Convergence and Competition: The Case of Bank Regulation in Britain and the United States

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CONVERGENCE AND COMPETITION: THE CASE OF BANK REGULATION IN BRITAIN AND THE UNITED STATES

Heidi Mandanis Schooner* and Michael Taylor**

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INTRODUCTION

Since the mid-1970s, financial markets have exhibited a clear trend towards globalization. This process, facilitated by the dismantling of exchange controls, resulted in a dramatic rise in cross-border investment and increased access to domestic markets by foreign institutions. Banks led this trend, both in terms of the growth of international lending and the emergence of multinational banks with offices spread across the globe. In contrast, the regulation of banks remains rooted in a world divided into sovereign nation states and is implemented by respective regulatory agencies that derive their powers from distinct politico-legal frameworks. This combination of integrated financial markets and fragmented national regulation raises major public policy issues. In this Article, we consider the extent to which the globalization of financial markets has caused a convergence in the policy goals, instruments, and styles of the various institutions charged with regulating banks in the United States and United Kingdom. Specifically, we focus on the question of whether the creation of a global banking market has compelled otherwise autonomous policy makers to adopt the same or similar rules and regulations.

In a world of integrated financial markets, policy convergence among national regulatory regimes might be expected for two main reasons. First, policy convergence between regulatory systems advances each regulator's primary goal of curbing banks’ special insolvency risk. Linkages between banks, whether through the payments system or through credit exposures in the interbank market, leave banks uniquely vulnerable to contagious collapse. Today, these linkages transcend national borders, creating a substantial risk of significant transnational spill-over effects from a bank insolvencies. Therefore, bank regulators can no longer rely exclusively on domestic regulation to address this basic regulatory concern and have a strong incentive to ensure that there is adequate bank supervision abroad. Convergence of bank supervision

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1. The Basle Committee on Banking Supervision was established in 1975 by the central bank governors of the Group of Ten countries. Originally known as the Blunden Committee—after its first chairman—and then the Cooke Committee—after its second—its members include the senior representatives of the bank supervisors and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Sweden, Switzerland, United Kingdom, and the United States. It usually meets at the Bank for International Settlements in Basle, Switzerland. In 1997, the Basle Committee issued its Core Principles of Effective Bank Supervision. The Core Principles are based on the premise that “[w]eaknesses in the banking system of a country... can threaten financial stability both within that country and internationally.” Basle Committee on Banking Supervision, Core Principles for Effective Banking Supervision, (visited Apr. 11, 1999) <http://www.bis.org/publ/index.htm>.
policy is not, of course, the only way to address the risk of cross-border contagion. That risk could also be addressed by effective, but different, systems of regulation in every state. Political as well as practical realities, however, suggest that convergence provides an easier, or more likely, answer.\(^2\)

Second, policy convergence eliminates competitive advantages or disadvantages that arise when banks compete internationally, but are regulated by differing regimes. Part of the rationale for the Basel Committee’s\(^3\) 1988 Accord on bank capital adequacy\(^4\) was to remove the perceived advantage enjoyed by weakly capitalized banks that compete with banks whose jurisdictions impose higher capital requirements.\(^5\) These level playing field considerations have also been at the heart of several other international agreements designed to deliver some degree of competitive equality between institutions regulated in different national jurisdictions.\(^6\)

Cooperation between the agencies of various nations, facilitated by a developing array of international institutions, thus has become an essential component of the regulatory response to globalization. International cooperation has resulted in the widespread adoption of similar methods and techniques of regulation, and has produced agreements in which national regulators have adopted harmonized standards.\(^7\) We suggest that

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2. Policy convergence among regulators may be the result of unequal bargaining power. One regulator using such power might attempt to impose its own rules on others—claiming its own to be superior. Policy convergence might also result from the almost opposite scenario in which no one regulator or subgroup of regulators has the power to impose its own standards on others. The group, therefore, would be left with the choice of either declining to converge (thereby accepting the diverse standards within the group requiring, at very least, each regulator to understand the regulatory approach of the others) or adopting distinct, uniform standards for all. The latter might prove the easier choice.

3. See supra note 1 (describing the formation of the Basle Committee on Banking Supervision).

4. See infra Part II.F.2.


7. The idea of policy convergence can involve a number of different dimensions. One regulator defined convergence as “the process of applying increasingly similar rules to a given situation in different jurisdictions, and is closely related to the harmonisation or approximation of laws.” Andrew M. Whittaker, Tackling Systemic Risk on Markets: Barings and Beyond, in THE FUTURE FOR THE GLOBAL SECURITIES MARKET 259, 261 (F. Oditah ed., 1996). This is best thought of as convergence of policy content that C.J. Bennett defines as “the more formal manifestations of government policy—statutes, administrative rules, regulations, court decisions and so on.” What is Policy Convergence and What Causes it?, 21 BRIT. J. POL. SCI. 215, 218 (1991). Policy convergence, however, is comprised of a number of different dimensions including: policy goals, “a coming together of intent to deal with common policy problems”; policy instruments “i.e. the institutional tools available to administer policy, whether regulatory, administrative or judicial”; and policy style, “a more
this convergence process might be described as "negotiated convergence" because the outcome is derived from extensive negotiation between different national authorities and involves the usual compromises and trade-offs inherent in bargaining.

In addition to negotiated convergence, the theoretical literature has emphasized an alternative process, which we call "convergence by competition." According to this view, rather than seeking to achieve ex ante harmonization through negotiated convergence, a more efficient solution permits and encourages competition between regulatory regimes, thereby allowing the optimal level of regulation to be determined by a process of regulatory arbitrage.8

This Article consists of four main parts. Part I introduces the convergence by competition model as it applies to the regulation of financial institutions and sets the stage for the test case application of the model to the regulatory systems in the United States and United Kingdom. Part II provides a comparative history of bank regulation in Britain and the United States. Central to our argument is the proposition that, even in the presence of globalized financial markets and the opportunities for rule competition brought in their wake, the bank regulatory systems of the United States and Britain continue to be shaped for the most part by their prior history.

This comparative history provides the basis for Parts III and IV, in which we aim to analyze the main regulatory changes in terms of a convergence of regulatory burden through competition. In Part III we conclude that, while there is some evidence that bank regulators in these countries are adopting similar approaches and methods, pronounced differences remain. In Part IV we assess the concept of competition between rules, and consider some of the important determinants of regulatory change that are not reflected in the competitive model. The first is path dependence, i.e., competition is conditioned by its initial conditions, conditions that are in place prior to the existence of significant opportunities for regulatory competition.9 These include the public policy objectives set for the regulatory system, which are themselves the

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8. See Benn Steil, Regulatory Foundations for Global Capital Markets, in Finance and the International Economy 6, at 64 (Richard O'Brien ed., 1992). Steil observed that "national regulations must themselves be subject to foreign regulatory competition, and... ultimately the form and level of regulation will largely be determined by the jurisdictional arbitrage activities of those who are being regulated."

9. In this case, the initial conditions are those that existed prior to significant globalization of financial markets.
products of politics and history. These conditions also impact the relative strengths and weaknesses of each participant in the competitive process. The second is the power of singularly domestic concerns. Even in our global economy, the domestic agenda continues to consume the consciousness of policy makers. The third is the process of negotiated convergence. Any competitive analysis must take into account the impact of agreements that limit competition between regulatory authorities. To the extent that such agreements among regulators are formed and endure, unlike typical cartel arrangements, convergence by competition is less predictive of changes in the regulatory landscape.

I. CONVERGENCE BY COMPETITION

The focus on convergence by competition in the context of law and regulation grows out of two distinct sources. In the first place, legal theorists have produced a significant body of scholarship on the primacy of Delaware corporate law in the United States. These commentators have observed states competing—with Delaware emergent as the clear winner—for corporate charters through their body of corporate law. The Delaware phenomenon has been both criticized, for producing laws that favor management over shareholder interests in a “race to the bottom,” and hailed for the efficient results of such competition in a “race to the top.”


The second source of this literature derives from the work of economists on the concept of competition in the provision of public goods, for example defense, law and order, or regulation. The core theoretical problem concerns the way in which consumer-voters can register their demand for these public goods, because no "market type" solution appears to exist for determining the optimal output. However, following the work of Tiebout on fiscal competition, a body of economic literature has developed that stresses the efficiency of permitting different jurisdictions to compete by providing different levels of public services at different "prices," i.e., tax rates. This model assumes that consumers will vote with their feet by relocating to the jurisdiction that most closely matches their bundle of preferences.\(^\text{12}\)

Proponents of regulatory competition are not always clear whether they posit the theory descriptively or normatively. Both elements of the theory appear to be present in equal measure. In this Article, we focus on the theory of regulatory competition as an explanatory tool for a process of policy convergence. While not all subscribers to this theory draw the conclusion that policy convergence will be the necessary result of competition between rules,\(^\text{13}\) a number of them have. This is a consequence of their specific interpretation of rule competition as one in which a central role is assigned to the arbitrage opportunities presented by the different "prices" charged by regulators for their services. Just as the existence of arbitrage opportunities means that the price of the same product in different markets will converge on a single price, so regulatory arbitrage might be expected to give rise to a convergent level of regulation.\(^\text{14}\)

There have been a number of attempts to apply this body of theoretical literature to the specific example of bank regulation. Unlike some other forms of competition in the provision of public goods, competition

12. The seminal contribution to this literature is Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. Pol. ECON. 416 (1956). However, support for the concept of competitive provision of public goods has been offered from a number of other economic perspectives, including those of the public choice school, which stresses the potential for competition to reduce rent-seeking behavior by politicians and bureaucrats. The work of F.A. Hayek is also central to this concept. See generally, F.A. HAYEK, *Law, Legislation, & Liberty* (1973).

13. There is no necessary reason why it should, since under Tiebout's model of fiscal competition, differences in the supply of public goods will reflect different preferences of customer-voters.

14. See Joel P. Trachtman, *Recent Initiatives in International Financial Regulation and Goals of Competitiveness, Effectiveness, Consistency and Cooperation*, 12 Nw. J. Int’l L. & BUS. 241, 246 (1991). Whether or not that level of regulation is optimum depends, of course, on how one defines regulatory goals. Professor Trachtman notes that if the goal of regulation is to enhance economic efficiency, then a competitive drive to limit regulatory costs would be consistent with that goal.
in bank regulation does not directly center on attracting filing fees or other enhancements to a given state's tax base, although there will undoubtedly be some fiscal advantages to a jurisdiction that is able to attract a large number of banks to its financial markets.

In the case of bank regulation, the competition is inevitably more complex. Considered from this point of view, nations' regulators compete with one another as providers of regulatory services. Thus, writes Kane, "financial analysis has focused traditionally on competition for customers by those who produce and distribute financial services. But running parallel to this competition between private financial institutions is a less-visible layer of competition for rights to produce and deliver regulatory services to financial institutions." Financial institutions compete on the basis of the price of their services; financial regulators compete on the basis of a "net regulatory burden" (NRB). The NRB model recognizes that regulators dispense both costs and benefits. Regulatory costs are incurred by institutions as a result of "effective regulatory constraints and regulators' explicit charges." Regulatory constraints include capital requirements, lending limits, liquidity ratios, reserve requirements, and activities limitations. Benefits include "(1) minimizing the cost of certifying the integrity and competence of individual institutions and other contracting parties; (2) improving productive efficiency by providing coordinating services that lower transactions costs; (3) assuring the stability and orderliness of the system over time; and (4) monitoring industry pricing arrangements for

15. See Joel P. Trachtman, International Regulatory Competition, Externalization, and Jurisdiction, 34 Harv. Int'l L.J. 47, 77 (1993). Professor Trachtman observes that "rather than merely collecting tax revenues, a state will have multiple policies to integrate. These policies include traditional domestic regulatory goals like fair and competitive markets, protection of the environment, and maintenance of a stable financial system. Each policy will be substantively related to the bases for jurisdiction applied in a different way. Differential mobility will operate differently with respect to each policy. On this basis, regulatory competition is an extremely complex game."


18. Unless otherwise indicated, we use the term "regulator" in a broad sense, i.e., as encompassing both the lawmakers and administrative agencies responsible for bank regulation in each country.


anti-competitive behaviour.” The NRB is the ratio of these costs and benefits. It varies among regulators just as it varies among regulatees.

Differences in NRBs are assumed to be akin to differences in quoted prices on any set of substitute services. Firms, therefore, can be expected to arbitrage between different regulatory regimes, affiliating with the one that can offer the lowest NRB. In an international context,

Regulatory burdens deemed excessive in one country can prompt banks and/or their clients to move to another jurisdiction where the burdens are lighter—a form of ‘regulatory arbitrage’ that can both erode the gains associated with financial intermediation and cause regulators to soften their approach, possibly excessively so.

The theory stresses, however, that competition between rules will not eliminate regulation, since some level of regulation will remain necessary given the over-riding importance of public confidence in the stability and integrity of financial markets. Moreover, Smith and Walter contend that “a long-run equilibrium can be maintained with a positive NRB . . . Financial institutions ought to value their access to lender-of-last-resort facilities, deposit/liability insurance, the opportunity to be headquartered in a stable political climate, and the like.” Their conclusion is bolstered by their observation that institutions in wholly unregulated markets, with an NRB approaching zero, have not dominated financial transactions.

A model of competition on the basis of respective NRBs can be used to analyze the process of policy convergence among regulatory regimes. For example, with regard to national stock and bond markets, the introduction of negotiated commission rates on the New York Stock Exchange in 1975 sparked a series of deregulatory measures in Lon-

21. Kane, supra note 16, at 120.
22. Firms can raise or lower their NRB by engaging in more or less taxed versus subsidized activities. All other things being equal, one would expect firms to seek the mix of taxed versus subsidized activities that would yield the lowest NRB.
23. SMITH & WALTER, supra note 19, at 155.
25. SMITH & WALTER, supra note 19, at 177.
don, Tokyo, Toronto, and Paris. 27 Story and Walter argue that in these financial centers "restrictive pricing conventions have been eliminated and business practices liberalised. Regulatory convergence has thus come some distance." 28 Moreover, Story and Walter predict that

Progressive convergence in regulation of banks and securities firms will continue, with players based in the more heavily regulated countries successfully lobbying for liberalisation, and the emergence among regulators of a consensus on minimum acceptable standards that will eventually be accepted by home countries with substandard regulatory regimes. 29

In other words, competition in rules will result in a process of convergence in which regulators eventually come to adopt the same basic norms.

This Article aims to test this hypothesis by examining recent changes in bank regulatory policy in Britain and the United States. If, in a world of integrated financial markets, convergence of regulatory regimes can be observed, it should be especially apparent in the approaches to bank regulation of these two countries.

First, regulatory convergence might be predicted on the basis of the long history of competition between the British and U.S. financial markets. Since at least the 1930s, when Sterling and the U.S. Dollar began competing with one another to be the world’s reserve currency, the City of London and New York have vied for the title of financial capital of the world. In the 1950s, competition intensified, and the world-wide deregulatory trend initiated two decades ago raised competition to new heights. In this competitive process London was initially the beneficiary of differential regulation in the two jurisdictions. 30 The interest rate ceilings imposed on U.S. dollar deposits by the Federal Reserve Board’s Regulation Q 31 were one of the main factors behind the growth of an offshore dollar deposit market in London, soon to be joined by the market for offshore deposits denominated in other currencies. These pools of

28. STORY & WALTER, supra note 20, at 177.
29. Id.
30. The dramatic increase in the number of U.K. branches established by member banks of the Federal Reserve System provides evidence. In 1959, seven member banks had a total of only ten branches in the U.K. with aggregate deposits of less than one billion dollars. By 1975, the number of member bank branches in the U.K. had risen to 55 and the deposits of these banks had risen to more than $70 billion. By 1985 member banks had 68 U.K. branches. See LONDON BUSINESS SCHOOL CITY RESEARCH PROJECT, SUBJECT REPORT XI: THE GROWTH AND STRUCTURE OF INTERNATIONAL BANKING 4-5 (1994).
ready liquidity in turn contributed to the growth of the Eurobond markets, the development of which was further fostered by the Securities and Exchange Commission's burdensome registration requirements, the separation of investment and commercial banking under the Banking Act of 1933,\textsuperscript{32} and by the Interest Equalization Tax imposed in the United States in 1963 on bond interest.\textsuperscript{33} Given this long history of competition, these two financial centers provide a valuable test for the theory of convergence by competition.

