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State v. National Banks: The Battle over Examination Fees

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I. INTRODUCTION

The battle over disparate levels of examination fees paid by national banks and state banks is fought between the Office of the Comptroller of the Currency (OCC), the regulator of national banks, and the fifty state banking supervisors, the regulators of state-chartered banks. The central issue is the proper way to fund the examination of state banks by their federal supervisors—the Federal Reserve Board (the Fed) or the Federal Deposit Insurance Corporation (FDIC). In July of 2001, the OCC submitted a proposal to Congress to reform the current fee system for bank examinations. After previous failed attempts to restructure the current fee system, the OCC's most recent proposal takes a substantially different approach to reform. Previous proposals have imposed new federal fees on state-chartered banks or barred the use of national banks' funds for

1. See, e.g., Louis Jacobson, Killing Bank; Exam Fees, Again, 33 NAT'L J. 1176 (2001) (describing the current examination fee system, criticism of the fee structure by the OCC, proposals to charge new fees, and opposition to change from the state charter).

2. See id. A similar fight exists in the credit union industry. See infra note 17.


4. See infra notes 68-73 and accompanying text.


While [requiring the Fed and the FDIC to charge for examinations of state banks] is in many ways the most straightforward, since it would end the subsidization of federal supervision for state banks by national banks and restore a healthier competition to the dual
federal regulation of state-chartered banks. However, the July 2001 proposal by the OCC suggests the FDIC insurance fund be used to pay for the supervision of all federal and state banks. As this proposal coincides with a serious effort to reform the deposit insurance system, raising the fees issue as a part of deposit insurance reform may be a good strategy.

This Note will begin with an abbreviated description of the current examination fee system and the specific characteristic of the dual banking system that causes so much of this conflict—federal examination of state banks. The next section will examine previous proposals to change the current system, followed by an analysis of the OCC's July 2001 proposal. This Note will conclude by examining the likelihood of success of the OCC's proposal for reforming the funding of bank supervision.

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6. See, e.g., Rob Garver, Hawke Parries Leach, Says System is Unfair, AM. BANKER, Dec. 21, 2000, at 1 (describing a suggestion by the OCC that national banks receive rebates for the portion of their insurance premiums which would be used for examination fees).

7. See COMPTROLLER OF THE CURRENCY, supra note 3.


9. See infra notes 14-35 and accompanying text.
10. See infra notes 36-50 and accompanying text.
11. See infra notes 51-67 and accompanying text.
12. See infra notes 68-154 and accompanying text.
13. See infra notes 155-157 and accompanying text.
II. THE CURRENT EXAMINATION FEE SYSTEM

In the United States' dual system of banking, financial institutions have the choice between a national or state charter. Banks electing a national charter are subject to federal regulation and supervision by the OCC. State-chartered banks, however, have a dual form of regulation: they are regulated under both state and federal law. State-chartered banks that become members of the Federal Reserve system (state "member" banks) are regulated by the Fed, and all other state banks (state "nonmember" banks) are regulated by the FDIC. In addition, both member and


15. See 12 U.S.C. §§ 26, 481 (2000); see also COMPTROLLER OF THE CURRENCY, ABOUT THE OCC (describing the functions of the OCC), at http://www.occ.treas.gov/aboutocc.htm (last visited Feb. 6, 2002) [hereinafter ABOUT THE OCC]. The OCC was established in 1863 as a bureau of the U.S. Department of the Treasury. Id. It has authority to examine banks, approve or deny applications for new banks, take action against banks that do not comply with regulations or that engage in unsound banking practices, and issue rules and regulations applicable to banks. Id.

16. 12 U.S.C. § 325 (2000). As a condition of membership in the Federal Reserve System, state member banks are subject to examination by the Fed. Id. The Federal Reserve, founded in 1913 to provide a safe, flexible, and stable financial system, has four general functions today: (1) conducting the monetary policy of the United States, (2) supervising and regulating state-chartered banks that are members of the Federal Reserve system, bank holding companies, and foreign bank offices in the United States, (3) maintaining stability in the nation's financial system, and (4) providing the United States government, the public, financial institutions, and foreign official institutions with certain financial services. Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purpose and Functions 1 (8th ed. 1994), available at http://www.federalreserve.gov/pfd/pdf/spspurp.pdf (last visited Feb. 6, 2002). By law, all federal banks are members of the Federal Reserve. Id. at 14. State banks may choose to become members, provided they meet requirements set by the Board of Governors of the Fed. Id. All member banks are required to purchase stock in their regional Federal Reserve Bank. Id.

nonmember state banks are subject to primary regulation by their respective state banking departments.\textsuperscript{18}

Under the current system, there are three means by which banks pay for the cost of their regulation.\textsuperscript{19} First, all federal and state banks, regardless of membership in the Federal Reserve System, must maintain a certain amount of reserves with the Fed.\textsuperscript{20} The Fed uses interest it earns on those reserves to pay for its...
examinations of state member banks. Additionally, banks insured by the FDIC finance the FDIC's deposit insurance fund through required premium payments. Interest on those assets fund the FDIC's examinations of state nonmember banks. Finally, all banks pay examination fees to their primary regulator: national banks pay fees to the OCC, and state banks pay fees to their state banking departments.

