Regulatory Simplification

In 1978 the Board of Governors established the Regulatory Improvement Project in the Office of the Secretary to help minimize the burdens imposed by regulation. In 1986 the Board reaffirmed its commitment to regulatory improvement, renaming the project the Regulatory Planning and Review Section and assigning supervision of its work to the Board's Committee on Banking Supervision and Regulation.

The purposes of the regulatory improvement and simplification function are to ensure that the economic consequences for small business are considered when regulations are written, to afford interested parties the opportunity to participate in designing regulations and comment on them, and to ensure that regulations are written in simple and clear language. Staff members continually review regulations for their adherence to these objectives.

In 1996 the Board's regulatory review activity increased from a handful of actions per year to more than a dozen significant reviews of Board regulations and policies. As part of the 1996 comprehensive regulatory review process, two regulations were rescinded (Regulations R and V); three were simplified and updated (E, M, and S); and four were in the process of comprehensive review at year-end (H, K, Y, and CC). Additional actions included deleting transitional rules for reserve requirements (Regulation D); increasing the tolerance for closed-end credit transactions (Regulation Z); revising the lending-rule prohibitions for insiders at member banks and their affiliates (Regulation O); and streamlining the application process for well-capitalized and well-managed banks (Regulation Y). Also, certain rules under Regulation Y for section 20 subsidiaries were revised to increase the revenue limits, clarify rules for administering the revenue test with respect to interest income on securities held for a bank's own account, and ease or amend the firewall restrictions.

Comprehensive Reviews

Section 303(a)(1) of the Riegle Community Development and Regulatory Improvement Act of 1994 requires the federal banking agencies to cooperate in conducting a systematic review of their regulations and written policies to improve efficiency, reduce unnecessary costs, eliminate inconsistencies, eliminate outmoded and duplicative requirements, promote uniformity among the regulations and policies of the agencies, and reduce regulatory burden "consistent with the principles of safety and soundness, statutory law and policy, and the public interest." As required by the act, a progress report on these efforts, *Joint Report: Streamlining of Regulatory Requirements,* was submitted to the Congress in September.

As part of promoting uniformity among the banking agencies, the Board adopted an interagency system for rating a bank's financial condition and adopted interagency guidelines for determining the safety and soundness standards for asset quality and earnings.

In addition to the streamlining efforts required by the Riegle act, the Board in 1996 engaged in internal activities such as reviewing all supervisory and regulatory (SR) letters issued by the Division of Banking Supervision and Regulation.

The SR letters, which communicate supervisory policy and guidance to the Reserve Banks, were reviewed to determine whether the policy was still applicable, whether it had been incorporated into the appropriate examination manuals or the *Federal Reserve Regulatory Service*, and whether it had been superseded by a subsequent letter. An updated list of "active" letters was sent to the Reserve Banks after the review.

The significant regulatory improvements made by the Board in 1996, as noted in the joint interagency report to the Congress, are discussed below.

Regulation D
Reserve Requirements of Depository Institutions

The Board revised Regulation D in December to simplify and update it and thereby also to reduce the burden it imposes on institutions. In general, the changes delete certain transitional rules relating to reserve requirements, NOW accounts, de novo institutions, ''dissimilar'' mergers, and other matters that no longer have significant effect.

Regulation E
Electronic Fund Transfers

In April, following a comprehensive review, the Board approved a final rule which simplified the language and format of each section of Regulation E and stated the requirements more clearly. The Board shortened the final rule by 15 percent, largely by deleting obsolete provisions and transferring explanatory material to the commentary. Changes to the rule included revisions of the existing exemption for transfers of securities and commodities as well as an increase in the asset size cutoff for the exemption of small institutions, from $25 million to $100 million. The Board also exempted preauthorized transfers to or from accounts at small institutions to reduce the burden of compliance for institutions that do not offer any other electronic fund transfer service.

The final rule also exempts from Regulation E the transfer of funds for certain purchases and sales of unregulated securities if the broker–dealer that handles the transaction is regulated by another federal agency, such as the Securities and Exchange Commission or the Commodity Futures Trading Commission. The final rule also extends the exemption to all securities or commodities held in book-entry form by the Federal Reserve Banks on behalf of the Department of the Treasury and other federal agencies. (In April the Board also proposed amendments to Regulation E; see the chapter on Consumer and Community Affairs.)