Second, the basic similarities of the economic and legal systems of the two countries provide a basis on which to test the hypothesis of convergence of NRB through competition. These similarities mean that a variety of extraneous factors, which might potentially impact on the NRB, can be held constant when assessing the comparative behavior of the bank regulatory regimes in Britain and the United States. For example, their economic systems are widely viewed as belonging to the same basic type in contrast to those of Continental Europe and Japan ("CEJ").\textsuperscript{34} Anglo-Saxon capitalism is distinguished from that of the CEJ countries by its greater reliance on capital markets as opposed to bank finance, in the separation of banking and commerce, and in corporate governance arrangements that stress the role of portfolio investors rather than equity stakes held by banks over long periods of time.\textsuperscript{35} In addition, both Britain and the United States share a commitment to free and open markets and to a minimalist governmental role in the economy. Unlike the CEJ countries, government neither acts as the promoter of national champions, nor is public ownership of major banks a feature of their financial systems. Finally, both countries share a broad political and cultural heritage, reflected in a general consensus in favor of economic liberalism, and a legal system based on the common law rather than the civil law systems of Continental Europe. These many common features allow an examination of these two countries' approach to bank regula-

\textsuperscript{32} See infra Part II.B.2.b. The restrictions on the combination of commercial with investment banking contained in the 1933 Act apply only to the domestic activities of U.S. banks. Overseas, U.S. commercial banks and their affiliates are among the top underwriters in the Eurobond market, and in 1985 enjoyed 11% of that market. London is the leading financial center for Eurobond trading. See George J. Benston, The Separation of Commercial and Investment Banking 9-10 (1990).

\textsuperscript{33} See Charles P. Kindleberger, A Financial History of Western Europe 441 (2d ed. 1993).

\textsuperscript{34} See Michel Albert, Capitalism Against Capitalism (Paul Haviland trans., Whurr Publishers Ltd. 1993) (discussing the pronounced similarities between England and the United States).

tion, while holding constant many other factors that distinguish their approach from that of the CEJ countries.

Notwithstanding the existence of competition between their financial markets and their marked economic and legal similarities, we argue that little evidence exists to suggest that regulation in the United States and the United Kingdom is converging as a result of competitive pressures. Absent the major international agreements that represent the outcome of negotiated convergence, the systems of rules, regulations, and norms applicable to banks in these two jurisdictions have not been notably convergent. Significant differences of policy approach and style remain, the kinds of policy instruments employed by regulatory agencies exhibit significant divergence, and the methods of regulation remain diverse.

Hence, little evidence suggests that regulatory competition between Britain and the United States has so far produced an outcome that approximates the convergence predicted by Story and Walter. Indeed, we argue that while regulatory competition may play an important role in the evolution of regulatory regimes, the competitive model—particularly as enshrined in the NRB—does not account for a number of other equally, and at times more, significant determinants of change.

II. HISTORY OF UNITED STATES AND UNITED KINGDOM PRUDENTIAL REGULATION

Despite the fact that the ultimate supervisory goal of the two countries is the same, i.e., safety and soundness, the story of bank regulation in the United Kingdom versus United States is very different in the telling. For the United Kingdom, the story involves few characters: essentially, the Bank of England (the Bank) and a concentrated industry dominated by a few elite firms.36 The plot centers on how the relationship withstood good times and bad, and how the supervisory relationship ultimately proved defective. In contrast, and perhaps not surprising for Americans, the story of U.S. bank regulation is one of excess: a fragmented industry supervised by a myriad of regulators. The history is driven by the attempts of this crowded cast of characters to stake out and maintain ground. While U.S. bank regulators are

36. Throughout this Article references to the United Kingdom should be interpreted as applying to England and Wales in the first instance. For much of the eighteenth and nineteenth century Scotland preserved a distinctive banking system, based on joint stock liability. Only in the early twentieth century did the two systems begin fully to integrate. Modern legislative developments apply, of course, to all parts of the United Kingdom.
commonly viewed as successful in their jobs, the United States' unique experience with bank failure plays an important role in the tale.

This Part provides an account of the development of prudential bank regulation in the United States and United Kingdom, beginning in the Nineteenth Century when the main building blocks of both regulatory systems began to be put in place. Our focus is on regulatory measures aimed at preserving bank safety and soundness; we do not attempt to catalog measures aimed at implementing monetary policy. In attempting to identify some common themes in the development of each regulatory regime, perfect chronology is sometimes sacrificed.

A. Early Regulation

The most important elements of prudential regulation in the United States and United Kingdom were established during the Twentieth Century. Still, the seeds for each country's system were planted much earlier. In the United States, legislation dating back to the Civil War provides some of the most enduring idiosyncrasies associated with U.S. regulation of banks. In the United Kingdom, the Nineteenth Century saw the establishment of the main outlines of the British banking industry's organization that ultimately impacted regulation. Towards the end of the last century, the Bank of England emerged as a recognizably modern central bank, while the Federal Reserve System was established in the early years of the Twentieth Century. These developments began a long struggle for both central banks with their respective roles as bank regulators.


From its foundation in 1694 until well into the Nineteenth Century, the Bank of England dominated the banking scene in Britain in a way that has no analogue in the United States.\(^{37}\) It was established as a commercial bank enjoying an extensive range of governmentally conferred privileges. In particular, it was alone among banks in being permitted to raise capital from a large body of investors.\(^{38}\) All other banks in England and Wales were forced to adopt the partnership form, and were limited

\(^{37}\) The Second Bank of the United States might potentially have developed into the same sort of role which the Bank of England had come to occupy in Britain by the second half of the nineteenth century. President Andrew Jackson, however, vetoed its charter renewal in 1832. JONATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW & REGULATION 8 (2d ed. 1997).

\(^{38}\) This privilege was granted in 1708, some years after the Bank's foundation. See Sir John Clapham, THE BANK OF ENGLAND: A HISTORY 1694-1797, at 65 (1945).
to a maximum of six partners. In consequence, outside London, where the Bank of England was dominant, banking remained comparatively undeveloped throughout much of the Eighteenth Century. Nonetheless, the general credit expansion resulting from the Napoleonic Wars resulted in a three-fold increase in the number of "country" banks, many of which were seriously undercapitalized. A growing crop of failures during the first quarter of the Nineteenth Century culminated in a general crisis in 1825-26 in which 93 banks in England and Wales found themselves unable to meet their customers' demands for cash. As a result, Lord Liverpool's administration introduced the 1826 Joint-Stock Bank Act ("1826 Act") that produced a much needed liberalization of the law.

The 1826 Act was the most significant Nineteenth Century bank legislation in the U.K.. It extracted the Bank of England's legislatively mandated monopoly by permitting the formation of banks with an unlimited number of partners or shareholders outside a radius of sixty-five miles from London. The 1826 Act "laid the legal foundation for the emergence of the modern form of bank—a bank whose capital structure and large capital resources enabled it to build up an extensive national, indeed international, business." By the end of the Nineteenth Century this legislation had provided the basis for the formation of a highly concentrated banking industry based on a few joint-stock commercial banks that operated extensive branch networks throughout large sections of England and Wales. Formed by a process of amalgamation that gathered pace towards the end of the century, this handful of very large institutions were generally referred to as "the Big Five."

The tight concentration that marks the modern U.K. banking industry, however, was still some way off in the first half of the Nineteenth Century. In the shorter term, the new joint stock banks were scrutinized by lawmakers. The 1844 Joint-Stock Bank Act

40. For a rare study of the immediate impact of this legislation on banks in England and Wales, see P. L. Cottrell and Lucy Newton, Banking Liberalization in England and Wales, 1826-1844, in THE STATE, THE FINANCIAL SYSTEM AND ECONOMIC MODERNIZATION 75 (Richard Sylla et al. eds., 1999).
41. COLLINS, supra note 39, at 10.
42. A House of Commons Secret Committee on the Joint Stock Banks (Secret Committee), reporting in 1836, noted, inter alia, that the minimum nominal capital of the joint stock banks was not mandated by law and could vary significantly from institution to institution. See REPORT OF THE SECRET COMMITTEE OF THE HOUSE OF COMMONS ON JOINT STOCK BANKS, 20TH AUGUST 1836, in SELECT STATUTES, DOCUMENTS & REPORTS RELATING TO BRITISH BANKING, 1832-1928 219, 227 (T. E. Gregory ed. 1929). The Secret Committee also noted that "the Law does not provide for any publication of the liabilities and assets of these Banks, nor
tightened the legislative framework around these institutions. The restrictions imposed by the 1844 Act resulted in a hiatus in the establishment of new banks, but did not prevent bank failures. The tighter regulation was in any case to be short-lived. The 1844 Act was repealed in 1857, effectively assuring the dominance of joint stock banking in the British financial system. The demise of the 1844 Act marked the end of attempts to use statute-based banking regulation in the U.K. for well over a century.

Following the 1840s, banking legislation largely followed the trend of general corporate law reform. The repeal of the tight restrictions of the 1844 Act was followed by a series of Acts (1858-62) that extended the right of limited liability to shareholders generally, culminating in the 1879 Companies Act that applied limited liability to bank shareholders. The 1879 Companies Act, like the 1844 Act, imposed an annual external audit requirement on the accounts of banking companies. Banking was not, however, subject to statute-based authorization procedures or ongoing supervision, nor was there a clear legal definition of a bank or of what constituted the business of banking.

The 1844 Act prescribed minimum nominal capital of £100,000, with at least one half of the nominal amount required to be paid up before a bank could commence business. Bank shares had to be issued in a denomination of £100. The 1844 Act required that the deed of partnership should be in a form approved by the Privy Council and provided that no bank should be permitted to purchase or lend upon the security of its own shares. The act also required a statement of assets and liabilities to be published once each month, and the examination of annual accounts by auditors elected by the shareholders.

The 1844 Act was the initiative of Prime Minister Sir Robert Peel, who seems to have regarded the law as an adjunct to his Bank Charter Act of 1844. The Bank Charter Act gave an effective monopoly of bank note issue to the Bank of England, while the 1844 Act was designed to further strengthen the banking system by introducing a regulatory regime for the new joint-stock banks. Walter Bagehot observed "in this, as in many other cases, perhaps Sir R. Peel will be found to have been clear sighted rather than far sighted. He was afraid of certain joint stock banks which he saw rising around him; but the effect of his legislation was to give these very banks, if not a monopoly, at any rate an exemption from new rivals." Walter Bagehot, Lombard Street: A Description of the Money Market 123 (1962).

The Royal British Bank, which collapsed in 1856, was one of the relatively few banks to be formed following the passage of the 1844 Act. See Theodor Emmanuell Gregory, Introduction to 1 Select Statutes & Reports Related to British Banking, 1832-1928, supra note 42, at xlv.

The 1879 Companies Act 42 & 43 Vict. c. 76 (Eng.). The Act was passed in response, in part, to the failure of the City of Glasgow Bank in 1878.

The lack of statutory definition of banking in English law gave rise to a surprising lack of legal problems until the case of United Dominions Trust v. Kirkwood, 1 Lloyd's Rep. 418 (Q.B. 1966), in which the central issue became whether the plaintiffs—a credit granting
The Nineteenth Century also saw the transformation of the Bank of England from the dominant commercial bank to an institution that while remaining privately owned, began to discharge some of the recognizable functions of a modern central bank. The Bank became the custodian of the banking system's reserves of coin and bullion against its note and deposit liabilities, and the existence of this large reserve meant that the Bank was able to act as the ultimate supplier of cash to the financial system in times of liquidity shortage. It gradually began to take on the role of lender of last resort without making an explicit commitment to accept this responsibility. While the Bank's willingness to provide support to institutions was not unqualified, by the time Walter Bagehot published *Lombard Street* in 1873, the Bank's role as lender of last resort during liquidity crises was entrenched.

2. United States Establishes a Dual Banking System and a Central Bank.

One of the modern complexities of the U.S. regulatory system was also established in the second half of the Nineteenth Century. The dual banking system was the unintended byproduct of Congress' decision in 1863 to create national banks. States began chartering banks long before the federal government did. Congress passed the National Bank Act of 1863 to provide for a uniform national currency to help finance the Civil War expecting that state banks would convert their charters to...
national ones. When wholesale charter conversion did not occur, Congress responded by imposing a prohibitive tax on state bank notes. State banks, however, avoided the tax by developing checking accounts, thereby eliminating the need for bank notes. The tax on state banks served as an incentive for new banks to seek national charters. Soon national banks began receiving charters, along with their state counterparts, firmly establishing the dual banking system.\(^{51}\)

The National Bank Act\(^{52}\) established the basic elements of bank regulation and monetary control.\(^{53}\) The Office of the Comptroller\(^{54}\) of the Currency ("OCC"), a new office in the Department of the Treasury, was established to administer the act. While it was not controversial at that time, because corporations were generally granted only specific, enumerated powers, the National Bank Act included a provision delineating "the business of banking," which has been the subject of later and much recent controversy and commentary. Section 8 of the National Bank Act provided that national banks may

exercise . . . all such incidental powers as shall be necessary to carry on the business of banking by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits, buying and selling exchange, coin, bullion; by loaning money on personal security; by ob-

\(^{51}\) For a general discussion of the chartering process at the federal and state level, see Butler & Macey, supra note 50, at 684-89.


\(^{53}\) The requirements for obtaining a national bank charter included:

(1) the maintenance of a reserve against deposits, which reserves were kept either in the bank itself or in a New York City bank; (2) a sizable deposit in the form of United States bonds was to be kept with the Comptroller of the Currency . . . in return for which the bank received national bank notes equal to ninety percent, and later 100 percent, of the value of the deposited bonds; (3) limitations on the total issue of national bank notes; (4) national banks were allowed to own real estate only if necessary for the transaction of business or acquired through foreclosure; (5) national banks could be used as depositories for government funds other than customs duties; (6) banks had to adhere to specific capital requirements and loan restrictions in order to obtain and retain their charters; and (7) the maintenance of reserve proportional to liabilities.

EDWARD L. SYMONS, JR. AND JAMES J. WHITE, BANKING LAW 23 (3rd ed. 1991). See also BENJAMIN HAGGOTT BECKHART, FEDERAL RESERVE SYSTEM 17-19 (1972) (describing the basic features of the national banking system).

\(^{54}\) Hugh McCulloch, was the first Comptroller of the Currency. He was president of the Bank of Indiana and accepted the position of Comptroller after two other men turned it down. Mr. McCulloch later went on to become the Secretary of the Treasury. ROSS M. ROBERTSON, THE COMPTROLLER AND BANK SUPERVISION: A HISTORICAL APPRAISAL 47-48 (1995).
taining, issuing, and circulating notes according to provisions of this act..."55

This statutory position contrasts sharply with that prevailing in Britain at the same time.