As the primary regulator of national banks, the OCC examines all national banks annually. To fund its operations, the OCC charges fees for those examinations. Examination fees charged by the OCC totaled approximately $383 million in 2000. State banking departments, the primary regulators of state-chartered banks, also charge examination fees. However, state banks pay fewer fees because state supervisors only have to examine each state bank every other year. In addition to regulation by the state banking departments, federal regulators examine state banks once every other year; however, neither the FDIC nor the Fed assesses fees for the examination services they provide to state banks.

21. Wasch, supra note 19, at D3.
23. Wasch, supra note 19, at D3.
24. Id.
26. 12 C.F.R. § 8.2 (2001); see About the OCC, supra note 15. In addition, the OCC charges fees for processing applications. Id. Income from the OCC's investments also provides some revenue to fund its operations. Id.
The FDIC does not charge examination fees to state banks because examinations are funded entirely by revenues earned on its deposit insurance funds, which have been financed by premium payments from insured banks.\textsuperscript{31} In 2000, $568 million of these funds were used to supervise state nonmember banks.\textsuperscript{32} Similarly, the Fed does not charge for examinations of state banks under its jurisdiction.\textsuperscript{33} Instead, the Fed finances the cost of supervising state member banks through revenues earned on its asset portfolio consisting of investments in government securities.\textsuperscript{34} The Fed spent about $300 million to supervise state member banks in 2000.\textsuperscript{35}

The total cost to the FDIC and the Fed of supervising state banks in 2000 was nearly $1 billion; however, state banks were not charged fees for these services.\textsuperscript{36} Both the FDIC and the Fed have authority to impose fees on state banks for the examinations they provide.\textsuperscript{37} However, they choose to continue to conduct the examinations completely free of charge because they have enough money in their budgets to pay for the examinations.\textsuperscript{38} At the end of 2000, the FDIC had $31.0 billion in assets in the Banking Insurance Fund (BIF) and $10.9 billion in the Savings Association Insurance Fund (SAIF).\textsuperscript{39} Both funds currently exceed the

\textsuperscript{31} COMPTROLLER OF THE CURRENCY, supra note 3, at 4-5. \textit{But see Deposit Insurance Reform, supra note 8} (explaining that many banks today are not required to pay any insurance premiums).

\textsuperscript{32} COMPTROLLER OF THE CURRENCY, supra note 3, at 4-5. An additional $70 million was used for the supervision of state-chartered thrift institutions. \textit{Id.}

\textsuperscript{33} \textit{Id.}

\textsuperscript{34} \textit{Id.}

\textsuperscript{35} \textit{Id.}

\textsuperscript{36} The FDIC spent $568 million to supervise state banks, and the Fed spent about $300 million. \textit{Id.; see also supra} notes 31-35 and accompanying text (discussing the costs of federal regulation of state banks).


required statutory reserve ratios, so the FDIC has excess funds available to finance state bank examinations.

The Fed is also experiencing a surplus in its regulatory budget. In 2000, the Fed earned $33 billion in interest income on reserves held by national banks and state member banks. The majority of the Fed's net income is remitted to the U.S. Treasury each year, and subsequently passed through to taxpayers. Therefore, any money that the Fed spends on regulating state member banks is money that would have otherwise benefited taxpayers.

The result of the decision of the FDIC and the Fed not to charge state banks for their examination services is an indirect subsidy of state-chartered banks. According to Comptroller of


42. Id. Of that amount, $32.7 billion was interest earned on U.S. government and federal agency securities, $269 million was interest on foreign investments, and $23 million was interest on loans to depository institutions. Id.


44. See 2000 BD. OF GOVERNORS OF THE FED. RESERVE SYSTEM ANNUAL REP. 321 (showing operating expenses of $2.9 billion), available at http://www.federalreserve.gov/boarddocs/RptCongress/annual00/ar00.pdf (last visited Feb. 6, 2002); see also COMPTROLLER OF THE CURRENCY, supra note 3, at 4; Hawke, Deposit Insurance Reform, supra note 5; SHADOW PROPOSAL, supra note 30.

45. See Garver, supra note 6, at 1.
the Currency John D. Hawke, Jr., this system places a disproportionate burden on national banks to fund the supervision of state banks.\textsuperscript{46} Because national banks hold a greater share of U.S. bank deposits than state banks,\textsuperscript{47} they necessarily contribute more to the FDIC insurance funds and the federal reserves.\textsuperscript{48} A portion of payments by national banks to the FDIC (in the form of insurance premiums) and the Fed (through non-interest bearing reserves) is used to pay for state bank supervisions, but none of the payments are distributed back to the national banks: national banks bear nearly the full cost of their supervision in the form of fees to the OCC.\textsuperscript{49} The resulting subsidy to state banks is, in the view of the OCC and national banks, an unjustified federal policy and a "fundamental flaw in our system of bank supervision."\textsuperscript{50}

III. FAILED ATTEMPTS TO CHARGE NEW FEES

Failed proposals to raise revenue by imposing new fees on state banks were included in seven Clinton Administration budget plans.\textsuperscript{51} In his Fiscal Year 2002 budget plan, President Bush also

\textsuperscript{46} Id.; COMPTROLLER OF THE CURRENCY, supra note 3, at 3.


