bank of New York. E. GERALD CORRIGAN, *FINANCIAL MARKET STRUCTURE: A LONGER VIEW* (1987). For an overview of 24 proposals for regulatory restructuring going back to the 1930s. *See* Kushmeider, *supra* note 63.

¹⁸² S. 1891, 100th Cong. (daily ed. 1987) (“This Commission would provide an umbrella supervisory structure. The Commission could regulate activities of banking, financial and commercial holding companies and establish minimum standards of capital adequacy for financial holding companies.”); *see also* S. 2433, 101st Cong. (1990); 133 CONG. REC. S16675 (Nov. 20, 1987); 136 CONG. REC. S4246 (daily ed. Apr. 5, 1990).

¹⁸³ *See* Nathaniel C. Nash, *Fed Backs Regulatory Umbrella*, N.Y. TIMES, Dec. 2, 1987, at D1 (“The chairman of the Federal Reserve Board today supported the creation of an umbrella agency to more closely coordinate policy among the major Government bodies that regulate financial institutions.”). While this article characterized Chairman Greenspan’s support for the creation of the Financial Services Oversight Commission proposed by S. 1981 as support for the creation of an “umbrella agency,” Chairman Greenspan did not use the phrase “umbrella agency” in his testimony before the Senate Banking Committee. *Cf. id.*; *see also*, Lionel Barber, *Greenspan Set to Compromise Over Banking Reform in US*, FIN. TIMES, Dec. 2, 1987, at 48 (“The idea of establishing an umbrella regulatory body to supervise US financial markets was backed yesterday by Mr. Alan Greenspan ”); Nathaniel C. Nash, *A New Urgency for Reforms in Policing Securities Trades*, N.Y. TIMES, Dec. 17, 1987, at D4 (“Many securities experts . . . argue that regulation requires a major umbrella agency overseeing all segments of finance and closely coordinating [the] parts.”).

¹⁸⁴ William Taylor, Staff Dir., Div. of Banking Supervision and Regulation, Fed. Res. Bd., Statement Before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives (Oct. 16, 1990), in 76 Fed. Res. Bull. 1032 (1990).

¹⁸⁵ *See* Financial System, *supra* note 70.

umbrella” of the Board’s supervision of foreign banks with operations in the United States.¹⁸⁶ Between 1991 and 1999, legislators, regulators, and commentators continued to use “umbrella supervision” to refer to the Board’s powers over domestic financial institutions, both in an existing and prospective way.¹⁸⁷

F. What Is the Relationship between the Umbrella and Other Supervisors?

Understanding the relationship between the umbrella and other supervisors involves matters of priority, cooperation, and responsibility. As to priority, the GLB Act preserved the independent and lead responsibility of the primary federal bank regulators and functional regulators for supervising institutions and activities under their jurisdiction. Umbrella supervision does not duplicate or replace supervision by primary federal bank supervisors or functional

¹⁸⁶ Daniel B. Gail, et al., *The Foreign Bank Supervision Act of 1991: Expanding the Umbrella of “Supervisory Reregulation”*, 26 INT’L LAW 993 (1992).

¹⁸⁷ During House debate on House Bill 6, Representative Dingell said: “[I]t preserves to the Federal Reserve Board its current role of an umbrella regulator of the holding company.” 137 CONG. REC. 29265 (1991) (statement of Rep. Dingell). During House debate on House Bill 10, Representative Kelly said: “[T]he Federal Reserve Board will remain the umbrella supervisor.” 144 CONG. REC. H3140 (daily ed. May 13, 1997) (statement of Rep. Kelly). *Modernization of the Financial Services Regulatory Systems: Hearing Before the H. Comm. on Banking and Fin. Servs.*, 104th Cong. 10 (1995) (testimony of Alan Greenspan, Chairman of the Fed. Reserve Bd.) (“[W]e must not lose sight, and the Leach bill does not, that the umbrella supervisor must still be permitted to monitor both the financial condition of the organization and the potential transfer of risks to the insured depository affiliates.”); see also *Bank Modernization Legislation: Hearing Before H. Comm. on Banking and Fin. Servs.*, 106th Cong. 3 (1997) (statement of James L. Bothwell, Chief Economist, GAO) (“The holding company regulation provided by the Federal Reserve can be referred to as ‘umbrella’ type regulation.”); see *infra* note 181. In 1996, the president of the Federal Reserve Bank of Cleveland wrote: “Closer connections among firms in the financial intermediation, risk management, and payments businesses suggest that an umbrella supervisor of some sort will likely be needed” Jerry L. Jordon, *The Future of Banking Supervision*, ECONOMIC COMMENTARY, April 1, 1996, at 4.

regulators.¹⁸⁸ The Board’s role in relationship to functional supervisors and primary federal bank regulators of FHC subsidiaries is secondary and supplemental.