Despite the increase in U.S. regulation, bank crises continued to occur. Demand deposits had become more widely used yet no dependable system for turning deposits into cash had developed.56 While banks were required to maintain cash reserves of between 15 to 25 percent of deposits, the system for maintaining reserves functioned poorly during periods of high demand for cash.57 Moreover, the national currency proved inelastic, with no ability to respond to variations in the demand for coin and paper money. Spurred by the banking panic of 1907 and after much controversy over whether a central bank should be privately or publicly controlled,58 Congress passed the Federal Reserve Act of 1913.59 President-elect Woodrow Wilson is credited with conceiving a plan that balanced the need for centralization with the concern of the agrarians for local control.60 The stated purpose of the Federal Reserve Act was: "To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial


56. See ROBERTSON, supra note 54, at 87-88.

57. See SYMONS & WHITE, supra note 53, at 23–24. Symons and White explain the flaw in the system of maintaining reserves:

Part of these reserves themselves, however, could be kept on deposit in one of the central reserve cities—New York, Chicago or St. Louis. Funds from other banks tended to flow to New York, the financial center of the country. New York banks then loaned these funds to stock-exchange brokers, and so fostered a rise in stock prices. The resulting boom created a demand for cash by the depositing banks for their own customers, and the banks sought to obtain cash from their New York reserves. This demand for cash put the New York banks in the position of (1) having to call in the loans they had made, thus putting pressure on speculators and causing stock prices to fall, or (2) being unable to call in the loans because to do so would force the stock exchange to close (and so to be unable to remit funds to the depositing banks).

Id. at 24.

58. See ROBERTSON, supra note 54, at 88–90.


60. ROBERTSON, supra note 54, at 89–90. (The central banking system was conceived with 12 regional federal reserve banks.)
paper, to establish a more effective supervision of banking in the United States, and for other purposes." Although subject to Congressional oversight, the Federal Reserve was established as an independent central bank. National banks were, and still are, required to become members of the Federal Reserve System, and were, thus, subject to Federal Reserve regulation and had access to the Fed's check clearing system and discount window. State banks were not, and still are not, required to become members, and few sought membership. After the Federal Reserve Act, national banks were subject to overlapping federal jurisdiction, which set the stage for strained relations between the OCC and the Federal Reserve Board. In fact, during the early 1920s and apparently incited by the unpopular Comptroller John Skelton Williams, lawmakers introduced several bills in Congress that would have abolished the OCC and transferred the OCC's authority to the Federal Reserve Board. None of these bills were successful.

During this nascent period of bank supervision and monetary control, the number of banks in the United States grew at a rapid rate. The number of banks in 1865 exploded from 1,532 in 1865 to 27,285 by 1913. In contrast to Britain, the banking system was dominated by unit banks that were protected from competition as a result of restrictions on branching by national banks. The unit banking system, combined with

64. By 1921, only 33 per cent of commercial banks were members. PAUL STUDENSKI AND HERMAN E. KROOS, FINANCIAL HISTORY OF THE UNITED STATES 335-36 (2nd ed. 1963). At the end of 1997, the number of non-member banks still clearly outstripped the number of member banks: 3,543 of all commercial banks are members of the Federal Reserve System (2,684 national banks and 1,014 state banks), and 5,560 of all commercial banks are state banks that are not members of the Federal Reserve System. Board of Governors of the Federal Reserve System, 84TH ANNUAL REPORT, at 306 (1997). Member banks, however, held significantly more deposits (2,094,630 million), than non-member banks (674,964 million). Id. at 299.
65. See ROBERTSON, supra note 54, at 107-12 (discussing the early relationship between the two agencies). The relationship between the two agencies still shows signs of strain. See infra note 239 and accompanying text (discussing the location of non-bank activities).
66. See ROBERTSON, supra note 54, at 113-16.
factors such as low minimum capital requirements for state banks and the OCC's liberal chartering policies, led to a large number of decentralized banks.  

B. The Great Depression

The U.S. response to the Great Depression solidified its system of prudential regulation. New Deal reforms, discussed below, established federal deposit insurance and formalized activities restrictions that remain the law today. Interest rate regulation that was imposed in the 1930s survived until the deregulation of the 1980s and geographic restrictions on banking were not dismantled until the early 1990s. By contrast, the banking system that was in place in Britain by the end of the Nineteenth Century survived two world wars and the Great Depression without fundamental change. This meant, above all, that the Bank of England continued to exercise its informal oversight of the system without legislative or political interference.


Strict hierarchy drove the development of British bank supervision. At the apex of the system were large clearing banks, dominated by the "Big Five" with their extensive branch networks. In relation to the clearing banks, the Bank discharged the functions of a modern central bank, at the same time remaining in private ownership. The clearing banks were organized into the Committee of London Clearing Bankers, and this body acted as a conduit for formal communications between the Bank's Governor and the clearing banks' chairmen. In many respects, the Bank's relationship with the clearing banks paralleled the relationship between a bank and its most important customers, i.e., the ability to control was balanced against the financial hegemony wielded by the

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67. Today, despite the industry consolidation that has persisted through the 1990s and the significant bank failures of the 1980s and early 1990s, the number of U.S. banks remains staggeringly large, especially when compared with other developed countries. In 1997, the U.S. had 10,923 insured depository institutions (commercial banks and savings associations). Federal Depository Insurance Corporation, The Historical Statistics on Banking (visited Oct. 23, 1999) <http://www2.fdic.gov/hsob>. In contrast, in 1997, Canada had eight "Schedule I" banks and 43 "Schedule II" banks. 1998 EUROPA WORLD Y.B. 826. Japan had 150 private commercial banks. Id. at 1891. In 1992, the U.K. had 518 authorized banking institutions, approximately half of which are branches or subsidiaries of overseas institutions. Id. at 3390. Despite some obvious potential for mixing apples and oranges in comparing the distinct categories of institutions in each country, it is apparent that the U.S. distinguishes itself in sheer numbers of industry participants.

68. The "Big Five" were Barclays, Lloyds' (not to be confused with the Lloyd's of London insurance market), Midland, National Provincial and the Westminster.

An additional source of control over the banks was provided by the accounting profession which, since the 1879 Companies Act, had been required to conduct an annual audit of banks' balance sheets and profit and loss statements. In addition to the clearing banks, the top tier of the U.K. banking system consisted of a small, elite group of institutions, i.e., the discount houses and the accepting houses. Together with the clearing banks, these institutions represented the core of the domestic banking system over which the Bank endeavored to exercise a tight grip. The Bank's aim in its role as central bank was to ensure stability rather than to encourage competition. Therefore, it encouraged the formation of cartels among both the clearing banks and the discount houses. Institutional linkages between banks and securities dealers and between banks and insurance companies were actively discouraged, although not prohibited by law or regulation. Informal means were also used to limit the growth of speculative bubbles in the stock market.

The Bank conducted its informal supervision of the financial system primarily through its Discount Office. Through the Bank's own market

70. Writing in 1938, one American banker observed of the British system of controlling banks: "They do it in a different manner in England. They do it voluntarily and with gentlemanly understandings, with harmony and co-operation, while we try to accomplish it here through law and regulation." WILLIAM T. MCCAFFREY, ENGLISH AND AMERICAN BANKING SYSTEMS COMPARED 188 (1938).

71. Corporation procedure in England for a long period of time has placed much reliance in audits on behalf of shareholders by accounting firms. As a result there has developed a group of reputable and experienced accountants whose audit and certification of the state of the company's affairs carries a high degree of moral responsibility as well as the reputation for a conservative presentation of the facts. The customary employment of these firms by the shareholders of these banks is an assurance to the depositor.

72. Like the commercial banks these specialist institutions were also organized into "Committees" or "Associations" which both facilitated the Bank's quasi-regulatory dealings with them and which exercised extensive self-regulation. The accepting houses, the City of London's leading "merchant banks", were organized into the Accepting Houses Committee. The discount houses were the conduit for the transmission of the Bank's market operations to the wider financial system. They were organized into the London Discount Market Association.


74. A. Wilfred May, Financial Regulation Abroad: The Contrasts with American Technique, 47 J. POL. ECON. 493 (1939) ("Except for informal cautioning by the Bank of England under exceptionally urgent exigencies, British banks and brokers encounter no official interference whatever in their security-loaning operations.").

75. SAYERS, supra note 69, at 272 ("Traditionally it was through the Discount Office that the Bank expected to sense the need for action, and through the Discount Office that most of its decisions impinged on the outside world.").
operations, it was able to influence significantly the activities of all parties involved in the discount market: discount houses, brokers, accepting houses, and clearing banks. In many cases, the Bank received regular balance sheet information from these institutions. The Discount Office’s practices set the style for British banking regulation well into the statutory period during the final quarter of the Twentieth Century. This style was informal, flexible, off-site, and not examination-based.

This style of supervision had fundamental limitations. The Bank presumed a relationship of trust and confidence between it and the institutions it supervised, and therefore, that all relevant information was made available to it. Indeed, one bank supervisor likened the Discount Office to a confessional.  

The fact that the 1930s did not produce significant change in this peculiar, informal system of banking regulation is noteworthy. Although the first half of the Twentieth Century had witnessed a number of bank failures in Britain, none were on the scale of those experienced in the United States. When it struck the United Kingdom, the Great Depression primarily impacted the real rather than the financial economy. Furthermore, there was comparatively little tradition in British political culture of popular hostility to bankers or to the City. The British Labour party, through which such views might have found expression, remained out of power throughout the 1930s, and was in any case committed to the goal of nationalizing industry rather than regulating it. These factors combined to ensure that legislative intervention


77. The failure of the 1930s to result in a more formalized system of bank regulation in Britain is even more extraordinary when the introduction of legislation in other European countries is also taken into account. Sweden enacted a law on Credit Institutions in 1934; Germany in 1934; and Italy in 1936. However, in a number of Continental European countries the Great Depression resulted in serious banking crises that required substantial public funds to resolve. Legislative change in this period is thus closely connected with the recent experience of public sector bail-outs of banking systems.

78. The largest bank to have failed in Britain between 1900 and 1930 was Farrow’s Bank, Ltd. in 1920 with 74 branches and £4.1 million in deposits. Of the seven other banks to fail during this period five were unit banks. See McCaffrey, supra note 70 app.

79. However, the Bank of England did become involved in a number of bank rescues during the late 1920s and early 1930s. In 1929 it organized the purchase of the troubled William Deacon’s Bank, which had extensive exposures to the depressed Lancashire cotton industry, by the Royal Bank of Scotland. See Sayers, supra note 69, at 253-59. It was also involved in the rescue of the Anglo-South American bank in 1931 and the accepting house, Frederick Huth & Co., in the same year. However, these rescues were organized discretely without the need for public money and did not raise widespread public concern. See id. at 263-71.

in the conduct of finance of the sort introduced in the United States in the wake of the Great Depression did not occur in the United Kingdom for another four decades.


During the prosperous 1920s, U.S. banks expanded their commercial lending and securities underwriting and the banking industry consolidated. Large banks grew, mergers were common, and branching spread. Still, the prosperity did not inure to all and the Federal Reserve was unable to stabilize the banking system sufficiently. Bank failures proliferated during this period, especially among state and nonmember banks.

In retrospect, the U.S. banking system seemed almost poised for collapse once the business boom turned bust; and it did. The country's financial fortunes began to fade in early 1929 and evaporated with the stock market crash in October of that year. The economic downturn persisted and worsened for years to come. Banks suffered the worst among businesses. During the Great Depression, the number of banks shriveled from 24,026 on December 31, 1929, to 13,949 on June 30, 1933 as waves of panic swept the country. In the first days of March 1933, and after almost all state governors had issued orders temporarily closing banks in their respective states, President Roosevelt declared a nationwide banking "holiday."

81. Banks conducted their securities activities through affiliates. By 1930, those affiliates were underwriting over half of all new securities issues. See Susan Estabrook Kennedy, The Banking Crisis of 1933, at 212 (1973).

82. See generally Robertson, supra note 54, at 100-05 (discussing branch banking).

83. These banks tended to have the least capital, they were subject to less regulation, and they operated in rural areas that did not benefit from urban prosperity. Studenski & Kroos, supra note 64, at 334-35.

84. "Instead of short panic, the 1930's featured a deflation and liquidation that became increasingly severe as time passed. National income dropped from $87.8 billion in 1929 to $75.7 billion in 1930 and $42.5 billion in 1932." Id. at 353.

85. The U.S. was not alone; the depression was experienced worldwide.

86. See Beckhart, supra note 53, at 258.

87. In a radio address, President Roosevelt commented on contagion fear phenomena of bank runs:

We had a bad banking situation. Some of our bankers had shown themselves either incompetent or dishonest in their handling of the people's funds. They had used the money entrusted to them in speculations and unwise loans. This was of course not true in the vast majority of our banks but it was true in enough of them to shock the people for a time into a sense of insecurity and to put them into a frame of mind where they did not differentiate, but seemed to assume that the acts of a comparative few had tainted them all. It was the Government's job to straighten out this situation and do it as quickly as possible—and the job is being performed.
Legislative reform and the first serious regulation of the banking industry followed. The Banking Act of 193388 ("1933 Act") and the Banking Act of 193589 ("1935 Act") established the most fundamental, unique, and enduring aspects of U.S. banking regulation. As discussed below, the 1933 Act established a federal deposit insurance scheme and the Federal Deposit Insurance Corporation ("FDIC") for its administration. The 1933 Act also included four provisions, commonly referred to as the Glass-Steagall Act ("Glass-Steagall"), which separated the businesses of commercial and investment banking.90 In addition to the creation of federal deposit insurance and the separation of commercial and investment banking, the 1933 Act and the 1935 Act incorporated other regulatory controls. Congress raised the minimum capital requirements for national banks and barred the payment of interest on demand deposits.

The public interest interpretation is that Congress' primary purpose in enacting these laws was to create and maintain a more stable financial system. The special interest view is that this legislation was a response to more base forces, such as a popular dislike for large money center banks, and the political power of small banks balanced against the political power of the money center banks.91

a. Federal Deposit Insurance

The FDIC was created to protect depositors92—to the tune of $2,500 per insured account.93 The notion of deposit insurance was quite

Franklin Delano Roosevelt, Radio Address Delivered From The President's Study (March 12, 1933), in PUBLIC ADDRESSES OF FRANKLIN DELANO ROOSEVELT 43, 47 (DeVorss & Co. 1st ed. 1934).


91. See MARK J. ROE, STRONG MANAGERS, WEAK OWNERS 97 (1994).

92. FDIC v. Philadelphia Gear Corp., 476 U.S. 426, 432 (1986) (concluding that "[c]ongress attempted to safeguard the hard earnings of individuals against the possibility that bank failures would deprive them of their savings.").

93. Insurance coverage was quickly increased, in 1934 to $5,000. It remained at $5,000 until 1950 when it was doubled to $10,000. In 1966, the ceiling was raised to $15,000; in
controversial. State deposit insurance programs had been unsuccessful. Big banks opposed the scheme, because they believed the scheme compelled them to subsidize the operations of weaker banks. President Roosevelt opposed the scheme for the same reasons. Deposit insurance, however, had tremendous appeal with the masses and unit bankers. Deposit insurance passed, despite the strong opposition, as part of a compromise that allowed for the larger package of bank reform. In the end, Roosevelt claimed credit for the deposit insurance scheme "to the amusement and outrage of contemporary and hindsight observers."

As originally conceived under the 1933 Act and the 1935 Act, all insured banks were required to be members of the Federal Reserve System. This would have increased the supervisory responsibilities of the Federal Reserve Board. Non-member banks, however, were able to bring sufficient political pressure to bear on this issue, so that in 1939, the membership requirement was dropped from the federal deposit insurance scheme.