\textsuperscript{48} For example, calculations by the OCC show that national bank contributions from 1990 to 2000 represented fifty-five percent of the FDIC's BIF. COMPTROLLER OF THE CURRENCY, supra note 3, at 4. According to OCC data, FDIC-supervised nonmember banks contributed thirty percent and Fed-supervised member banks contributed fifteen percent. Id.

\textsuperscript{49} COMPTROLLER OF THE CURRENCY, supra note 3, at 4.

\textsuperscript{50} Id. at 1; see generally Hawke, Deposit Insurance Reform, supra note 5 (discussing the perceived unfairness in the current examination fee system).

proposed to charge fees to state-chartered banks to finance their federal examinations by the FDIC and the Fed.\textsuperscript{52} The House of Representatives Committee on Financial Services opposed the plan in President Bush's budget proposal that would have imposed fees on state banks and bank holding companies.\textsuperscript{53} The House Committee noted that state banks already pay "significant" fees for examinations conducted by their state banking supervisors.\textsuperscript{54} Small state banks would be disproportionately affected by the imposition of new fees, which could result in negative effects on small businesses and farmers, who typically rely on smaller state-chartered banks for their credit needs.\textsuperscript{55} The House Committee also pointed out that sufficient


\textsuperscript{54} Id.

\textsuperscript{55} See id. at 9. In September of 2001, the OCC also published a notice of proposed rulemaking in the Federal Register to establish a minimum supervision fee for national banks. See Assessment of Fees, 66 Fed. Reg. 48,983 (Sept. 25, 2001) (to be codified at 12 C.F.R. pt. 8). Smaller banks, with less than $2 million in assets would be charged a flat fee of $10,000, which represents a sixty-four percent increase in fees. Nicole Duran, OCC Plans $10K Fee to End Smallest Banks' Bargain Rate, AM. BANKER, Sept. 26, 2001, at 15. Karen Thomas, of Independent Community Bankers of America, argues that the fee increase has a disproportionate impact on small banks. Id.; Richard Cowen, National Banks: OCC Proposes Change in Fee Assessment with Largest Impact on Smallest Institutions, BNA Banking Daily, Sept. 26, 2001, at D3. However, an OCC spokesperson contends that larger banks currently subsidize the cost of examining smaller, riskier institutions; thus, the flat rate is necessary to make the system more fair. Duran, supra, at 15; Cowen, supra, at D3.
funds already exist to pay for federal examinations of state banks without assessing additional fees.\textsuperscript{56}

Because the imposition of additional fees on state banks would eliminate the cost incentive of electing a state charter, institutions might choose the national charter in order to avoid double examination fees.\textsuperscript{57} In the House Committee's view, this creates an unfair advantage for the national charter that could potentially undermine the nation's dual banking system.\textsuperscript{58} For these reasons, the House Committee opposed the examination fee proposal as "unnecessary and burdensome."\textsuperscript{59}

The Senate Committee on Banking, Housing, and Urban Affairs also opposed the Bush Administration's inclusion of state bank examination fees in its budget proposal.\textsuperscript{60} Like the House Committee, the Senate Committee expressed concern that imposing new fees would create an inequity for state banks since they already pay fees to their state regulators, and that such a system would be especially detrimental to smaller banks.\textsuperscript{61} The Senate Committee emphasized the importance of maintaining a balanced regulatory system in which both state and national banks pay fees only to their chartering agency.\textsuperscript{62}

The proposal was also met with opposition from trade groups contesting the examination fee requirements, including the

\textsuperscript{56} See Staff of House Comm. on Fin. Serv., supra note 53, at 8-9; supra notes 38-42 and accompanying text (discussing the budget surpluses of the Fed and the FDIC).

\textsuperscript{57} See Staff of House Comm. on Fin. Serv., supra note 53, at 9.

\textsuperscript{58} See id. For a discussion of the advantages and purposes of the dual banking system, see infra notes 104-107 and accompanying text.

\textsuperscript{59} Staff of House Comm. on Fin. Serv., supra note 53, at 9. Very similar justifications for opposing new fees were given for President Clinton's previous seven proposals. See, e.g., Staff of House Comm. on Banking and Financial Services, 105th Cong., FY2000 Budget Views (1999) (opposing the proposal because (1) state examiners already charge fees; (2) the BIF is fully capitalized; (3) the cost of credit would increase; and (4) the dual banking system would be threatened), available at http://www.house.gov/financialservices/ffy2000bv.htm (last visited Feb. 6, 2002).


\textsuperscript{61} See id.

\textsuperscript{62} See id. Presently, both types of banks pay examination fees to their chartering agencies (the OCC or state banking commission) as well as deposit premiums to cover operating expenses of the FDIC. Id.
Conference of State Bank Supervisors (CSBS), which wrote an anti-exam fee letter to the United States Senate expressing disapproval of the Bush Administration's budget proposal. The letter requested Senate support for a budget amendment drafted by Senators Michael Enzi (R-WY) and Thomas Carper (D-DE) which would strike the proposal to impose new fees from the budget. The CSBS argued that charging state banks for federal supervision would negatively impact the dual banking system by moving toward a completely federal regulatory scheme, with a few large banks dominating the market. The Enzi amendment was passed by voice vote on April 6, 2001, successfully erasing the examination fees proposal from the fiscal year 2002 budget.