The Board’s supplemental role is mandated by the Fed Lite provisions of the GLB Act.¹⁸⁹ The Board must rely on reports and examinations of other regulators to the fullest extent possible. In unusual situations involving certain material risks, compliance with the law, or threats to an insured depository institution subsidiary, the Board can seek special reports through other regulators or seek information directly from supervised entities through reports or examinations.¹⁹⁰ The Board may adopt consolidated capital requirements, but compliance with the capital requirements of functional regulators prevents the Board from imposing more stringent capital requirements on functionally regulated subsidiaries.¹⁹¹ A functional regulator can also prevent the Board from requiring a functionally regulated subsidiary to contribute funds or assets to an affiliated depository institution if the functional regulator determines that the transfer would have a material adverse effect on the functionally regulated entity.¹⁹² These GLB Act limitations delineate a secondary and supplemental role for the Board in relation to primary bank and functional regulators.

The supplemental role of the Board is reinforced by remarks of regulators about umbrella supervision. For instance, in 1995, James L. Bothwell of the GAO testified: “The holding company regulation provided by the Federal Reserve can be referred to as ‘umbrella’ type regulation because it is *in addition* to other regulation of holding company subsidiaries”¹⁹³ In 1997, Chairman Greenspan testified:

¹⁸⁸ *The Condition of the U.S. Banking System: Hearing Before the Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 53 (2001) (appendix report of Staff of Board of Governors of the Federal Reserve System) (“Such supervision is not intended to impose bank-like supervision on FHCs, nor is it intended to duplicate or replace supervision by the primary bank, thrift, or functional regulators of FHC subsidiaries.”)..

¹⁸⁹ Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, § 111, 113 Stat. 1362-66.

¹⁹⁰ *Id.* § 111, 113 Stat. at 1362-63.

¹⁹¹ *Id.* § 111, 113 Stat. at 1365.

¹⁹² *Id.* § 111, 113 Stat. at 1369.

¹⁹³ *Modernization of the Financial Services Regulatory System: Hearing Before H. Comm. on Banking and Fin. Servs.*, 104th Cong. (1995) (statement of James L. Bothwell, Director, Financial Institutions and Markets Issues, GAO) (emphasis added).

“The Congress, in its review of financial modernization, must consider legal entity supervision alone versus legal entity supervision *supplemented* by umbrella supervision.”¹⁹⁴ In 2000, Comptroller Hawke said the GLB Act “preserved the Federal Reserve’s role as the regulator of bank holding companies, with the mission of *supplementing* the work of the primary bank regulators by focu[sing] on risks arising outside the bank.”¹⁹⁵

While the Board’s role as umbrella supervisor is secondary and supplemental, it is also clear that the Board has the final word in certain situations.¹⁹⁶ For instance, while the Board must rely upon reports to other regulators to the fullest extent possible, the Board may require any bank holding company subsidiary to submit reports to keep the Board informed of its financial condition, systems for monitoring and controlling risk, and transactions with depository institution subsidiaries.¹⁹⁷ In addition, subject to satisfaction of certain conditions, the Board may conduct an examination of a functionally regulated subsidiary in connection with material risks to a depository institution subsidiary of a financial holding company.¹⁹⁸ Furthermore, and once again subject to certain conditions, the Board may take enforcement action against a functionally regulated subsidiary to address a material risk posed to an affiliated depository institution or the domestic or international payments system.¹⁹⁹ Despite limitations, the Board has ultimate authority to obtain reports, conduct examinations, and take enforcement action in critical situations.

Understanding the relationship between the umbrella and other regulators also requires a grasp of the many forms of cooperation among them. On a regulatory level, the Board routinely works with the primary federal bank regulators to implement uniform regulations, standards, forms, and guidance through the Federal

¹⁹⁴ See Greenspan Testimony, *supra* note 169 (emphasis added).

¹⁹⁵ Hawke, *supra* note 136 (typographical mistake in original corrected)

¹⁹⁶ Meyer, *supra* note 135 (“Given the systemic risk associated with the disruption of the operations of large banks . . . the Federal Reserve believes that it needs to know more about the activities within large insured depository institutions than can be derived from access to public information or from the reports of the primary bank supervisor.”).