Regulation H
Membership of State Banking Institutions in the Federal Reserve System

The Board began a review of Regulation H with an eye toward simplifying, updating, and reorganizing the regulation. In particular, the Board is revising the regulation to eliminate out-dated requirements and conditions that are not absolutely necessary for membership, to make regulatory language easier to understand, and to reorganize the contents to make the provisions more easily referenced. The Board anticipates final action on the revised regulation during the first quarter of 1997.

Regulation K
International Banking Operations

The Board took several actions in 1996 to remove obsolete or superseded portions of Regulation K and to reduce

unnecessary regulatory burden. As part of these actions, the Board amended the rules allowing foreign banks to establish U.S. representative offices, required foreign banks to select a home state, removed the restrictions on certain mergers by U.S. bank subsidiaries of foreign banks outside of the home state, and prohibited foreign banks from using their U.S. branches or agencies to manage activities through offshore offices that could not be managed by a U.S. bank at its foreign branches or subsidiaries. In addition, the Board also established criteria for evaluating the continued operation of a foreign bank in the United States.

The Board began a comprehensive review of Regulation K that will focus on streamlining processes and making U.S. banking organizations more competitive internationally. At the same time, the review will consider all aspects of foreign bank regulation with an eye toward adopting further streamlining and burden reduction measures as well as further liberalizations, especially as provided in the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994.

Regulation M
Consumer Leasing

In September the Board revised Regulation M to simplify and clarify the required disclosures for car leasing and other types of consumer lease transactions. The changes focused on automobile leasing because of the increased use of such leases. The Board's action revised the disclosure format, adopted a total-payments disclosure that will facilitate comparisons, and required a mathematical progression that shows how the monthly lease payment is calculated. The revisions also implemented the advertising provisions of a 1995 amendment to the Consumer Leasing Act.

Regulation O
Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks

The Board revised Regulation O in November to allow insiders of a bank and of the bank's affiliates to obtain loans under a company-wide employee benefit plan. The final rule also simplifies the procedures for a bank's board of directors to exclude executive officers and directors of affiliates from policymaking functions of the bank and thereby from the restrictions of Regulation O.

Regulation S
Reimbursement for Providing Financial Records; Recordkeeping Requirements for Certain Financial Records

The Board took separate actions on two provisions of Regulation S during 1996. In July the Board updated and streamlined subpart A, which implements the Right to Financial Privacy Act (RFPA). As part of the revision, the Board increased the fees that financial institutions may charge a government authority for providing financial records pursuant to a request under the RFPA.

Earlier in the year the Board added subpart B to the regulation. The new subpart cross-references the substantive provisions of a joint rule adopted by the Board and the Department of the Treasury relating to the recordkeeping requirements for transmittals of funds under the Bank Secrecy Act. The joint rule is intended to assist in the investigation and prosecution of money-laundering activities.

Regulation T
Credit by Brokers and Dealers

In April the Board amended Regulation T to provide significant regulatory relief to broker–dealers. The changes eliminated restrictions on the ability of broker–dealers to arrange for credit, increased the type and number of domestic and foreign securities that may be bought on margin, increased the loan value of some securities that are already marginable, deleted Board rules regarding options transactions in favor of the rules of the options exchanges, and reduced restrictions on transactions involving foreign persons, foreign securities, and foreign currency. The Board also made technical changes to the rules to provide clarification and update references.

In November the Board issued an interpretation of the margin regulations in response to the enactment of the National Securities Markets Improvement Act of 1996. Under this legislation, the Board no longer has the authority to regulate certain loans to registered broker–dealers unless it finds that such rules are necessary or appropriate in the public interest or for the protection of investors.

The interpretation makes it clear that the Board has not made such a finding and that provisions in its margin regulations for which the Board no longer has general authority are without effect. The Board also requested public comment on the regulatory amendments to reflect the new legislation.

Regulation Y
Bank Holding Companies and Change in Bank Control

During 1996 the Board conducted an extensive review of Regulation Y and issued a proposal designed to improve the competitiveness of bank holding companies by eliminating unnecessary regulatory burden and operating restrictions and by streamlining the application and notice provision. The proposal, which was published for comment in August, reorganizes and expands the regulatory list of nonbanking activities and removes outmoded, superseded, or unnecessary restrictions on those activities that would not apply to insured banks that conduct the same types of activities.

The proposal also includes significant amendments to the tying restrictions. One proposed amendment eliminates the Board's regulatory extension of the antitying statute to bank holding companies and their nonbank subsidiaries, thus subjecting these entities to the same general antitrust laws that govern their competitors. Other proposed amendments broaden the product exception and the types of arrangements to which the traditional bank product exception applies.