The FDIC's operations can be considered successful. During its first forty-one years (1934-74), the FDIC disbursed $3,536,026 to depositors, but lost only $102,795. Of course, this period was remarkably stable, averaging only about 13 bank failures per year. The next twenty years (1975-94), however, present a different picture. During that time, the FDIC oversaw an average of 78 bank failures a year, disbursed $99,945,147 to depositors, and lost an alarming $36,428,629.

These statistics quite predictably led to many of the regulatory reforms of the modern period.

1969 to $20,000; and in 1974 to $40,000. The current $100,000 coverage was established in 1980. 1995 FDIC ANN. REP. 110.

94. STUDENSKI & KROOS, supra note 64, at 396 ("[T]he FDIC was a tonic to the jaded psychology of the American public, for it did much to remove the public's distrust of the banking system.").

95. See Jonathan R. Macey and Geoffrey P. Miller, Deposit Insurance, the Implicit Regulatory Contract, and the Mismatch in the Term Structure of Banks' Assets and Liabilities, 12 YALE J. ON REG. 1, 19-20 (1995) (arguing that the primary beneficiary of deposit insurance was the banks). Professors Macey and Miller conclude that the benefits of deposit insurance to depositors are eroded largely by the lower interest rates banks can pay on insured deposits. See id. at 19.

96. KENNEDY, supra note 81, at 222 (footnote omitted).

97. 1994 FDIC ANN. REP. 127.

98. See 1994 FDIC ANN. REP. 125. Of the 514 bank failures during this forty-one year period, 77% occurred during the first ten years. Id.

99. Id.

100. 1994 FDIC ANN. REP. 127.

101. See infra Part II.F.
b. Separation of Commercial and Investment Banking

The basic intent of the separation of commercial and investment banking—included in the 1932 Democratic platform—is unclear. The public interest interpretation of Congress' purpose is the most conventional view. According to this view, Congress blamed banks' securities activities for causing the 1929 stock market crash and sought to prevent history from repeating itself. Moreover, Glass-Steagall may represent a public interest oriented law if Congress thought that the public was better served by banks channeling their resources into the traditional business of commercial lending. Others argue that Glass-Steagall is the product of special interest group pressures. According to this view, Congress was motivated by investment bankers who were able to persuade Congress to prohibit commercial banks from competing against them in the securities business.

While Glass-Steagall's restrictions on banks' securities activities remain essentially unchanged today, significant changes in agency interpretation of these restrictions have expanded the extent of banks' securities activities since the period following the Depression.

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103. See, e.g., Investment Co. Institute v. Camp, 401 U.S. 617, 629-30 (1971); Roe, supra note 91, at 95 (1994); Kennedy, supra note 81, at 212.

104. See Langevoort, supra note 102, at 697. Professor Langevoort argues that "the principal motivation was pursuit, perhaps more emotional than rational, of the challenging objective—an attempt to force banks to redirect their resources, efforts, and energies to the traditional business of commercial and agricultural lending by foreclosing the securities temptation." As Professor Macey notes, if this was the motivation, it was not rational. See Jonathan R. Macey, The Political Science of Regulating Bank Risk, 49 Ohio St. L.J. 1277, 1291 n.75 (1989) (arguing that commercial lending and securities underwriting achieve the same economic purpose, and thus forcing a bank to use one financial vehicle over the other would not prove beneficial.)


106. See infra Part II.F.3 and accompanying text (discussing current restrictions on banks' securities activities).
c. Geographic Restrictions

In an amendment to the McFadden Act, the 1933 Act permitted national banks to branch anywhere within a state that permitted state-wide branching for state banks. Prior to the passage of the McFadden Act in 1927, national banks did not have the authority to branch. States, however, had begun to permit at least some branching within their borders. Like the Glass-Steagall Act, Congress's intent in passing the McFadden Act and the 1933 amendment is far from clear. Courts interpreting the law have stated that "Congress intended to place national and state banks on a basis of ‘competitive equality’ insofar as branch banking was concerned." It is likely that Congress' intent was more complex than simply an attempt to level the playing field. The special interest view is that the McFadden Act was passed to satisfy unit bankers’ desire to protect their markets from competitors and to gain their support for federal deposit insurance. The public interest interpretation is that the branching provisions were an attempt, albeit misguided, to prevent geographic expansion to promote community reinvestment, preserve local control, and avoid "undue" concentration. Whatever their purpose, geographic restrictions on banking continue in the United States today, although in much weaker form than those established in the 1920s and 1930s.

d. Interest Rate Regulation

The New Deal legislative package also prohibited the payment of interest on demand deposits and gave the Federal Reserve Board the authority to regulate interest paid on time deposits. Consistent with the other major provisions of the New Deal reforms, Congress’ intent with

107. The McFadden Act, c. 191, § 2, 44 Stat. 1226 (1927) had permitted national banks to branch within the limits of the city, town or village in which they were located if state banks had that power.
110. Langevoort, supra note 102, at 720-23. See also Kennedy, supra note 81, at 7 ("The McFadden Act of 1927 sought to eliminate any branch banking in the United States, allegedly to rescue the nation from Eastern aggression.").
111. Langevoort, supra note 102, at 720-23.
112. Daniel R. Fischel et al., The Regulation of Banks and Bank Holding Companies, 73 Va. L. Rev. 301, 331 (1987). It is part of American culture to distrust big business. In 1914, Louis Brandeis wrote of his distrust of big business, particularly big banks. See Louis D. Brandeis, Other People's Money and How the Bankers Use It 163-64 (1914) ("[B]oth the financial concentration and the combinations which they have served were, in the main, against the public interest. Size, we are told, is not a crime. But size may, at least, become noxious by reason of the means through which it was attained or the uses to which it is put.").
113. See infra Part II.F.3 (discussing the IBBEA).
respect to the interest rate restrictions can be viewed as motivated by the public interest and/or as service to special interest groups. The public interest view is that the ability to offer high rates of interest on deposits had forced banks into riskier investment practices. The special interest view is that large banks sought to limit interest rate competition on demand deposits—their private agreements having been ineffective—and that this concession was given to them in exchange for their support for federal deposit insurance.

C. Post War Period

The 1930s did not result in significant change to the informal system of bank regulation in Britain. However, in the aftermath of the Second World War there was a fundamental shift of British economic philosophy towards a guided or managed economy. The Bank of England was nationalized in 1946, although in practice this did not result in any significant change in its earlier practices, either with regard to monetary policy or towards banking regulation. However, the newly nationalized central bank did begin to play a full role in implementing the new approach towards economic management. Its authority was not statutory. It influenced the process of credit creation through its powers of "moral suasion"—the informal influence resulting from its longstanding relationship with the leading commercial banks. The Bank's informal control was effective because "only a small group of very large [clearing] banks was involved, banks with a tradition of acting in unison and of co-operating with the central bank. . . . Legislation proved unnecessary, with the authorities appealing to the bankers' sense of public responsibility." While the Bank was statutorily authorized to issue formal directives, none were ever issued. During the immediate post-war period, the Bank focused exclusively on promoting the growth of credit and the maintenance of orderly markets. Safety and soundness considerations did not arise in any meaningful sense: the maintenance of cartel-type arrangements guaranteed profitability, and removed the prospect of serious financial failures among the largest institutions. The

115. See Benston, supra note 105, at 228 (explaining that "[a]lthough the FDIC insured individual deposit accounts only to a maximum of $2,500 . . . , assessments were imposed on a bank's total deposits. Thus the larger banks, that held largely uninsured deposit accounts, subsidized the small banks . . . . this cost was almost exactly offset by their savings of interest payments on demand deposits.") (citations omitted).
116. COLLINS, supra note 39, at 479.
Bank's primary focus in its supervision of commercial banks was to ensure that they maintained adequate liquidity, rather than adequate capital. The liquidity ratio—the reserve asset ratio—in turn became a key instrument for controlling the growth of credit, rather than reflecting any specifically prudential concern. 118

Similarly in the United States, bank safety and soundness was not a pressing issue during this period. The years after the Depression and before the S&L crisis of the 1980s proved stable for the banks. There were very few bank failures 119—a pattern that continued until the 1980s. 120 New Deal legislation protected banks from competition among themselves and from other financial institutions. Legislative efforts during this period focused primarily on shoring up existing interests which included the maintenance of a fragmented industry.

Bank holding companies had been in existence for years and concern had grown regarding the use of bank holding companies to avoid branching restrictions and the consequent increased concentration. The Bank Holding Company Act of 1956 121 was designed to restrict the expansion of banking enterprises. 122 The impact of the Bank Holding Company Act was not as large at the time of its enactment as it would become in the years to follow. The Bank Holding Company Act would change the Federal Reserve Board's supervisory role from a minor one, with responsibilities for only the smallest institutions, state member banks, 123 to a starring one. While the Bank Holding Company Act closed a loophole in the federal scheme of geographic restrictions, bank holding companies still emerged as the preferred business form 124 and would

118. During this period the Bank of England prescribed a minimum ratio for banks' reserves of liquid assets. The attempt to control bank liquidity reflected the assumption "that control over commercial banks' reserves of liquid assets would provide control, in turn, over the general level of their loans and liabilities" and hence of the growth of credit in the economy. COLLINS, supra note 39, at 475. On occasion the Bank also resorted to direct controls over credit in the form of letters from the Governor to the Chairmen of the Clearing Banks requesting a reduction or an increase in their lending.


120. From 1943 to 1981, an average of 5 banks failed per year. See id.

121. May 9, 1956, c. 240, § 2, 70 Stat. 133.

122. The goals of the act were achieved through three principal proscriptions. First, bank holding companies were required to register with the Federal Reserve. See 12 U.S.C. 1844(a) (1994). Second, the act restricted geographic expansion through the bank holding company structure. See 12 U.S.C. 1842(d) (1994). Third, the act limited the activities of bank holding companies and affiliates (separated the banking business from other businesses). See 12 U.S.C. 1843(c) (1994).

123. Prior to the passage of the Bank Holding Company Act, the Federal Reserve conducted few bank examinations and generally relied on the OCC's examinations.

124. Because of the eventual loosening of state law restrictions, the bank holding company form because important to the geographic expansion of banks during the 1980s.
eventually control the vast majority of commercial banks and commercial bank assets. While in 1956, there were only 53 registered holding companies, by the end of 1997, there were 6,102 bank holding companies controlling approximately 7,015 banks, and held 93.8 percent of all bank assets. The extent of the Federal Reserve Board's supervisory power is directly related to the prevalence of the bank holding company as the predominant business form in the banking industry.

D. Regulatory Response to Increased Competition

The remarkably stable post-war period in both the United States and the United Kingdom was undermined during the 1960s by developments in the relatively unregulated sectors of their respective financial markets. In the United States, the 1960s began a long story of disintermediation. Banks began losing commercial loan customers to the commercial paper market. Banks increased consumer and mortgage lending. These changes diminished the overall quality of banks' assets. Disintermediation occurred not only on the asset side of banks' balance sheets but also on the liability side. Soaring oil prices during the 1970s led the Federal Reserve to drive up interest rates. Depositors seized opportunities to earn higher interest rates offered by money market mutual funds and withdrew their money from interest rate regulated bank accounts. The 1970s also saw a marked increase in competition from foreign banks in the United States.

In Great Britain, the 1960s saw significant growth in banking outside of the sectors controlled by the Bank of England, making its system of credit control much less effective. Initially the Bank adopted a policy of benign neglect towards the emergence of the euromarkets and adopted an accommodating stance toward foreign institutions seeking to establish branches or subsidiaries in the City. It also displayed little interest in a new breed of "secondary" institutions at the base of the banking hierarchy. However, the emergence of euromarkets provided the liquidity and wholesale market funds to spur the growth of an unregulated domestic banking sector. This sector, which resided outside

Moreover, the bank holding company form has played an important role in the expansion of banks' securities activities. See infra Part II.F.3.


127. See Beckhart, supra note 53, at 346.

128. These "Secondary" or "fringe" banks were banks that were recognized under Section 123 of the Companies Act; however, they were not subject to authorization or supervision by any public body. See supra note 47 (describing secondary banks).
the Bank's traditional sphere of influence, or indeed interest, was none-theless to provide the source of the explosive credit growth which lead to the United Kingdom's most serious banking crisis of this century.

The immediate regulatory response in both the United States and the United Kingdom to these market developments was deregulation. The deregulatory efforts of this period, however, did not necessarily result in less formal regulatory regimes. In Britain, dismantling the post-war system of credit control in favor of a system which gave market forces a greater role in credit allocation was balanced by the impact of the Secondary Banking Crisis, which forced the Bank into a formalized statute-based system of safety and soundness regulation. Similarly in the United States, while significant deregulation has been achieved during the last twenty years, its regulatory regime remains the most comprehensive and formal in the world.

1. United Kingdom's Interregnum: 1970s

The Bank of England responded to the growth of the secondary banking sector and the emerging presence of foreign institutions by deregulating the U.K.'s domestic financial markets. Increased competition was the purpose of the Competition and Credit Control (CCC) system introduced in September 1971.129 The CCC regime was implemented administratively, without the need for legislative authorization, although it enjoyed the full support of the then Conservative government. The new regime placed increased reliance on manipulating interest rates to regulate credit, as opposed to the more quantitative techniques employed in the past. The CCC regime was not, however, entirely deregulatory. Under the new regime, a wider range of banks were obliged to comply with the Bank's monetary and credit controls. Significantly, this extended the reserve asset ratio to all "statistical" banks,130 requiring them to maintain interest free reserves, a specified ratio of their Sterling deposits, with the Bank.

129. The Governor of the Bank described it as "a new approach to credit control designed to permit the price mechanism to function efficiently in the allocation of credit, and to free banks from their rigidities and restraints which have for far too long inhibited them from efficiently fulfilling their intermediary role in the financial system." COLLINS, supra note 39, at 490.

130. The statistical banks were those from which the Bank collected regular statistical reports, especially balance sheet data and the currency composition of their lending. The provision of this information was purely voluntary. By late 1973 there were 323 banks listed by the Bank of England as the contributors to the published banking statistics. In addition, there were 133 companies holding section 123 certificates that were carrying on banking businesses. By definition, the latter were outside the scope of the Bank's statistical reporting system. See MARGARET REID, THE SECONDARY BANKING CRISIS 1973-75, at 51 (1982).
The extension of its reserve asset ratio to all statistical banks was part of the Bank’s attempt to assert its control over new parts of the banking sector and to reduce incentives for arbitrage. The Bank’s efforts, however, were too little too late. As a result of deregulation and the Conservative government’s loose fiscal and monetary policies, Sterling bank lending rose significantly. While the statistical banking sector accounted for a significant proportion of the increase, unregulated secondary banks made a major contribution. When the inflationary bubble burst, secondary banks were left heavily exposed to a real estate sector which was unable to meet its repayment obligations. A number of institutions faced serious liquidity problems, and as the crisis wore on a growing number of them became insolvent.

The Bank of England was forced to launch a “lifeboat,” a rescue package for troubled secondary banks. The Bank, along with London and Scottish clearing banks, contributed its own resources to the lifeboat. Although the lifeboat was originally intended to provide liquidity to solvent secondary banks, eventually lifeboat funds were used to bail out depositors of insolvent institutions. While the lifeboat was successful in preserving the stability of the banking system and effectively insured secondary banks’ deposits, the Secondary Banking Crisis represented the last occasion on which the Bank was able to mobilize the City “club” to act in for a collective good. Moreover, the lifeboat was the last occasion on which the Bank was able to take charge of a major crisis without some attempt by the government to exert oversight and control.