IV. ANALYSIS OF PROPOSAL BY THE OCC

A. The OCC's Proposal

In July of 2001, the OCC announced a unique proposal to change the current system: examinations of all banks should be funded by payments from the FDIC's insurance funds directly to

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64. See Financial Institutions: Bush Budget Provides More Funding for OFHEO Supervision of Fannie, Freddie, BNA BANKING DAILY, Apr. 10, 2001, at D2; Memorandum from American Bankers Association, et al., to Members of the U.S. Senate, supra note 63.
65. See Memorandum from American Bankers Association, et al., to Members of the U.S. Senate, supra note 63.
66. See Jacobson, supra note 1, at 1176. John Ryan, senior vice president for policy at CSBS, said in other nations, where the regulatory system of banks is purely federal, the market is dominated by only a few large banks. Id.
67. News Release, Senator Mike Enzi, Enzi Budget Amendment Eliminates Bank Fees, (Apr. 6, 2001) http://enzi.senate.gov/bankfees.htm (last visited Feb. 17, 2002). Senator Enzi and supporters of the amendment said the effect of the new fees would have been a federal tax on state-chartered banks, which already pay state banking departments for examinations. Id. "This is a double charge," he said. "Charging the fees would only hamper initiatives the states have made to improve cost effectiveness. Competition maximizes efficiency and is a good thing even in a regulatory world." Id.
the OCC and state supervisors. Under the OCC's proposal, the FDIC, OCC, and state bank supervisors would work together to develop a formula for allocating the insurance funds. To determine the formula, they would consider current funding levels, the number of institutions and total amount of assets being supervised, and the financial condition and growth of the institutions. Payments would come only from investment earnings of the insurance funds, never from the funds’ principal. If earnings of the insurance funds were ever insufficient to cover allocations to all the supervisors, payments to each supervisor would be reduced pro rata. Individual supervisory agencies would still be authorized to impose additional fees on their banks to meet unusual demands.

The OCC predicts that all banks would enjoy benefits from such a modification of the examination system. In particular, the OCC's plan would eliminate the subsidy of state bank examinations by federal bank examiners, without imposing any new costs on state banks or jeopardizing the deposit insurance funds. According to the OCC, investment income from assets in the Bank Insurance Fund are more than adequate to cover the supervisory expenses of the OCC, the FDIC and the fifty state supervisors. The OCC argues that bank examinations would be more effective, since all supervisors would have sufficient funds allocated for examinations. Additionally, the OCC insists its plan would facilitate the ultimate goal of deposit insurance reform—to

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68. See COMPTROLLER OF THE CURRENCY, supra note 3, at 7-8; see also Hawke, Consolidation, supra note 5 (examining the possibility of a system that uses FDIC funds to pay for both state and national bank exams). The proposal excludes the Fed from receiving payments from the insurance funds. See COMPTROLLER OF THE CURRENCY, supra note 3, at 7-8.


70. See id.

71. See id.

72. See id.

73. See id. at 8.

74. Id.

75. See COMPTROLLER OF THE CURRENCY, supra note 3, at 8.

76. Id.

77. Id.
allocate the costs and benefits of deposit insurance equitably—and "revitalize" the dual banking system.\textsuperscript{78}

The CSBS, representing state banking departments,\textsuperscript{79} does not agree that the OCC's proposal is in the best interest of the banking system, especially as far as state banks are concerned.\textsuperscript{79} The group has expressed its opposition to the OCC's proposal,\textsuperscript{81} and has been critical of the OCC for using the deposit insurance reform issue as a means to force consideration of its "controversial plan."\textsuperscript{82}

Supporters of the current system have previously argued that the purpose of the current system is not to subsidize state banks, but to provide a more effective and efficient examination system through cooperation between federal and state supervisory agencies.\textsuperscript{83} Their primary argument against changing the fee

\textsuperscript{78} Id. "It would revitalize the dual banking system to move beyond the current charter price competition and recapture the elements of the dual banking system that have made it vital to the fabric of our nation's banking system: creativity, efficiency and healthy competition." Id.

\textsuperscript{79} For example, the North Carolina Banking Commissioner's position is reflected in the stance taken by CSBS. Telephone Interview with David Hanson, Bank Analyst, North Carolina Banking Commission (Oct. 1, 2001). The Office of the Commissioner of Banks has written letters to North Carolina Congressional representatives supporting CSBS's position. Id.


\textsuperscript{81} Neil Milner, president of CSBS, said that the OCC's proposal "federalizes state banking supervision. It undermines the federal safety net for depositors. It does nothing to enhance quality supervision and may even discourage administrative efficiency." Deposit Insurance Hearing, supra note \textsuperscript{80}.

\textsuperscript{82} Id.