The Board expects to take action on the comprehensive review proposal and tying provisions in 1997.

In addition to the proposal, the Board also issued several amendments or interpretations to Regulation Y. A final amendment to the Board's interpretive rule regarding investment adviser activities permits a bank holding company (and its bank and nonbank subsidiaries) to purchase, in a fiduciary capacity, securities of an investment company advised by the bank holding company. To take advantage of this provision, the purchase must be specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered.

In October the Board announced an interim rule to implement provisions of the Economic Growth and Regulatory Paperwork Act. The new rule estab-

lishes expedited procedures for well capitalized bank holding companies that also meet other criteria to obtain Board approval for certain acquisitions and certain nonbanking activities. The affected acquisitions are those of smaller companies that engage in any permissible nonbanking activities listed in Regulation Y, and the affected nonbanking activities are those that the Board has approved only by order.

During the year the Board also approved changes to three areas affecting section 20 subsidiaries of bank holding companies—firewalls, revenue limits, and treatment of income earned on securities. In general, the amendments modify the interlock restriction, eliminate the cross-marketing restriction, and ease the financial assets restriction.

In December the Board raised the limit on the amount of revenue that a section 20 subsidiary may derive from underwriting and dealing in securities. Under the new rules, the permissible revenue limit will change from 10 percent to 25 percent of the subsidiary's total revenue. The revenue limit is designed to ensure that a section 20 subsidiary will not be engaged principally in underwriting and dealing in securities in violation of section 20 of the Glass–Steagall Act.

In a separate announcement the Board clarified that interest income earned on the types of debt securities that a member bank could hold for its own account shall not be treated as revenue from underwriting or dealing in securities for purposes of section 20. Interest earned on these securities will continue to be included in total revenue.

Regulation Z
Truth in Lending

The Board revised Regulation Z in September to incorporate the Truth in Lending Act Amendments of 1995. The amendments establish new creditor-liability rules for closed-end loans secured by real property or dwellings and consummated on or after September 30, 1995, and establish several tolerances for accuracy in disclosing the amount of the finance charge. Creditors have no civil or administrative liability if the finance charge and affected disclosures are within the applicable tolerances. The amendments also clarify how lenders must disclose fees connected with mortgage loans.

In addition to the changes required by the statute, the revised regulation also includes a new rule regarding the treatment of fees charged in connection with debt cancellation agreements. This rule is similar to the existing rule for credit insurance premiums and provides for more uniform treatment of these fees.

Regulation CC
Availability of Funds and Collection of Checks

The Board continued its comprehensive review of Regulation CC. The proposed amendments arising from the review are primarily technical in nature and do not represent any major policy changes. In some cases, the amendments also reduce the compliance burden for depository institutions.

Proposed changes to subpart B, which governs availability schedules and disclosures, address a variety of issues, including the treatment of deposits received at ''contractual'' branches, such as affiliates. In general, proposed amendments provide more flexibility for banks giving hold notices under emergency conditions, clarify the various media through which written notices may be given, delete certain requirements for notice content, and revise

the model forms in appendix C of the regulation.

Other proposed changes to subpart B clarify the interaction between Regulation CC and the Uniform Commercial Code, set forth rules for checks drawn on certain U.S. territories, and address other check collection matters. In conjunction with the proposal, the Board is requesting comment on several items: the time required for a bank to qualify a returned check for automated processing, the provisions regarding the extension of the midnight deadline, and the extent of a presenting bank's preferred claim against a closed paying bank.

Rescission of Regulations R and V

As a result of the Board's periodic regulatory review process, the Board determined that two of its regulations, Regulations R and V, were obsolete and no longer necessary. Both regulations were subsequently rescinded.

Regulation R (Relations with Dealers in Securities Under Section 32 of the Banking Act of 1933), restated the statutory language of Section 32 of the Glass–Steagall Act and set forth the only exemption to the act adopted by the Board. The Board determined that the existing exemption in the regulation was no longer necessary in view of interpretations of the act developed since 1969. The Board also noted that having a substantive regulation solely to restate a statutory provision is unnecessary.

Regulation V (Loan Guarantees for Defense Production), implemented the Defense Production Act of 1950 and was intended to permit defense agencies to enter into defense-related contracts without regard to whether appropriations had been made for the underlying projects. A subsequent amendment to the act made it unlikely that a loan guarantee application would be filed; however, the Federal Reserve System would be able to process such an application under existing fiscal agency procedures. ▪