The Secondary Banking Crisis of 1973–74 spurred the development of statute-based bank regulation. The crisis also resulted in some immediate and significant changes in the Bank’s methods of supervision. While the Bank’s then Governor, Gordon Richardson, publicly singled out the secondary banks for special blame in the crisis, a number of statistical banks had engaged in similarly poor banking practices. Confidence needed to be restored in both the City and the Bank by high-profile action.

131. The first year after the introduction of the CCC sterling bank lending rose 70%. Two years into the new regime lending rose 145%. Property lending rose 250%. See id. at 60.
132. See supra note 47 (describing secondary banks).
133. By mid-summer of 1974, the Bank and the clearing banks had committed £1,200 million to the lifeboat operation, a sum which amounted to 40% of the combined reserves of the London and Scottish clearing banks. See REID, supra note 130, at 137.
134. The clearing banks reluctance, twenty years later, to take part in a bail-out package for Barings was a major factor in the Bank’s decision to allow the institution to fail. See infra notes 197–200 and accompanying text (discussing the Barings scandal).
The Bank took immediate steps to improve its supervisory practices. It created a new Banking and Money Markets Supervision Division (BAMMS) to replace the supervisory functions previously discharged by the Discount Office. By 1978, BAMMS had a staff of seventy, nearly five times the staff of the former Discount Office.

Along with organizational changes came changes to the Bank's supervisory practices. The Bank's past supervision had placed particular emphasis on the liquidity ratios of clearing banks and accepting houses. While continuing to monitor liquidity closely, BAMMS began to place a new emphasis on capital ratios. BAMMS also extended the range of information it collected and the scope of the institutions from which it gathered information. All British registered banks, which included all British owned banks and subsidiaries of foreign banks, but not their U.K. branches, were requested to submit additional quarterly returns. These returns provided BAMMS with much more detailed information than had been available to the Discount Office.

In retrospect, the 1970s can be seen as an interregnum in the history of British bank regulation. On the one hand, much of the old system of direct credit controls was dismantled, in theory allowing more competition. The Bank abandoned its past support for cartel arrangements involving U.K. financial institutions. On the other hand, the Bank of England continued to operate through its traditional and informal approach of moral suasion. While the Bank sought to develop its regulatory capacity and expertise, and importantly took a leading international leadership role as chairman of the Basel Committee on Banking and Regulation and Supervisory Practices, the Bank did so without formal statutory authority. This was an inherently unstable position, and subsequently proved so.

2. United States Adjusts New Deal Constraints: 1980s

Deregulation was a popular cry in the 1980s and perhaps loudest from the banking world. Congress responded with the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"). Congress based the passage of DIDMCA on the finding that regulated interest rates were not beneficial to depositors or banks. The legislation called for the phase out of interest rate ceilings

135. See Reid, supra note 130, at 196.
136. See Basle Committee on Banking Supervision, supra note 1.
138. Specifically, DIDA sets forth Congress's finding that:
and established the Depository Institutions Deregulation Committee ("DIDC") to implement the phase out.\textsuperscript{139} This eventually led to the complete phase out of interest rate regulation on deposit accounts, except for business checking accounts.\textsuperscript{140} The DIDMCA also required all banks, both members and nonmembers, to maintain reserves with the Federal Reserve.\textsuperscript{141}

The DIDMCA also eliminated many restrictions on the activities of federally chartered thrifts. It authorized thrifts to make commercial real estate loans, secured and unsecured consumer loans, to issue credit cards, and invest up to 20\% of their assets in commercial paper and corporate debt. The Garn-St Germain Depository Institutions Act of 1982\textsuperscript{142} expanded thrift powers even further, allowing for thrifts to make commercial loans and accept commercial deposits.

While U.S. banks sought deregulation of their own activities, they also sought to curtail the competitive advantage of the growing number of foreign banks operating in the United States. Concurrently, U.S. regulators became anxious about the lack of supervision over the U.S.
operations of foreign banks. Congress responded to these concerns by passing the International Banking Act of 1978 ("IBA"),143 which imposed many of the same regulatory restrictions on foreign banks as on domestic ones. The IBA was based on the principle of "parity of treatment" between domestic and foreign banks.144 In effect, the IBA closed loopholes that had allowed foreign banks operating in the United States to avoid restrictions on bank holding company activities, Glass-Steagall Act restrictions on securities activities, and interstate banking restrictions.145 Significantly, Congress did not respond to the increase of foreign bank competition with deregulation. The IBA could be seen as protectionist in the sense that it imposed new restrictions on foreign banks. On the other hand, Congress could have imposed stricter requirements on foreign banks operating in the United States but chose not to in an attempt to encourage other foreign nations to treat U.S. banks operating abroad in a similar fashion.146

Increased international lending by domestic banks, coupled with a mounting debt crisis, was the impetus for the passage of the International Lending Supervision Act of 1983 ("ILSA").147 ILSA, among other things, requires banks to maintain special reserves against certain international loans.148 Significantly, the ILSA contained the first statutory capital requirements. It directed the federal banking agencies to require banks "to achieve and maintain adequate capital by establishing minimum levels of capital."149 Congress also signaled its desire for international convergence of capital standards by directing the banking agencies to "consult with the banking supervisory authorities of other countries to reach understandings aimed at achieving the adoption of effective and consistent supervisory policies and practices with respect to international lending."150 Congress' exhortation would be answered by a joint initiative between the United States and United Kingdom and later by the Basel Accord.151

151. See infra Part II.F.2.
E. United Kingdom Adopts Statute Based System

The Bank of England’s informal system of banking supervision, which had matured during the 1930s and continued with only modest change during the immediate post-war period, could not survive the Secondary Banking Crisis. The fall out from the Secondary Banking Crisis made legislation inevitable despite the Bank of England’s preference for the status quo. Nonetheless, the Bank of England’s experience as a statutory regulator was shaped by the informal and institution-specific nature of its pre-statutory supervision. In many respects, the history of the Bank’s role as statutory regulator can be characterized as an attempt to reconcile a set of assumptions, a culture, and a strategy that it had inherited from its pre-statutory role to the demands of a statute-based system. The Bank never successfully reconciled these different demands.

1. Banking Act of 1979

The Secondary Banking Crisis highlighted four major deficiencies in the informal system of regulation. First, considerable public confusion existed regarding the status of banking recognitions.152 Second, many depository institutions were completely unsupervised. Third, no formal arrangements existed to protect depositors of failed institutions. Finally, even where the Bank did play a supervisory role, its efforts were not wholly effective.

Concurrent with the United Kingdom’s reexamination of its system for bank supervision, European Union law became an important consideration. In December of 1977, the European Economic Community (“EEC”) adopted its first Council Directive “on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institution.” This became known at the first Banking Coordination Directive (“1BCD”).153 The 1BCD was concerned with the authorization of “credit institutions,” which it defined as institutions that engage in both deposit taking and lending. The directive set forth five minimum conditions for the authorization of a

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152. In the late 1960s it was customary for the Bank to refer to a hierarchy of banking recognitions. The clearing banks, accepting houses, and discount houses were considered to be at the apex of the banking hierarchy. Numerous other designations and statutory authorizations existed below this top tier. Slightly below the top rung of the banking ladder were the Section 127 banks that were exempt from the provisions of the Protection of Depositors Act of 1963. Further down the ladder was the Section 54 recognition that authorized an institution to pay annual interest on deposit accounts. The bottom rung of the ladder was occupied by institutions granted a certificate issued by the Department of Trade (now the Department of Trade and Industry) under Section 123 of the Companies Act of 1967.

credit institution. The directive additionally called for the establishment of common prudential ratios, but the EEC countries could not agree on these for many years to come. In the shorter term, the United Kingdom was now obliged to implement a formal system of bank licensing and regulation for the first time in one hundred and fifty years.

The Bank of England inherited statute-based supervision as a natural extension of its traditional role. While U.K. lawmakers gave some consideration to granting bank supervisory powers to a new commission or to the Department of Trade, the Bank's Governor Richardson successfully lobbied in Whitehall for the Bank to take on the statute-based supervisory role. Governor Richardson had important influence over the substance of the new law as well. He suggested that the real defect in the current system was the lack of a clear distinction between the primary and secondary banking sectors. He insisted that there was no need to interfere with the Bank's relationship with the primary sector. The new legislation, the Banking Act of 1979, included a two tier system of banking supervision. The law drew a distinction between "recognized banks" and "licensed deposit takers" ("LDT"). While Richardson would have preferred a system that imposed no statutory oversight on the recognized banks, 1BCD applied its minimum criteria to all banks. Schedule 2 of the Banking Act of 1979 reflects this tension. While some of its criteria apply to both recognized banks and licensed deposit takers, there are important differentiations. Both types of institutions must employ at least two individuals to "effectively direct" its business, and both types of institutions must conduct their business in a prudent manner. On the other hand, the minimum capital required for an LDT was set at

154. (1) the credit institution must possess separate own funds; (2) it must possess adequate minimum own funds; (3) there shall be at least two persons who effectively direct the institution's business; (4) those persons must be of "sufficiently good repute" and have sufficient experience" to perform their duties; (5) applications for authorization must be accompanied by a "programme of operations" setting out, inter alia, the types of business envisaged and the structural organization of the institution. Id. at 33.

155. See infra Part II.F.2.

156. Both the Prime Minister and Chancellor of the Exchequer had their doubts about whether the Bank was the right institution to conduct banking regulation, and even some figures with the Bank itself had similar reservations. See Michael Moran, The Politics of Banking 120 (2d ed., 1986); Stephen Fay, Portrait of an Old Lady, 90 (1987).

157. Two criteria served to distinguish recognized banks from LDTs. First, a recognized bank had to provide either "a wide range of banking services" or "a highly specialized banking service." The latter was not defined by the Act, leaving its interpretation to the discretion of the Bank. "A wide range of banking services" was defined as deposit taking, lending, foreign exchange, trade finance, and financial advice. Banking Act 1979, ch. 37, sched. 2, para. 2(2) (Eng.). Second, a recognized bank was one which "enjoys, and has for a reasonable period of time enjoyed, a high reputation and standing in the financial community." Id. para. 1(1). The act did not define this standard, leaving substantial discretion to the Bank in its interpretation.
£250,000, whereas for a recognized bank it was £5 million. Moreover, many of the criteria applied to LDTs were more specific, although not necessarily more onerous, than those applied to the recognized banks. Significantly, the 1979 act provided the Bank with the power to require the production of information only from LDTs, but not from recognized banks.

In these respects, the 1979 Act perpetuated the Bank’s established practice rather than requiring any significant break with the past. The distinction between recognized banks and LDTs had been constructed to permit the Bank to continue its non-statute based form of supervision. Unlike many continental European banking statutes, the 1979 Act made no attempt to lay down detailed and rigid capital and liquidity requirements. This enabled the Bank to continue to apply the flexible, case-by-case approach it had followed since the days of supervision by the Discount Office.

The 1979 Act, however, did more than establish authorization requirements and grant the Bank chartering and supervisory authority. The new law also reflected important influence from the Labour party, which had controlled the government since February 1974. Consumer protection had strong appeal within Labour and the proposed banking law acquired some of the trappings of consumer legislation, in part to ensure that the government would award it sufficient parliamentary time to ensure its passage. In place of the unsatisfactory ad hoc arrangement adopted during the Secondary Banking Crisis, the 1979 Act established a Deposit Protection Scheme. The U.K.’s deposit insurance differed significantly from the system developed in the United States more than 40 years earlier. The Deposit Protection Scheme included no access to taxpayer money but was funded solely by a levy on the banking industry. The Deposit Protection Fund (“DPF”) was created to lend credibility to the scheme. The deposit protection afforded by the fund was only for a relatively small amount: 75% of a maximum of £10,000 of an

158. A recognized bank was required to maintain “net assets which together with other financial resources available to the institution of such nature and amount as are considered appropriate by the Bank, are of an amount which is commensurate with the scale of the institution’s operations.” Id. para. 6. In the case of a LDT, however, the net assets had to be “sufficient to safeguard the interest of its depositors,” having regard to “the scale and nature of the liabilities of the institution and the sources and amounts of deposits accepted by it” and to “the nature of its assets and the degree of risk attached to them.” Id. para. 10. Similarly, the management criterion was more specific for LDTs than for recognized banks. The management of recognized banks was required to carry on business with “integrity and prudence” and with “those professional skills which are consistent with the range and scale of the institution’s activities.” Id. para. 3. In contrast, the management of LDT has to be “a fit and proper person to hold that position.” Id. para. 7.

159. See Moran, supra note 156, at 121.
institution’s sterling liability to an individual depositor.\textsuperscript{160} The relatively low coverage was intended to protect “small” depositors and the 75% cap provided some level of co-insurance.\textsuperscript{161}

With regard to the Bank’s supervisory role, the 1979 Act imposed on the Bank a statutory duty to “protect the interests of depositors.” This was not necessarily consistent with the Bank’s traditional central bank role in which its primary concern was systemic failure. The Bank’s reluctance to acknowledge the implications of this new statutory duty resurfaced in the years to come.\textsuperscript{162}

2. Banking Act of 1987

The first major challenge to the Bank’s traditional style of supervision was the rescue of Johnson Matthey Bankers (“JMB”) in 1984.\textsuperscript{163} JMB, a subsidiary of Johnson Matthey gold refiners, was one of the five London gold-dealing banks. It was a recognized bank under the 1979 Act. As an institution considered of “high reputation and standing,”\textsuperscript{164} JMB was subject to little supervision. JMB’s problems arose when it grafted a rapidly growing lending business onto its gold-dealing activities. In the four and a half years prior to September 1984, JMB’s loan portfolio grew from £34 million to £450 million, with one-third of the increase occurring in the last six months of the period. JMB’s lending was also highly concentrated, with two customers borrowing sums amounting to 65% and 34% of the bank’s capital, respectively. On September 25, 1984, JMB’s accountants recommended additional loan loss provisions that would have virtually wiped out JMB’s capital.

The Bank of England did not detect JMB’s imprudent lending practices until too late. Among the reasons for this failure were that the Bank staff was seriously overextended and that JMB submitted late and misleading quarterly returns to the Bank. Most importantly, however, was

\textsuperscript{160} In contrast, since 1980, U.S. deposit insurance has covered $100,000 in deposits without a co-insurance provision. See 1995 FDIC ANN. REP. 110.

\textsuperscript{161} The DPF was controversial. The Committee of London Clearing Bankers criticized the proposal because of the moral hazard created. The industry levy was also criticized for failing to distinguish between institutions’ differing degrees of insolvency risk. See JOHN GRADY \& MARTIN WEALE, BRITISH BANKING 1960–1985, at 43 (1986).

\textsuperscript{162} In February 1997—a matter of months before the Bank was stripped of its supervisory powers—it was still struggling to reconcile these conflicting objectives. See Michael Taylor, “Strengthening, but not Ensuring, the Protection of Depositors”: the Bank of England on the Objectives of Supervision, 12 BUTTERWORTHS J. INT’L BANKING & FIN. L. 151, 151 (1997).

\textsuperscript{163} For comprehensive accounts of the JMB rescue, see generally FAY, supra note 156; MARGARET REID, ALL-CHANGE IN THE CITY (1988).

\textsuperscript{164} See supra notes 157–58 and accompanying text (describing classification and supervision of recognized banks).
the Bank's overall trust in recognized banks. "Its practice had been to rely on the accuracy of their statistical returns, and to encourage bankers to bring their troubles to the attention of the Bank. In the case of JMB, this practice proved inadequate."165

Although JMB was not a significant bank and might have been allowed to fail, the Bank did not wish to risk serious instability in the gold market given JMB's numerous dealings with other gold banks. Therefore, the Bank purchased JMB for £1 after its parent company, Johnson Matthey, agreed to inject £50 million of capital. The Bank installed new management, under the chairmanship of one of its own directors. New managers immediately increased loan loss provisions by £254 million.