\textsuperscript{83} See Garver, supra note 6 ("[T]he perception of inequity [is] the result of a decision by the OCC to market the national charter to banks as a one-stop regulatory shop, making it impossible for the agency to share responsibilities with the Fed and the FDIC."); Oklahoma Commissioner Says OCC Has a "Strange" Strategy, EXAMINER (Conf. of State Bank Supervisors, Washington, D.C.), Sept. 22, 2000 (quoting Letter from Mick Thompson, Oklahoma Bank Commissioner, to John Bodnar, Deputy Comptroller of the Currency, Southwest District (Sept. 19, 2000)) ("[S]tate coordination and cooperation with the FDIC and Fed is one of the great innovations of the state banking system."). at http://www.csbs.org/pr/examiner/examiner.asp?x=37-00&s=1 (last visited Feb. 14, 2002); Exam Fees are "DOA," So OCC Tries New Approach, EXAMINER (Conf. of State Bank Supervisors, Washington, D.C.), Dec. 22, 2000 (noting the lower costs that result from sharing
structure has been that imposing new fees would reduce the cost-efficiency of state bank exams, a quality that has long been publicized by CSBS and state supervisors as an advantage of the state banking system.\textsuperscript{44} Historically, the OCC has responded to this argument by insisting that the state banking system is not a model of efficiency,\textsuperscript{45} since an examination by two agencies, when one agency could perform the same function at a lower cost, is an inefficient system.\textsuperscript{46} However, the OCC's new proposal averts that argument by taking a more straightforward approach: elimination of the subsidy to state banks by providing equal funding to national banks.\textsuperscript{47}

B. Criticisms of the Current System

Comptroller Hawke calls for a restructuring of the current examination fee structure as part of the FDIC's review of the deposit insurance system.\textsuperscript{48} The OCC identifies four flaws in the current examination system: unfairness, distortion of the dual banking system, compromise to safety and soundness, and inconsistency with the goals of deposit insurance reform.\textsuperscript{49}

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\textsuperscript{44} See Rob Blackwell, State, Federal Regulators Fight Over Charter Flips, AM. BANKER, June 19, 2000, at 4 (quoting West Virginia banking commissioner Sharon Bias as saying that "two sets of eyes are better than one" and "our system of two regulators is safer"); Conference of State Bank Supervisors, VA. STATE BANKER (Va. Bureau of Financial Institutions), Winter 2001, at 3 (explaining that state-chartered banks choose state charters because regulation is "efficient, responsive, accessible, and cost-effective"), available at http://www.state.va.us/scc/division/banking/news/sb_win01.pdf (last visited Feb. 14, 2002).

\textsuperscript{45} Comptroller Hawke has stated that "efficiency has nothing to do with it." Hawke, Deposit Insurance Reform, supra note 5.

\textsuperscript{46} Id.

\textsuperscript{47} See supra notes 4-7 and accompanying text.


\textsuperscript{49} COMPTROLLER OF THE CURRENCY, supra note 3, at 2.
1. Unfairness

The OCC criticizes the current system for its unfairness to national banks and taxpayers. Unlike the FDIC and the Fed, the OCC does not have revenue sufficient to cover exam costs, so national banks must pay for the cost of their examinations. In fact, the law requires that the OCC impose a fee on national banks equivalent to their regulatory costs. Not only must national banks pay for their own mandatory examinations, but they are also required to contribute to the FDIC's insurance funds, which subsidize state examinations. Although state banks also make premium payments to the insurance fund, state banks are not required to expend any of their own funds for federal examination fees. The OCC argues the result is an involuntary subsidy by national banks for the benefit of state nonmember banks.

Under the system proposed by the OCC, all banks would be put on an equal footing regarding examination fees. With payments being made from the insurance fund to the primary bank regulators, every bank would receive the same benefit from the insurance premiums that have built up the fund. Barring any unusual circumstances, no bank would pay examination fees,
which would completely eliminate any fee disparity found in the current system.\textsuperscript{98}

Even though the OCC’s plan eliminates the fee disparity, the plan does not address the fact that state banks would still be receiving more federally funded examinations than national banks.\textsuperscript{99} Money from the insurance funds would cover state regulators’ costs of examining state banks.\textsuperscript{100} However, the FDIC and the Fed would continue to provide biennial examinations to state banks free of charge.\textsuperscript{101} Since the OCC views these free examinations as the source of the unfairness,\textsuperscript{102} the proposal fails to address this alleged fault in the current system.

2. Distortion of the Dual Banking System

Comptroller Hawke is also concerned that the present examination fee framework undermines the dual banking system.\textsuperscript{103} Generally, state and national bank regulators agree that the advantage of a dual system is its furtherance of healthy competition among banks and bank regulators.\textsuperscript{104} The cost of

\textsuperscript{98} Id. If unusual circumstances placed higher demands on an agency, that agency might charge “supplemental assessments.” Id. at 8.

\textsuperscript{99} See id. at 7-8.

\textsuperscript{100} See id.

\textsuperscript{101} See id.

\textsuperscript{102} See COMPTROLLER OF THE CURRENCY, supra note 3, at 1.

\textsuperscript{103} See id. at 5 (stating if many banks were to elect a state charter in order to save examination fees, the national bank charter could suffer significantly, which would undermine the dual banking system).

\textsuperscript{104} See, e.g., D.C. Speaks, supra note 92 (citing the growth of negotiable order of withdrawal (NOW) accounts in the 1970s as an example of healthy competition between the state and national charters); Chairman of the Federal Reserve Alan Greenspan, Remarks before the Annual Meeting and Conference of the Conference of State Bank Supervisors (May 2, 1998) (referring to state banks’ creation of demand deposits as an example of innovation that results from competition between charters), http://www.federalreserve.gov/boarddocs/speeches/1998/19980502.htm (last visited Feb. 6, 2002) [hereinafter Our Banking History]; Kansas Office of the State Bank Commissioner, Advantages of a Kansas State Chartered Bank (stating that the Kansas Bank Commissioner supports the dual banking system because it furthers market competitiveness), at http://www.osbckansas.org/AbouttheOSBC/advantage.html (last visited Feb. 14, 2002). But see Henry N. Butler & Jonathan R. Macey, The Myth of Competition in the Dual Banking System, 73 CORNELL L. REV. 677, 680 (1988) (“[W]e not only fail to find any evidence of the regulatory competition that the supporters of the dual banking system envision, we find that such competition
supervision, the quality of examinations, the scope of permissible activities, and supervisory responsiveness are all issues that banks might consider in choosing their charter. Therefore, the OCC and the state regulators presumably compete to be the best in all of these areas, so as to attract the most banks to their charter. However, if there were not a dual banking system, there would be less motivation for the regulator to increase efficiency, provide effective exams, or be responsive to banks requests and concerns.