¹⁹⁷ 12 U.S.C. § 1844(c)(1)(B)(i); *id.* § 1844(c)(1)(B)(iii)(I); *id.* § 1844(c)(1)(B)(iii)(II); Gramm-Leach-Bliley Act of 1999 § 111, Pub. L. No. 106-102, 113 Stat. 1338; *see also supra* text accompanying notes 108-10.

¹⁹⁸ 12 U.S.C. § 1844(c)(2); *id.* § 1844(c)(2)(B); *id.* § 1844(c)(2)(E); Gramm-Leach-Bliley Act § 111; *see also supra* text accompanying notes 111-13.

¹⁹⁹ Gramm-Leach-Bliley Act § 113, 113 Stat. at 1369.

Financial Institutions Examination Council. On the supervisory level, the Board and other regulators routinely interact with each other in the following ways: sharing information; obtaining reports on each other's behalf; coordinating the timing and focus of examinations; participating in joint examinations; relying on each other's findings and evaluations; consulting with each other before taking action; and deferring to each other's judgment in appropriate situations. These cooperative efforts were affirmed by, yet long precede, the GLB Act, as they go back to the origin of bank holding company supervision in the Banking Act of 1933.²⁰⁰

At times, the complicated and overlapping regulatory schemes for financial institutions present challenges to effective supervision.²⁰¹ There may be gaps in regulation or supervision, and confusion or hesitation may arise with respect to supervisory responsibility when dealing with an activity or product that involves many legal entities or business lines within a financial holding company structure. Supervisory agencies may resist the involvement of other regulators. Meeting these challenges requires constant effort to improve cooperation.

As to responsibility, the umbrella supervisor focuses on different concerns than those of the primary bank and functional regulators. First, the regulators have different statutory responsibilities: bank regulators focus on prudent operation, securities regulators focus on disclosure to investors, and insurance regulators focus on solvency. Second, the umbrella supervisor assesses and responds to risk for the organization as a whole rather than risk posed to a single legal entity within that organization. Third, the umbrella supervisor addresses threats arising from outside, rather than inside, a depository institution: the umbrella supervisor seeks to prevent the

²⁰⁰ See 1934 FED. RES. BD. ANN. REP. 54. (1935). Under the GLB Act, for instance, the Board must consult with the appropriate state insurance authorities before authorizing a financial holding company or insured depository institution to affiliate with a company engaged in insurance activities. See Gramm-Leach-Bliley Act § 307(c), 113 Stat. at 1416.

²⁰¹ Concerns with duplication, confusion, and burden caused by overlapping jurisdiction arise frequently. See, e.g., *Hearing Before the Subcomm. on Insts. of the S. Comm. on Banking, Housing, and Urban Affairs*, 93d Cong. 619 (1973); 55 CONG. REC. 1580-81 (Apr. 30, 1917); 144 CONG. REC. H3130 (daily ed. May 13, 1998) (statement of Rep. Gillmor); 1938 FED. RESERVE BD. ANN. REP. 13-15 (1939); Financial System, *supra* note 70; Jerry Knight, *Who's on First in the S&L Bailout Structure?*, WASH. POST, Feb. 20, 1990, at E3.

transfer of risks from a nonbank subsidiary to a depository institution subsidiary and the deposit insurance fund. Finally, the umbrella supervisor facilitates the sharing of information among functional and banking regulators.

IV. Conclusion

The preceding analysis demonstrates that umbrella supervision is a set of supervisory practices conducted within the scope of the Board’s legal authority. Although Congress acknowledged and limited Board practice in the GLB Act, it did not define umbrella supervisory practice. In one sense, the phrase “umbrella supervision” is a synonym for the Board’s consolidated supervision practices related to reporting requirements, examinations, capital oversight, and enforcement powers. In another sense, umbrella supervision focuses on assessing consolidated risk, reacting to threats from outside depository institutions, and sharing information with other regulators. The Board possessed all the powers necessary for it to practice umbrella supervision in 1983. The Board’s potential to practice umbrella supervision expanded to functionally regulated subsidiaries in 1999. The term “umbrella supervision” came into common usage in the late 1980s and early 1990s. It requires respect for the primary and secondary roles of regulators for supervision of various entities, cooperation between the umbrella and other regulators, and understanding the responsibilities of the umbrella and other regulators. Umbrella supervision is an important part of the supervision of financial institutions in the United States.