The JMB rescue had a number of important implications for the Bank. First, the Bank had been unable to rally support from the clearing banks as it had done in the past.166 Second, the episode exposed the Bank to a level of public scrutiny it had not previously encountered.167 As a result, a committee was established to study the system of bank regulation and its recommendations were subsequently incorporated in the Banking Act of 1987. The committee, which came to be known as the Leigh-Pemberton committee, was far from impartial. It was chaired by Bank Governor Leigh-Pemberton and included both the Deputy Governor and the Associate Director responsible for banking supervision.168

The Leigh-Pemberton committee's most important recommendation was to abolish the two-tier system. The 1987 Act thus replaced the recognized banks/LDT distinction with a single category of "authorised institution" subject to statutory criteria set forth in Schedule 3 of the Act: Directors, controllers, and managers must be "fit and proper;" the board of directors must consist of an appropriate number of

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165. Fay, supra note 156, at 150.

166. In sharp contrast to its experience in the lifeboat operation ten years earlier, see supra Part II.D.1, the clearing banks reluctantly contributed only £34 million of the £150 million required in the bailout. One clearing banker objected to being asked to take a share of the costs for an episode that he blamed on the Bank's failed supervision. See Reid, supra note 163, at 227.

167. Treasury ministers allowed it to be known that they had major reservations regarding the Bank's handling of the affair. This was an unprecedented airing of differences between the finance ministry and the central bank. The Chancellor of the Exchequer, Nigel Lawson, went even further in a statement to the House of Commons, when he concluded that the Bank's supervisors "did to some extent fall down on the job." While the words are measured, this was considered an unmistakable rebuke. Other parliamentarians were less restrained, with one Opposition backbencher describing Governor Leigh-Pemberton as a "useless deadbeat." Reid, supra note 163, at 229, 232.

168. The secretary of the committee was also a Bank official. Two other members of the committee were Treasury officials. The director of Barclays was the sole "independent" member. Report of the Committee Set Up to Consider the System of Banking Supervision, HMSO, Cmdn. 9550, June 1985 [hereinafter Leigh-Pemberton Report].
non-executives; the institution's business must be governed with "integrity and skill" and "in a prudent manner." 169 The new Schedule 3 was more precise than the 1979 Act with regard to the "general prudent conduct" criterion. It included a requirement that an institution maintain "own funds" that were "commensurate with the nature and scale of the institution’s operations" and that took into account the "risks inherent in [the institution's] operations," or those of any other undertaking in the same group that might affect the institution. 170 An authorized institution was also required to maintain adequate liquidity, make adequate provision for bad and doubtful debts, and maintain adequate accounting records and systems of control.

The Leigh-Pemberton committee also recommended explicit limits on large exposures. This recommendation was incorporated as Section 38 of the 1987 Act, which required the reporting of all transactions with a single borrower or group of closely related borrowers that in the aggregate amounted to more than 10% of an institution's capital. 171 Although the failure to make a report to the Bank was made a criminal offense, 172 the Act did not grant the Bank the power to prevent an authorized institution from entering into a large exposure once the report had been made. 173 The Bank could, however, determine that a loan transaction violates the "prudent conduct" criterion of authorization.

Section 39 of the 1987 Act granted the Bank the power to obtain information and require the production of documents from all authorized institutions. 174 In particular, Section 39 empowered the Bank to instruct an authorized institution to provide it with a report from "an accountant or other person with relevant professional skill." These "Section 39" reports were intended as a compromise between the Bank's traditional style of supervision and an examination-based system, 175 like that of the

170. Banking Act 1987, Sch. 3, para. 4(2) and para. 4(3).
171. Section 38 of the Banking Act also required the authorized institution to make a report to the Bank if it proposed entering into a transaction which "would result in its being exposed to the risk of incurring losses in excess of 25 per cent of those resources." Banking Act 1987, ch. 22, § 38(1)(b) (Eng.).
172. Id. at § 38(9).
174. Prior to 1987, the Bank had this type of formal authority only with respect to the LDTs. See supra note 158 and accompanying text.
175. The Leigh-Pemberton committee recommended also that Bank supervisors increase their visits to authorized institutions to "broaden their knowledge of banks' managements and to help in the assessment of their control systems." Leigh-Pemberton Committee Report, supra note 168, at § 13.17. These visits, however, were not intended to
United States. This solution essentially privatized the examination process, putting it in the hands of accounting firms who were usually also the bank's auditors.\(^\text{176}\)

The Leigh-Pemberton committee also made recommendations regarding the staffing and ethos of the Bank’s Banking Supervision Division. The committee’s report recommended staff increases and the recruitment of supervision experts as opposed to the generalists who had staffed the Supervision Division in the past.\(^\text{177}\) The Bank, however, struggled both to create this cadre of specialists and to accord bank supervision prestige equal to that of monetary policy making.\(^\text{178}\)

Beyond the recommendations of the Leigh-Pemberton committee, the 1987 Act created the Board of Banking Supervision, which had the responsibility for overseeing the Bank’s execution of its supervisory duties and to provide consultation in difficult cases. The Bank could reject the Board’s advice, but in that event it was required to inform the Chancellor of the Exchequer. In theory, the Board served a useful oversight function, but in practice the Board had limited knowledge of the activities of the Supervision Division.\(^\text{179}\)

The 1987 Act was unusual in its specific proscriptions. In general, however, the Act continued to grant the Bank substantial supervisory discretion. For example, the “prudent conduct” criterion was intended to allow flexible interpretation.\(^\text{180}\) The Bank provided some interpretation of these requirements in its Statements of Principles and various policy notices it issued beginning in the 1980s. The extensive supervisory discretion not only essentially precluded legal challenge to its rulemaking, but it also enabled the Bank to maintain the flexible and institution-specific approach to supervision on which it rested so much pride.
F. Modern Transitions

In recent years, the United States has continued on a course of incremental deregulation that began in 1980. At the same time, the United States has enhanced its relatively formidable regulatory powers over banks and their officers and directors in response to the S&L scandal and other banking crises. Moreover, the United States has continued to struggle with the tension and overlap that exists among the numerous federal and state agencies responsible for bank regulation. While important proposals to consolidate or restructure agency responsibilities have been made, more serious legislative attention has always been given to passage of laws that impact more directly on the crisis or new competitor of the day.

During the last decade, the Bank of England's supervisory backbone has been tested by two high profile international banking crises. Moreover, the Bank of England's resolve to remain a flexible supervisor—avoiding rigid supervisory standards—was undermined by the rise of European Union law. Ultimately, the Bank's ambivalence toward bank supervision was answered in 1998 with the transfer of that responsibility to a new regulator, the Financial Services Authority.

1. Continued Crisis Management

While lacking the dramatic numbers involved in the bank failures of the Great Depression, the U.S. bank and savings and loan failures of the 1980s and 1990s were notorious. From 1980 to 1994, over 1,600 FDIC-insured banks were closed or received financial assistance from the FDIC. An analysis of the causes of the banking crisis of the 1980s and 1990s is beyond the scope of this Article, but certainly one factor was the increased competition from within the banking industry and from non-bank competitors that led banks to engage in more speculative activities such as commercial real estate lending. Of course, some of the increased competition was the result of the deregulatory efforts of the early 1980s. Regional economic recessions contributed to bank failures, especially given the geographic restrictions that were still in place during the 1980s. Finally, management inattention and misconduct has also shared the blame for the crisis.

181. See infra Part II.D.
182. FDIC, HISTORY OF THE EIGHTIES, LESSONS FOR THE FUTURE: AN EXAMINATION OF THE BANKING CRISSES OF THE 1980S AND EARLY 1990S 3 (Vol. 1, 1997). The number of savings association failures during this period was equally dismal—1,300 failed. Id. at 4 n.1.
183. For a detailed discussion of the causes of banking failures, see id. at 3–38.
In response, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). The primary purpose of this legislation was to rescue the thrift federal deposit insurance fund, but FIRREA went much further. It granted the FDIC and the other federal bank regulators greater enforcement powers and created the Office of Thrift Supervision, the federal thrift regulator. FIRREA expanded the federal banking regulators' power to impose civil money penalties—potentially as high as one million dollars for each day that the violation continues. It made enforcement available against "institution affiliated parties," which include bank directors, officers, shareholders, attorneys, and accountants. FIRREA also reversed the long running practice of confidentiality by requiring cease and desist orders issued by the federal banking regulators to be made public.

Armed with new statutory powers, the federal agencies stepped up their enforcement activities against banks and their officers and directors. The FDIC, acting as receiver for failed institutions, began an aggressive campaign to restore funds lost by the bank insurance fund. Suits brought against officers and directors of failed banks and thrifts drew particular attention and criticism. In litigation, the FDIC went so far as to assert a broad federal policy against depletion of the deposit insurance fund. The Supreme Court rejected that principle, stating simply that "there is no federal policy that the fund should always win."

The United Kingdom experienced nothing comparable to the bank and savings and loan crises in the States, but the United Kingdom has had its share of high-profile crises in the last decade. The closure of the Bank of Credit and Commerce International ("BCCI") on July 5, 1991 came after many years of suspicion regarding its activities. While the Bank had shared those suspicions, it was blamed for its lack of inquisitiveness. The Bank insisted in its defense that it lacked sufficient evidence to revoke the institution's authorization. An independent investigation of the matter, chaired by Sir Thomas Bingham, concluded otherwise. The Bingham report concluded that the Bank had the power it needed but was reluctant to use it. Writing on the BCCI episode before the publication of the Bingham report, Nigel Lawson, former Chancellor of the Exchequer and chief architect of the 1987 Act, observed that

[The Bank] had never fully come to terms with the task of taking tough supervisory decisions within a statutory framework. . . . [O]n a number of occasions during my time. . . . I found the Bank fearful of taking a particular course of action because of a misplaced fear of being successfully taken to court if it did. 190

The Bingham report did not include a recommendation for new legislation. Instead, the report concluded that the Bank’s overall style of supervision should remain unchanged, but that a different approach should be used with an institution that failed to be open and cooperative with its supervisor. Thus, a Special Investigations Unit, staffed by fraud and audit specialists, was added to the Banking Supervision Division.

The BCCI scandal had an impact in the United States as well. 191 Congress responded, some argue overreacted, 192 with the passage of the Foreign Bank Supervision Enhancement Act of 1991 ("FBSEA"), 193 which was implemented by the Federal Reserve Board’s Regulation K. 194 The FBSEA requires Federal Reserve Board approval for the establishment of a branch, agency or commercial lending company by a foreign bank. 195 The Federal Reserve Board may not approve such application unless it determines that the foreign bank “is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country” and the foreign bank has provided the Federal Reserve Board with the information needed to assess the application. 196

190. LAWSON, supra note 178, at 410. While U.S. agencies have been subjected to their share of criticism, one would likely be hard-pressed to find anyone critical of the agencies’ willingness to test the bounds of statutory interpretation.


192. See BHALA, supra note 191, at xxii.


While the BCCI affair ultimately had little impact on U.K. banking regulation, the collapse of Barings did. BCCI had been viewed as a rogue institution. This mitigated the Bank’s failures with regard to its supervision. Barings was a completely different story. Barings had been under the Bank’s supervision for well over one hundred years. Members of the Barings family had served on the Bank’s Court (board of directors) and had provided a Governor of the Bank. If a system based on principles of trust, candor, and cooperation was ever to work effectively, Barings would surely provide a test case.

Once again, however, the Bank was found to be lacking inquisitiveness. The Bank failed to question the large trading profits reported by Barings on the back of its Singapore operations. The Bank permitted a situation in which some very large intra-group exposures—the funding for the margin calls by the Singapore Monetary Exchange (“SIMEX”)—were not reported. Moreover, the Bank failed to identify serious management inadequacies that existed at all levels at Barings.

The investigation of the Barings collapse was conducted not by an independent expert, as in the case of BCCI, but by the Bank’s Board of Banking Supervision. Among other things, the Board recommended a thorough review of the Bank’s supervisory system. Arthur Andersen was hired for the job. Their report stopped short of recommending a more formal, rule based approach to supervision. They did, however, observe that the discretionary approach utilized by the Bank placed a considerable premium on individual supervisors’ ability to relate their judgments to the overall objectives of supervision, and it also required a good understanding of both the nature and risk of a particular institution’s business. Arthur Andersen concluded that the Bank’s supervisory methods needed to become more professional and standardized. This would require enhanced training for supervisors and deeper understanding of the operations of the institutions supervised. More specifically, the Andersen team developed a model for a standardized system of assessing risk, much like the CAMELS ratings used in the United States.

197. In its February 1997 report on the episode, the all-party House of Commons Treasury Select Committee exhibited a clear sense of exasperation that yet again the Bank’s supervisors had failed to be sufficiently alert to the emerging problem.

198. It appears that in the short-term, the government wanted to avoid a major new policy initiative. With a small and dwindling majority in parliament, the Conservative government may not have been prepared to introduce new banking legislation.

199. CAMELS (originally CAMEL) is an acronym for a six factor rating system which assesses capital adequacy, asset quality, management ability and effectiveness, earnings quantity and quality, liquidity, and sensitivity to market risk. Each of the six factors is ranked on a scale of one to five, one being strong and five being unsatisfactory. Each bank then
The Bank accepted Andersen’s recommendations and set about implementing them. Before long, however, the new Labour government would bring about a radical change in the supervision of the entire U.K. financial industry and the Bank would not be given the opportunity to reform its supervisory practices.

2. Mounting Formalism

At the same time that the Bank of England was adjusting, or not, to its relatively new statutory supervisory powers, outside elements had pushed the Bank to a more formal scheme of regulation. The Bank had long prided itself on its flexible approach to supervision. It drew a contrast between “supervision,” which it performed, and “regulation,” as practiced by regulators in other jurisdictions, like the United States, and in the United Kingdom’s own securities regulators. In practice, this meant that the Bank preferred to operate with broad discretion. Formal, detailed rules were kept to a minimum, and policy was promulgated in the form of “Notices” issued periodically by the Bank on specific subjects. Policy Notices were not intended to be formal legal documents. Instead, they were meant to provide broad, general guidance and permitted considerable leeway in their application to individual cases. The rise of European law, however, had a subtle but fundamental impact on the Bank’s Policy Notice system.

By the late 1980s, the Policy Notices had become the mechanism through which European Union directives on bank regulation were implemented in the United Kingdom. This meant that the system of Notices ceased to be the sole responsibility of the Bank, because since the Treasury and Treasury Solicitors department had to ensure that they complied with the United Kingdom’s obligations under the directive. Thus, the Bank’s Policy Notices gradually became more formal and prescriptive, and provided for less discretion in their application to individual cases.


200. See infra Part II.F.3.

201. Brian Quinn, former Executive Director of the Bank said that regulation “is about rules and about the precise formulation and policing of those rules. In respect of financial services it calls for the codification of a corpus of strictly defined and detailed rules relating to particular activities, products and services.” He described supervision, on the other hand, as “setting the framework within which authorised companies may operate, rather than prescribing in detail how the relevant goods and services should be provided. Within that context, the companies providing those goods and services are, broadly speaking, left to make their own business decisions.” Brian Quinn, The Bank of England’s Role in Prudential Supervision, 33 BANK ENG. Q. BULL. 260, 260–61 (1993).
The European Union sought to create a system of authorization that would allow for banks to operate throughout the Union on the basis of a single authorization. The single authorization concept is set forth in the "Second Banking Co-ordination Directive." The adoption of common minimum prudential standards is central to this concept. While some of these prudential standards were modeled on the Bank's pre-existing practice, others were not. Moreover, these directives setting forth prudential standards contained extensive detail regarding their application, reducing the Bank's discretion in applying these regulatory norms and requirements.