Over the past several decades, Congress has increased the responsibility of federal supervisors in their examination of banks in order to ensure the protection of consumers. Because the OCC must charge for its examinations of national banks, these increased supervisory requirements translate into an increase in examination fees that national banks must pay. Of course, the costs of supervising state banks also increases, since the FDIC and the Fed also have increased supervisory roles. However, since states do not pay for their biennial federal examinations, the gap between examination costs to national banks and state banks has increased.

Many state bank commissioners, recognizing the cost incentive of being a state-chartered bank, advertise their lower

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105. See Comptroller of the Currency, supra note 3, at 5.
106. See Schooner, supra note 14, at 266 ("Banks' ability to choose their regulator, arguably, pits federal and state agencies against one another, forcing them to alter regulatory practices and procedures to enhance their ability to attract and retain bank charters."); Our Banking History, supra note 104 (arguing that the dual banking system protects against "overzealousness" and "arbitrary and capricious" policies).
107. See Our Banking History, supra note 104 (voicing concerns about "the possibility that a single regulator would inevitably become rigid and insensitive to the needs of the marketplace").
110. See Comptroller of the Currency, supra note 3, at 5.
111. See id.
112. See id. According to the OCC, state banks today pay less than half the examination costs charged to national banks. Id. OCC figures show that a $500 million national bank pays an average of $113,000 per year, while a state bank of comparable size pays only $43,000 in examination fees. Id.
fees to attract new state charters. The OCC acknowledges that lower fees are an advantage of the state charter and argues that the disparity could undermine the national charter and the purpose of the dual banking system to ensure efficiency and healthy competition. Furthermore, if many national banks were to convert to state charters, the FDIC and the Fed would have to spend an increasing amount on state bank supervision, which essentially increases the costs to taxpayers and national banks.

In short, the OCC implies that the amount charged for examinations is the chief consideration to banks in choosing a charter. The CSBS does not agree; it believes banks base their decision on other factors, such as the responsiveness they get from a primary regulator that understands the local economy. If the choice between a national and state charter really centers on the cost of supervision, the OCC's proposal to eliminate this factor seems reasonable. According to the 2000 annual report of the Federal Financial Institutions Examination Council (FFIEC), there are 2,301 national banks compared with 996 state member banks and 5,171 state nonmember banks. However, OCC-supervised institutions held approximately fifty-six percent of the total assets, while Fed-supervised institutions held about twenty-six percent and FDIC-supervised institutions held roughly

113. See, e.g., Ben Jackson, Charter-Shift Movement in Oklahoma, AM. BANKER, Dec. 15, 2000, at 5 (stating that nine Oklahoma banks converted from national to state charters in 2000 because they were "promised lower exam fees"); Laura K. Thompson, Lower Fees Spur Charter Swap for Farmers of Md., AM. BANKER, Jan. 2, 2001, at 4 (identifying a Maryland bank's primary reason for converting from a federal to state charter as the expense of national charter examinations). In 2000, Alabama's banking commissioner admitted to using the lower fees of the state charter to entice SouthTrust Corporation to convert from a national bank to an Alabama state-chartered bank. Blackwell, supra note 84, at 4. Neil Milner, president of the CSBS, defended the practice of using the fee comparison to solicit national banks to switch to a state charter. Id.

114. COMPTROLLER OF THE CURRENCY, supra note 3, at 5.

115. Id.

116. See id.

117. Telephone Interview with Neil Milner, President and CEO, Conference of State Bank Supervisors (Oct. 1, 2001) [hereinafter Milner Interview].

eighteen percent.\footnote{119} One possible inference from this data is that larger institutions choose the national charter, and smaller banks choose the state charter. Perhaps the smaller institutions choose the state charter primarily because they cannot afford the fees charged by the OCC.\footnote{120} If so, the OCC's proposal seems like a fair way to eliminate the focus on the cost of supervision, without negatively affecting those smaller institutions.

On the other hand, another reasonable hypothesis based on the FFIEC data is that smaller institutions benefit from the other aspects advertised by state banking departments: more responsiveness to local concerns and the advantage of being examined by two different supervisors.\footnote{121} If that is the case, the OCC's proposal will not likely attract any more banks to the national charter. In fact, even though state supervisors would benefit financially from the OCC's proposal, CSBS opposes the plan because of its potential to undermine the dual banking system by eliminating the state charter.\footnote{122} According to Neil Milner, president and CEO of CSBS, federal funding leads to federal rules, which leads to a "monolithic regulatory system, which undermines initiative and creativity."\footnote{123} The fear is not that all state banks will convert to the national charter; rather, CSBS is concerned that the choice itself will eventually be eliminated.\footnote{123}

3. Compromise to Safety and Soundness

The OCC also argues that the current fee structure compromises bank safety and soundness by reducing the availability of supervisory resources when they are most likely to be needed.\footnote{125} The OCC cites the many bank failures during the

\footnote{119} See id. at 27. The FFIEC data indicates that national banks held $3.34 trillion in assets, while state member banks held $1.54 trillion and state nonmember banks held $1.08 trillion. \textit{id.}

\footnote{120} See supra notes 54-55 and accompanying text.