Similar to the impact of European Union law on the United Kingdom's regulatory regime, international agreements have further formalized, from different starting points, both the United States and United Kingdom's approach to capital adequacy requirements. Naturally, both the United States and United Kingdom used capital measurements as one of their key supervisory tools, but prior to the 1980s, neither country had formal capital adequacy requirements. Increased international competition spurred a dialogue between U.S. regulators and the Bank of England, which in 1987 resulted in an agreement on risk-based capital. The United States/United Kingdom


203. Nowhere was this more obvious than in the implementation of the EU's directive on the capital adequacy of investment firms and credit institutions which establishes a methodology for calculating capital requirements in respect of the market risks of both banks and securities firms. This directive contains extensive detail about the method of calculation to be adopted in assessing the capital required against equity and bond positions and their various derivatives. See generally Council Directive 93/6/EEC of 15 March 1993 on the Capital Adequacy of Investment Firms and Credit Institutions, 1993 O.J. (L 141) 1.


205. In the United States, the International Lending Supervision Act of 1983 (ILSA), Pub. L. No. 98-181, 97 Stat. 1278 (1983), established the first statutory capital requirements. It directed the federal banking agencies to require banks "to achieve and maintain adequate capital by establishing minimum levels of capital." 12 U.S.C. § 3907(a)(1) (1994). Congress also signaled its desire for international convergence of capital standards by directing the banking agencies to "consult with the banking supervisory authorities of other countries to reach understandings aimed at achieving the adoption of effective and consistent supervisory policies and practices with respect to international lending." 12 U.S.C. § 3901(b) (1994).
agreement quickly led the Basel Committee\textsuperscript{206} to adopt a common framework for measuring capital and minimum capital requirements. The Basel Capital Accord\textsuperscript{207} sought "to strengthen the soundness and stability of the international banking system," and to provide a framework that would be "fair and have a high degree of consistency in its application to banks in different countries with a view to diminishing an existing source of competitive inequality among international banks."\textsuperscript{208}

The 1988 Accord established a definition of capital, which consists of core capital, or basic equity, and supplementary capital, which includes undisclosed reserves, revaluation reserves, general provisions, hybrid debt capital instruments, and subordinated term debt. It also established weighted risk ratios for on and off balance sheet items, and a target minimum standard of eight percent.\textsuperscript{209} In June of 1999, the Basel Committee issued a consultative paper introducing a new capital adequacy framework to replace the 1988 Accord.\textsuperscript{210} The consultative paper (revised Accord) outlines a framework consisting of three "pillars": minimum regulatory capital, supervisory review, and market discipline. The first pillar builds on the framework of the 1988 Accord and seeks to "clarify and broaden the scope of application of the current Accord."\textsuperscript{211} The second pillar emphasizes the role of supervision and considers the possibility of using a bank's internal ratings and credit risk modeling for regulatory capital purposes.\textsuperscript{212} The third pillar, market discipline, emphasizes the role of improved transparency in private sector monitoring of capital adequacy. Comments on the Revised Accord are due to the Basel Committee by March 31, 2000.

The focus on capital adequacy requirements as an international supervisory tool has had significant ripple effects in domestic regulation as well. The Federal Deposit Insurance Corporation Improvement Act of

\textsuperscript{206} See Core Principles, supra note 1.
\textsuperscript{208} Id. at 1.
\textsuperscript{210} See Basle Committee on Banking Supervision, \textit{A New Capital Adequacy Framework} (visited September 26, 1999) <http://www.bis.org/publ/bcbs.htm>.
\textsuperscript{211} Id.
\textsuperscript{212} Comptroller of the Currency John D. Hawke, Jr., speculates that use of internal bank ratings and credit risk modeling is promising, but far off. "But given the current state of the art of these methodologies... it is questionable whether they will be feasible in the near term." News Release, Comptroller of the Currency, NR 99-53 (June 7, 1999) (available on Office of the Comptroller of the Currency website, <http://www.occ.treas.gov/99rellst.htm>).
1991 (FDICIA),213 passed in response to the crisis of the 1980s and 1990s in an effort to protect the deposit insurance fund,214 uses capital adequacy as the springboard for an increasingly formal system of regulation. With the passage of FDICIA, Congress limited federal banking agencies’ discretion and mandated the exercise of their enforcement powers long before an institution fails or faces imminent threat of failure. The prompt corrective action provisions of FDICIA215 forced the regulators to assume a more formal and proactive role with regard to supervision of operating institutions. Under FDICIA, the failure of a bank to meet defined capital216 and safety and soundness standards217 sets various supervisory controls in motion.218 FDICIA also mandated not less than one full-scope on-site examination each twelve-month period219 and imposed new internal and external audit requirements. FDICIA made important changes to the system of deposit insurance as well. It required the FDIC to adopt a system of risk-based premiums. It also prohibited institutions that are not “well-capitalized” from accepting brokered deposits. FDICIA made important changes to the treatment of failed banks by requiring the FDIC to resolve bank insolvencies in a manner that is the “least costly” to the bank insurance fund220 and by limiting the FDIC’s power to provide financial assistance to open banks.221 Finally, FDICIA limited the Federal Reserve discount window lending to undercapitalized institutions.222

3. Recent Deregulation and Reform

Given the healthy state of the banking industry since the early 1990s, reform in the United States in recent years has been decidedly deregulatory. In 1994, Congress passed the Riegle-Neal Interstate

214. Congress stated that the purpose of the prompt corrective action provisions “is to resolve the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund.” 12 U.S.C. § 1831o(a)(1) (Supp. 1994).
216. See id.
218. The statute provides that “[e]ach appropriate Federal banking agency and the [FDIC] . . . shall carry out the purpose of this section by taking prompt corrective action to resolve the problems of insured depository institutions.” 12 U.S.C. § 1831o(a)(2) (Supp. 1999) (emphasis added).
Banking and Branching Efficiency Act of 1994 ("IBBEA")\(^{223}\) that repealed the McFadden Act's interstate banking restrictions\(^{224}\) and the Douglas Amendment's restrictions on intrastate bank holding company acquisitions.\(^{225}\) The IBBEA shows noteworthy deference to states' restrictions on branching. While the IBBEA eliminated state law restrictions on bank holding company acquisitions across state lines,\(^{226}\) it stopped short of usurping a state's right to decide whether interstate branching would be permissible within its borders. The IBBEA permits the federal banking agencies to approve mergers between banks organized in different states unless one of the states adopted a law, after September 29, 1994 and before June 1, 1997, that prohibits such mergers.\(^{227}\) Only one state, Texas, adopted such legislation.

The deregulatory movement was not confined to Congress. Significant deregulation since the 1980s can also be found at the agency level. Perhaps the most visible forms of agency deregulation have been in the area of banks' securities activities. In 1987, the Federal Reserve Board approved an application by Citicorp, J.P. Morgan, and Bankers Trust, allowing the bank holding companies to create a non-bank subsidiary—commonly referred to as a "Section 20 subsidiary"—that is permitted to underwrite commercial paper, municipal revenue bonds, and mortgage-backed securities.\(^{228}\) The Federal Reserve Board's approval was based on an interpretation of the "engaged principally" language found in Section 20 of the Glass-Steagall Act.\(^{229}\) The Federal Reserve Board determined that the Section 20 subsidiary would not be engaged principally in underwriting securities if the underwriting of bank ineligible securities was limited to five percent of the subsidiaries' gross revenues, and the activities with regard to bank ineligible securities did not constitute more than five percent of the market for any type of security. In addition, the Federal Reserve Board imposed certain "firewalls" to address safety and

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\(^{224}\) The McFadden Act gave national banks the authority to open branches, but only to the extent that a state bank was so permitted. Ch. 191, 44 Stat. 1224 (1927) (codified as amended at 12 U.S.C. § 36 (1994)).

\(^{225}\) The Douglas Amendment prohibited acquisitions of banks across state lines by bank holding companies unless such acquisition was specifically permitted under the state law of the bank to be acquired. Ch. 240, § 3, 70 Stat. 134 (codified as amended at 12 U.S.C. § 1842(d) (1994)).

\(^{226}\) 12 U.S.C. § 1842(d)(1)(A). In approved bank holding company interstate acquisitions, however, the Fed must abide by State age laws and certain deposit caps. \(\text{Id.}\)


\(^{229}\) Section 20 of Glass-Steagall prohibits member banks (i.e., national banks and state member banks) from affiliating with any firm "engaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities. 12 U.S.C. § 377 (1994).
soundness issues and potential conflicts of interest. A federal appellate court upheld the Federal Reserve Board’s interpretation, but eliminated the market share limitation.

In the years since that decision, the Federal Reserve Board has incrementally liberalized its interpretation of permissible activities by Section 20 subsidiaries. In 1989, the Federal Reserve Board approved the underwriting of debt and equity securities for Section 20 subsidiaries. The Federal Reserve Board increased the revenue limitation, first from five to ten percent, and then, in 1996, from ten to twenty-five percent. In 1997, the Federal Reserve Board eliminated most of the firewalls originally imposed on Section 20 subsidiary activities.

Not to be outdone by the Federal Reserve Board, the OCC adopted a controversial rule governing the activities of operating subsidiaries of national banks, commonly known as the “op-sub” rule. Most importantly, the op-sub rule provides that, assuming compliance with certain procedures and safeguards, a national bank may acquire or establish a subsidiary that can engage in activities that would not be permissible for the bank itself.

While the regulators have steadily expanded banks’ securities activities, Congress has given serious consideration to legislation that would repeal Glass-Steagall. On July 1, 1999, the U.S. House of Representatives passed H.R. 10, a bill that would allow banks to engage in securities dealing and underwriting through a holding company.

230. The “firewalls” were imposed not under the Glass-Steagall Act, but under Section 4(c)(8) of the Bank Holding Company Act which restricts bank holding company activities and investments to those that are “so closely related to banking.” 12 U.S.C. § 1843(c)(8) (1994).
On May 6, 1999, the U.S. Senate passed S. 900, which would also repeal Glass-Steagall. The Senate bill is opposed strongly by the Clinton administration and industry lobbies because of the bill's proviso that new bank activities, such as securities activities, must be conducted through a bank holding company's non-bank affiliate rather than through a bank-owned subsidiary. Amid this intense focus on repeal of Glass-Steagall and other New Deal restrictions, efforts to restructure or consolidate the banking agencies remain dormant.

In contrast to the United States, banking regulation in Britain has always been carried out by a single agency, the Bank of England. However, in a surprise decision in May 1997, the newly elected Labour government announced that it would create a unified regulatory authority for the banking, securities, and insurance industries. This new body, the Financial Services Authority ("FSA"), will unify all regulation presently conducted by nine existing regulatory bodies and will gain significant additional powers of its own. A new statute, The Financial Services and Markets Act, which is currently passing through parliament, will underpin the FSA and replace existing statutes regulating banking, securities, and insurance businesses. In the interim, the Bank of England's powers to regulate banks have already been transferred to the FSA by virtue of the amendments made to the Banking Act 1987 by the Bank of England Act 1998. One consequence of the decision to unify


239. The Comptroller (regulator of bank subsidiaries) criticized this approach as too restrictive on the prerogative of businesses to decide how to structure their businesses. On the other hand, the Federal Reserve Board (regulator of non-bank affiliates of bank holding companies) has insisted on this approach. See generally, Beverly Longstreth & Ivan E. Mattei, Organizational Freedom for Banks: The Case in Support, 97 COLUM. L. REV. 1895 (1997) (arguing in favor of the Comptroller's position).


all financial regulation in a single agency is that banking regulation in the United Kingdom will inevitably come to be more influenced by the practice and style of the regulation of other types of financial institutions. This is likely to result in a regulatory system in which formalism plays a much greater role than in the past.

III. COMPARING THE NRB OF U.K. AND U.S. BANK REGULATION

Sound-bites capture the apparent contrast between the British versus American style of bank supervision. The United Kingdom's is an informal, moral suasion based regulation, while the United States' is a formal, statute-based system of control. As so often is the case, however, these generalities belie the complexities and dynamic subtleties underlying two systems.

In contrasting the two systems, an essential difference lies at the threshold: Bank regulation in the United Kingdom developed largely outside of the law. The Bank of England's form of supervision did not rely on legal institutions for its authority. Its authority derived from private ordering, i.e., its close, trusting relationships with individual firms in the banking industry. Even when the Bank was granted statute based authority, it was reluctant to use it. In contrast, the U.S. system of bank regulation is an almost purely legal system. The agencies themselves are creatures of statute with no history of private organization. Bank regulation in the United States grew, in large part, out of antipathy toward large banking institutions rather than trust in them. Through this lens, this Part considers whether the NRB of each country displays convergence.

The NRB model demonstrates that regulatory regimes impose costs and provide benefits to their regulated constituents. On the benefits side of the model, the United States and United Kingdom both have provided their respective banking institutions with significant national goodwill given the overall stability and strength of the respective governments and economy. In addition, both countries impose competition-limiting entry restrictions on deposit taking firms. Significantly, the United States provided earlier and more extensive deposit insurance. Beyond the United Kingdom's threshold decision in 1979 to provide

243. See supra Part II.E.
244. See supra notes 19–22 and accompanying text.
245. See supra Part II.A.2 (discussing the United States' dual bank chartering system); see supra Part II.E.1 (discussing 1BCD authorization of credit institutions).
246. See supra Part II.B.2.a.
deposit insurance, however, there are no apparent signs of convergence on the issue of deposit insurance. The U.S. system remains unique in the breadth of protection provided and shows no tendency toward change. The United Kingdom, as well, shows no signs of providing greater protections than those currently in place.

The cost side of the model is more complex. The U.K. has imposed relatively few restrictions on activities, and it has not regulated banks' investment or geographic location. While the United Kingdom has eliminated activities restrictions, it has imposed relatively recently formal restrictions on entry and capital requirements. The United States has loosened activities and geographic restrictions, but has come to rely heavily on increasingly formal capital requirements and

247. Britain's decision to create a deposit insurance scheme does not appear to stem from international competitive pressures but, rather, from domestic crisis. See supra Part II.E.1 (discussing Britain's response to the Secondary Banking Crisis).

248. In this policy area, however, European law has been increasingly influential. Council Directive 94/19/EC of 30 May 1994 on Deposit-Guarantee Schemes, 1994 O.J. (L 135) 5, brings responsibility for deposit protection into line with the responsibility for supervision by requiring the home state which authorizes a credit institution to ensure that its deposit protection scheme covers deposits in all the EU branches of that credit institution. Deposits in all currencies are covered, and are subject to a minimum compensation level of 90% for the first ECU 20,000. Implementation of this directive required Britain to dilute its co-insurance principle, see supra note 161, by requiring depositors to take only a 10% haircut on deposits with a failed institution rather than the 25% required under both the Banking Acts 1979 and 1987. Nonetheless, the U.K. authorities insisted that some element of co-insurance be retained within the directive.

249. However, the Second Council Directive of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending Directive 89/646/EEC, art. 12(1) & (2), 1989 O.J. (L 386) 7, contains formal limits on banks' investments. Equity holdings in an individual industrial or commercial enterprise are limited to 15% of a bank's capital, while in aggregate such equity holdings should not exceed 60% of its capital. See id. Although these provisions limit the ability of some Continental European banks to continue with their past practice of taking large equity stakes in industrial or commercial concerns, the practice has been so rare in the U.K.'s banking system that the 2BCD limits and restrictions are without real practical importance for it. Equity investments in banks or other financial concerns are generally deducted from a bank's regulatory capital.

250. While Britain has never had formal statutory restrictions on banks' non-bank activities, until the late 1980s, a variety of agreements, administrative arrangements, and Stock Exchange rules served narrowly to constrain them to the business of commercial banking. The Bank of England disapproved of banks taking long-term equity stakes in industrial or commercial concerns, and it could use its power of moral suasion to ensure that banks would sense its disapproval. It also maintained an (unpublished) arrangement with the Department of Trade, which regulated insurance companies, to the effect that neither would permit the acquisition of a bank by an insurance company or vice versa. Finally, until 1986, Stock Exchange rules required member firms to adopt the partnership form, which largely precluded membership by banks or bank subsidiaries. These various restrictions have now been dismantled.

251. See supra Part II.E.2.

252. See supra Part II.F.3.
supervisory tools linked to capital, such as prompt corrective action. While the United Kingdom’s style of supervision has become increasingly statute based, it remains decidedly British, eschewing the intrusive and on-site examinations of the U.S. system. Moreover, the United States’ reliance on an examination based system appears unwavering given FDICIA’s mandate of annual examinations of most banks. Finally, while it is impossible to predict the ultimate impact of the consolidation of financial service regulators into the United Kingdom’s new FSA, one can conclude with a high degree of certainty that no similar consolidation of financial services regulators will come about in the United States in the foreseeable future.

These regulatory costs and benefits taken together, yielding each country’s NRB, should demonstrate a path of convergence, if the NRB model has real explanatory force. Competition between bank regulators to attract financial institutions to their respective jurisdictions might have been expected to result in increasing similarities of styles, approaches, and instruments. The distribution of the benefits conferred by regulators and the costs they impose on firms should have begun to resemble one another as competitive processes, and the ability of firms to arbitrage between jurisdictions, bid away remaining national differences in regulation. It should, in other words, be possible to identify a common direction of change in bank regulation, even if there remain important differences in the detail.

Our investigation of the comparative history of bank regulation in the two countries, however, fails to demonstrate a consistent pattern of change. Recent history of bank regulation in Britain and the United States shows regulatory policy moving across several different dimensions at once. The British system, admittedly, has come to resemble that of the United States in the sense that increased reliance is now placed on formal requirements to ensure the capital strength and prudential soundness of banks. Especially important in bringing about some measure of convergence between the two approaches has been the implementation of a risk-based approach to setting capital standards under the 1988 Accord. However, the mounting formalism of the U.K. banking regulation since the early 1980s cannot be attributed to a competitive process vis-a-vis the United States. To a very large extent it reflects the influence of...

253. See supra Part II.F.2.
254. See supra Part II.E.
255. See supra Part II.F.2.
256. U.S. lawmakers have been unable to adopt a plan to consolidate the four federal banking regulators, let alone consolidation of other financial services regulators. See supra Part II.F.3.
European Union law, which is itself a product of negotiated convergence rather than competition. The need to emulate or compete with U.S. practice has been at best a minor concern. Although the U.K. system may have become more formalized in recent decades, the systems of bank regulation in the two countries have at best a superficial resemblance.

IV. Determinants Of Regulatory Change

Our comparative history of banking regulation in Britain and the United States reveals no consistent pattern of convergence that can be attributed to regulatory arbitrage. The most significant evidence of convergence can be attributed to the anti-competitive process of negotiated convergence. 257 The significance of this conclusion rests not only on the observation that the competitive model is seriously incomplete as an account of regulatory change, but also on the consciousness that regulatory convergence will not necessarily result in efficient regulation.

Based on our study of U.S. and U.K. bank regulation, we find three factors that are arguably of at least equivalent importance to competition in explaining regulatory change. 258 The first factor is the path dependence of regulation, i.e., rule competition takes place against a background of prior institutional and legislative history which conditions the terms on which the different jurisdictions compete. The second factor is that, even in a world of globalized financial markets, domestic concerns loom large in the design of the legal frameworks within which bank regulation is practiced. For the makers of bank regulatory policy, whether legislators or regulators, the consciousness of competition from other jurisdictions is only one factor among many other economic, cultural, and political influences that impact their policy decisions. The third factor is negotiated convergence. While the existence of competition between regulatory regimes may result in negotiated arbitrage, it may also result in attempts to limit competition through discrete agreements between regulatory authorities. Such agreements reduce opportunities for convergence by competition.

Given its apparent stronghold on the bank supervisory regimes in both the United States and United Kingdom, we consider first the issue of path dependence. Our comparative history demonstrates that the defining decade for bank regulation in both Britain and the United States

257. See supra Part II.F.2. (discussing the 1988 Accord).

258. The factors we identify are perhaps of even greater importance that the existence of competition to the extent that the last factor involves a process that reduces competition. See infra notes 269–75 and accompanying text.
was the 1930s. The New Deal legislation, which resulted from the Great Depression, set the pattern for U.S. bank regulation which persists to this day. Recent U.S. legislative history in this field is to a large extent a debate about the extent to which financial services firms should be freed from the constraints imposed by this sixty-year-old structure. By contrast, the important factor in the history of British banking regulation is precisely that the 1930s did not result in fundamental legislative change. The consequence was that British banking regulation continued on a path determined by the Bank of England’s informal supervision at the apex of the banking hierarchy. To a substantial degree, the subsequent history of British banking regulation is the story of the Bank of England’s attempts to free itself from the customs and practices it had developed during the period of informal supervision and to adapt them to the very different demands of a statute-based system. That its attempts to do so were ultimately unsuccessful is reflected in the recent transfer of authority to the FSA, which will undoubtedly bring a different style of bank regulation in its wake.

The countries’ different experiences during the Great Depression established the basis for two divergent patterns of banking regulation. The path dependence exhibited by the patterns set in the 1930s have been the single most important factor shaping the subsequent forms and methods of banking regulation in the two countries.

The importance of path dependence is closely connected with our second main observation: that consciousness of competition from other jurisdictions is only one, and not the predominant, factor that shapes regulation. Domestic considerations—economic, cultural and political—are undoubtedly more powerful. The structure of U.S. bank regulation that was put in place during the 1930s reflected a powerful current of domestic politics and its associated ideology that can be traced back to the early Progressive movement. This ideology expressed itself in terms of a deep-seated suspicion of the power of money and hostility to what Justice Brandeis described as the “curse of bigness.” The Great Depression provided the catalyst for these political forces to remold banking legislation in accordance with their presuppositions. The result was a system of banking regulation that enshrined unit banking and further segmented markets through the separation of commercial and investment banking. The difficulties the United States has encountered in dismantling this system of constraints on banking is testament to the continued political appeal of this ideology as well as to the strength of

259. See supra Part II.B.2.
260. See supra Part II.B.1.
261. BRANDEIS, supra note 112, at 162-88.
the domestic interests that benefit from the limitations on competition it creates.

By contrast, Britain has lacked a corresponding domestic ideology of hostility to banks and bankers. A highly concentrated banking industry, based around a few large clearing banks, was established well before the Depression hit. The strength of these institutions permitted them to weather the storm much more effectively than their American counterparts. The result was that, contrary to the U.S. example, bank regulation never became a popular rallying cry in Britain and the large British banks were left to their informal, non-statute based methods for another fifty years. When change did come, it was a result of domestic political pressures, especially the Secondary Banking Crisis, with the addition of the complicating factor of membership in the European Economic Community.

Subsequent changes have also reflected the overwhelming importance of domestic political considerations, ranging to those behind the introduction of the 1987 Banking Act to the formation of the Financial Services Authority. For example, the formation of the FSA was overwhelmingly a response to domestic political considerations, from which the international dimension to regulation was almost entirely absent. Indeed, the international competitiveness of the City of London may suffer in the future if the FSA imposes an inappropriate regulatory burden on markets—like the Eurobond market—that have previously enjoyed a policy of benign neglect from the regulators it replaces. In addition, the bold move to strip the Bank of its supervisory role may have been possible, at least in part, because the Bank historically had sole responsibility for bank regulation. This has enabled critics to place the blame for bank crisis at the foot of the Bank whereas in the United States, with its extraordinary dispersion of regulatory power, it is more difficult to assign blame.

262. Congressional law-makers who enacted the New Deal legislation in the U.S. might also have looked over the border to Canada to draw a different lesson from the Great Depression experience. The Canadian banking system, like the British, was based on a few large joint-stock banks with nationwide branching rights. They survived the Great Depression largely unscathed. Unit banking, rather than the combination of investment and commercial banking, seems to have been at the root of the problems of the U.S. banking system in the early 1930s. See BENSTON, supra note 32, at 1.

263. See supra Part II.D.1.

264. See supra Part II.F.2.

265. One of the most controversial aspects of the new Financial Services and Markets Bill, which will provide the Financial Services Authority with statutory underpinning, is whether maintaining “a vibrant, competitive, world class industry” should form part of the new agency’s statutory objectives. The government has decided that it should not feature as an explicit statutory duty. See Joanna Gray, Financial Services and Markets Bill is Introduced, FINANCIAL TIMES FINANCIAL REGULATION REPORT, Jul.-Aug. 1999, at 19.
One of the difficulties in applying the competitive model to a regulatory regime is the extraordinarily complex mechanism by which regulators come to change the rules in their domestic jurisdictions. The competitive model works best when a country has the ability to raise or lower its NRB with the same relative ease that a private firm can raise or lower the price of its goods or services. The reality in the world of regulation is quite the contrary. In both Britain and the United States, rule changes are intermediated by political processes, and as a result many other factors than just the recognition of competition from other jurisdictions can enter the process of change. A feature of both regulatory systems that emerges from our comparative history is that they can be described as being scandal-driven in that the main factors influencing the process of regulatory change are disasters, i.e., significant banking system failures. Under such circumstances, lawmakers will focus on policy initiatives that will prevent similar failures, instead of on the NRB’s calculus of costs and benefits.

This observation highlights an important shortcoming in the way in which the application of the competitive model conceptualizes the behavior of regulatory authorities as competing providers of regulatory services, i.e., as competing firms in an industry. Under the competitive model, the regulator is essentially a maximizer of its market share in the global financial system. In reality, however, regulatory authorities do not face a single, unambiguous utility function. In contrast to the management of a firm, regulators must respond to the demands of a diverse constellation of conflicting interests, including individual lawmakers, government officials and ministers, the industry they regulate,

266. See Jonathan R. Macey, Regulation and Disaster: Some Observations in the Context of Systemic Risk, in BROOKINGS-WHARTON PAPERS ON FINANCIAL SERVICES 1998, at 405 (Robert E. Litan & Anthony M. Santomero eds. 1998). Professor Macey writes: “Disasters bring an unusual amount of public attention and criticism to the legislative process. This unusual level of public attention creates an environment favorable to legislation because it overcomes the normal collective action and free-rider problems that generally prevent the public from galvanizing into an effective political coalition for the purpose of seeking legislation.” Id. at 413.

267. That is not to say that the impact of proposed legislation on the competitiveness of domestic firms internationally will not be a factor in the consciousness of lawmakers during a crisis. Such issues were debated, for example, in the wake of the savings and loan crisis. See, e.g., Treasury Recommendations to Improve Competitiveness: Hearing of the International Competitiveness Task Force Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs, 101st Cong. (Jul. 27, 1990) (statement of John Lafalce, Comm. Chairman). Issues of competitiveness, however, do not appear to be the driving force of this type of legislation.

268. That is not to say that firms lack constituents other than their shareholders. Firms have them, and often respond to them. Those other constituents, however, lack the real authority and power of the diverse group of constituents to which the regulators must respond.
and the wider public they exist to serve. This means that rule competition, and the competition for market share, must take a subsidiary role to responding to the demands of these different audiences.

Finally, the competitive model fails to adequately explain why regulatory authorities may deliberately agree not to compete or why such agreements can prove to be more stable than comparable agreements among firms in an industry. In the Introduction we stressed the importance of negotiated convergence as an alternative to the process of convergence by competition. Regulatory agencies that enter into the process of negotiated convergence are effectively behaving like members of a cartel in that their aim is to limit or restrict the opportunities to compete. For example, the 1988 Accord was formulated precisely to avoid a process of competition between regulatory authorities, which had become apparent by the early 1980s. From the NRB perspective, such an agreement can only be interpreted as being intended to allow regulatory authorities to engage in rent seeking behavior, i.e. by permitting them to dispense fewer benefits or to impose higher costs on their firms than they would be able to do under a more competitive environment. Our analysis, however, indicates that motivations other than simple rent-seeking may explain why regulatory authorities engage in negotiated convergence. One especially powerful factor is that negotiated convergence allows regulatory authorities to respond to, and deflect, domestic political criticism by diffusing responsibility for regulatory policy through international organizations. Moreover, if the competitive model applies, international agreements not to compete are unlikely to prove more stable than agreements between the members of an industrial cartel. The same incentives for participants to free-ride on collective agreements should exist in the regulatory sphere as in the industrial one. However, a noteworthy feature of the leading agreements produced by negotiated convergence is that they are remarkably stable over time.

There are a number of reasons why these agreements might prove to be more enduring than similar agreements between competing firms. First, negotiated agreements among regulatory authorities are often

269. See supra Part II.F.2.
270. See KAPSTEIN, supra note 5, at 104-05 (1994).
271. Kapstein emphasizes the domestic political factors, especially in the United States, which led to the Basel Capital agreement. Id. at 106-08. Kapstein's analysis thus supports that advanced by this Article, namely that such factors are more significant elements in the process of regulatory change than is awareness of competitive challenge from regulatory agencies in other jurisdictions.
translated into domestic law.\textsuperscript{273} While domestic law is not immutable, significant costs thwart easy change once the law is established. Second, unlike agreements among private firms, international regulatory accords are public and publicized. This public aspect creates expectations by parties not technically party to the agreements, e.g., international banks, thereby creating a broader constituency. Moreover, while regulators may have the incentive to "cheat" through lax enforcement of agreed upon standards, the public nature of such agreements makes cheating easier to detect\textsuperscript{274} and costlier for the regulators.\textsuperscript{275} Hence, in contrast to the predictions of a competitive model, once standards have been developed from a process of negotiated convergence they might be expected to become relatively permanent features of the regulatory landscape.

CONCLUSION

Our analysis of the comparative history of bank regulation in Britain and the United States provides little evidence to support the hypothesis that long term competition between jurisdictions will result in convergence towards a common NRB. We suggest a number of factors that appear to explain why simple competition is comparatively unsuccessful in explaining the actual path of bank regulation even during recent decades when the globalization of financial markets has been at its most pronounced. In particular, the competitive model does not capture the very important factors of path dependence, the saliency of domestic issues—economic and political—in regime design, and the process of negotiated convergence. Undoubtedly, the future will witness a degree of convergence between the bank regulatory systems of the United States and United Kingdom as financial markets continue their march toward globalization. We believe, however, that such convergence will not primarily be the result of competitive forces, and therefore will not be justified on the basis of the efficiencies that attend to a competitive process. Rather, we predict that future convergence will be the byproduct of negotiated, multinational, agreements that cannot be justified or criticized as the product of a race to the top or bottom.

\begin{itemize}
  \item \textsuperscript{273} See supra Part I.F.2 (discussing the 1988 Capital Accord).
  \item \textsuperscript{274} Not only the parties to the agreement, but also third party beneficiaries have the incentive to monitor for cheating.
  \item \textsuperscript{275} The failure to enforce domestic law inevitably leaves regulatory authorities subject to scrutiny from all sides, including lawmakers, consumer groups, and competitors of the regulatees.
\end{itemize}