\footnote{121} Milner Interview, supra note 117. Milner indicated that banks that choose a state charter do so primarily because (1) they like having a primary regulator that understands the local economy, and (2) "two sets of eyes are better than one." \textit{id.}

\footnote{122} \textit{id.}

\footnote{123} \textit{id.}

\footnote{124} \textit{id.}

\footnote{125} \textit{See Comptroller of the Currency, supra note 3, at 6.}
late 1980s and early 1990s as an illustration. During that period of time, each bank failure resulted in reduced income to the OCC at a time when the need to prevent future failures caused examination costs to rise. The result was an increase in examination fees to all national banks when they could least afford it, resulting in the loss of even more national banks. In times of crisis, the current system inevitably places the burden of managing problem banks on the better managed national financial institutions; all banks are either subject to increased examination fees or decreased supervision, even if they are sound institutions.

Furthermore, according to the OCC, the present system negatively affects bank supervision even when there are no economic problems. In both the national and state banking systems, assets are concentrated in a few large banks. As a result, the loss of just one large bank (because of charter

126. See id.
127. Id.
128. Id. Presumably, many national banks who could not afford their supervisory costs failed or converted to state charters, whose increased examination fees were paid for by the FDIC and the Fed.
129. Id.
130. See id.
131. COMPTROLLER OF THE CURRENCY, supra note 3, at 6; see also The Failure of Superior Bank, FSB, Hinsdale, Illinois: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs, 107th Cong. (Sept. 11, 2001) (prepared testimony of Karen Shaw Petrou, Managing Partner, Federal Financial Analytics, Inc.) [hereinafter Petrou Testimony] ("The consolidation in the banking industry means that the OCC [is] increasingly dependent on a few very large institutions for the bulk of [its] revenue.").

At year-end 2000, Bank of America had the greatest amount of assets of all FDIC-insured nationally-chartered banks, with over $584 billion. Fed. Deposit Ins. Corp., Statistics on Depository Institutions Report: Assets and Liabilities, at http://www3.fdic.gov/sdi/main.asp (last visited Feb. 6, 2001). The total assets for all insured national banks were $3.41 trillion. Id. Among the insured banks chartered by the North Carolina Banking Commission, Branch Banking and Trust (BB&T) had the greatest amount of assets, with nearly $47 billion at year-end 2000. Id. The total assets for all insured North Carolina-chartered banks was approximately $91 billion. Id. The FDIC's Statistics on Depository Institutions (SCI) database allows the user to create detailed financial reports with customized peer groups of FDIC-insured institutions. To obtain this data, the author generated a report on October 28, 2001, by selecting the following peer groups: (Column 1) Standard Peer Group—Federally chartered—National; (Column 2) Single Institution—FDIC Certification # 3510 (Bank of America); (Column 3) Standard Peer Group—State chartered—NC; (Column 4) Single Institution—FDIC Certification # 9846 (Branch Banking and Trust). The author chose a report date of December 31, 2000, and selected the Assets and Liabilities report option.
conversion, failure, or merger) requires the supervisory agency to adjust its budget, either by raising examination fees or by reducing the amount of money it spends on supervision.\textsuperscript{132} If the agency raises examination fees, some banks may not be able to afford them. But if it tries to operate on a smaller budget, examinations will be less thorough and less likely to detect problems with financial security.\textsuperscript{133} By eliminating the need to charge examination fees, neither the state nor the national banking systems will face this threat to the security of their institutions.

4. Inconsistent with Deposit Insurance Reform

Lastly, the OCC points to goals of deposit insurance reform as a justification for revising the current examination fee system.\textsuperscript{134} The FDIC has recently completed a major study of the deposit insurance system to make certain that consumers maintain confidence in the nation’s banks.\textsuperscript{135} As part of deposit insurance reforms recommended in this study, the FDIC seeks to eliminate subsidies to riskier banks by lifting restrictions on risk-based pricing.\textsuperscript{136} The OCC maintains that eliminating the examination fee disparity is as necessary to deposit insurance reform as elimination of the risk subsidy.\textsuperscript{137} Because contributions to the insurance fund by national banks are partially used to subsidize state bank examinations, their premiums do not accurately reflect the risk of loss they present.\textsuperscript{138} By distributing a portion of the revenue generated from their insurance premiums back to national banks, the OCC says its proposal would eliminate this subsidy to

\textsuperscript{132} \textsc{Comptroller of the Currency, supra} note 3, at 6. For example, if North Carolina lost BB&T to the national charter, it would lose close to fifty percent of its revenue. See \textsc{Fed. Deposit Ins. Corp., supra} note 131.

\textsuperscript{133} \textit{See} Comptroller of the Currency, \textit{supra} note 3, at 6 (arguing the loss of a large bank could have a crippling effect on an agency’s ability to provide quality supervision).

\textsuperscript{134} \textit{See id. at} 6-7. For more detailed information regarding deposit insurance reform, see generally Coppola, \textit{supra} note 8.


\textsuperscript{136} \textit{Id.; see supra} notes 22, 40 (briefly describing the current restrictions on risk-based premiums).

\textsuperscript{137} \textit{See Comptroller of the Currency, supra} note 3, at 6-7.

\textsuperscript{138} \textit{Id. at} 6.
state banks and further the underlying reform goal: equitable distribution of the costs and benefits of deposit insurance.139

Because the OCC views the FDIC's free examination of state banks as an inequitable distribution of earnings on the insurance funds to which all banks contribute, the OCC presents this issue as a fundamental aspect of deposit insurance reform.140 During recent Congressional hearings, Comptroller Hawke remarked on the OCC's views of deposit insurance reform.141 In a statement before the House of Representatives Subcommittee on Financial Institutions and Consumer Credit, Comptroller Hawke expressed the OCC's concern over flaws in the deposit insurance system, and supported insurance reform measures consistent with those proposed by the FDIC in April 2001.142 He also introduced to the Subcommittee members the OCC's most recent proposal for changing the examination fee system.143 By expressing encouragement of the FDIC's reform efforts,144 the OCC may be hoping to get cooperation on exam fee reform from the FDIC and Congressional members supporting the FDIC's position. But whether raising the fees issue as part of deposit insurance reform will prove successful remains to be seen. Although a few individuals have supported considering the OCC's proposal as part of deposit insurance reform,145 FDIC Chairman Donald Powell did not address the OCC's proposal in his recent testimony before the House of Representatives.146 Even though Chairman Powell did not oppose the OCC's plan, he offered no indication that he would

139. See id. at 6-7.
140. See id. at 7.
141. See Hawke Testimony, supra note 95.
142. See id. (supporting the FDIC's recommendations to merge the insurance funds, establish more risk-based premiums, eliminate the current reserve ratio and allow the FDIC to establish a required range and give rebates; but opposing the FDIC's proposal to increase the insurance coverage level to reflect its real value); see also FED. DEPOSIT INS. CORP., supra note 135, at 6-21 (describing the FDIC's recommendations for reform measures).
143. See Hawke Testimony, supra note 95.
145. See, e.g., Failure of Superior Bank: Hearing Before the Senate Comm. on Banking Housing and Urban Affairs, 107th Cong. (Oct. 16, 2001) (prepared testimony of Dr. George C. Kaufman, Loyola University Chicago); Petrou Testimony, supra note 131.
146. See Deposit Insurance Reform, supra note 8.
advocate the proposal as part of reforming the deposit insurance system.¹⁴⁷

Unlike the numerous budget proposals that attempted to impose new fees on state banks, the OCC's proposal may be met with less criticism from Congress. When both the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs voiced their disapproval of the budget provisions that would have restructured the current fee structure, their main concern was that the imposition of new fees would be harmful to many small state banks.¹⁴³ Without a requirement that state banks pay for federal regulations, this concern no longer exists.

If Congress does consider the OCC's proposal as part of overhauling deposit insurance, the OCC will have to convince Congress that the plan is feasible. Karen Shaw Petrou, managing partner of the Washington-based consulting firm Federal Financial Analytics, Inc., has identified some potential problems with using the insurance fund to defray the cost of examinations by the OCC and state supervisors.¹⁴⁹ Payments to the OCC and state banking departments would decrease the funds available to insure failed institutions.¹⁵⁰ If the FDIC's resources were diminished too much, all banks could see a rapid increase in premiums.¹⁵¹ Since one of the FDIC's reform goals is to avoid volatile premiums, a plan that increases the possibility of unexpected premium increases would be undesirable.¹⁵² The FDIC also seeks the discretion to adjust the reserve ratio and the ability to charge appropriately for risk, even during economic good times.¹⁵³ Under such a modified system, more banks would be subject to premium payments, and identifying the portion of premium payments to return to each supervisor could be more difficult.¹⁵⁴

¹⁴⁷. See id.
¹⁴⁸. See STAFF OF HOUSE COMM. ON FIN. SERV., supra note 53, at 8-9; SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, supra note 60.
¹⁴⁹. Petrou Testimony, supra note 131.
¹⁵⁰. See id.
¹⁵¹. See id.
¹⁵². See Deposit Insurance Reform, supra note 8.
¹⁵³. See id.
¹⁵⁴. Petrou Testimony, supra note 131.
VIII. CONCLUSION

The OCC's proposal adds another controversial element to the already complex debate over deposit insurance reform. Convincing Congress that examination costs should be defrayed by the deposit insurance fund, rather than some other source, will be an arduous challenge. An even bigger hurdle, however, may be persuading Congress that the current system is not the best one. Even though the OCC's most recent proposal varies significantly from those previously rejected by Congress, the bottom line is that Congress continues to permit an indirect subsidy in favor of state banks. The OCC's proposal would move closer towards eliminating that subsidy, and Congress may be unlikely to go that far.

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155. See supra notes 149-154 and accompanying text (examining potential problems of using the insurance fund to defray the cost of bank examinations by the OCC and state supervisors).
156. See supra notes 51-67 and accompanying text (discussing failed attempts to change the current fee system).
157. See id.