From Confidential Supervision to Market Discipline: The Role of Disclosure in the Regulation of Commercial Banks

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I. INTRODUCTION

Bankers and bank regulators fear the flow of information to the outside world because of runs on banks. Their concern stems from a fear that the release of damaging information to the public will result in a run on the bank, leading to its failure, and to a general bank panic as well.

Apprehension concerning the vulnerability of a bank in the event of the dissemination of adverse financial information is not without foundation. An article published in 1908 recounts an episode involving a run on a reputable New York bank. A newspaper published a story asserting that an employee

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1. A run is the withdrawal of funds from a bank by depositors at an unusually high frequency over a very short time period.

had absconded with a large sum of the bank's money. The story further claimed that accountants were working clandestinely at night in the bank to ascertain the extent of the theft. Contrary to the story, the employee was actually on a leave of absence due to an illness and the alleged accountants were workmen repairing bank fixtures. Nevertheless, the rumor triggered a run upon the bank. The bank survived, but a bank of smaller size might not have been as fortunate.

The foregoing incident involved the dissemination of false information, but the same considerations may well arise where truthful information is released. One such incident involved the Reconstruction Finance Corporation (RFC). Established as part of Franklin Roosevelt's New Deal Program, the RFC's primary purpose was to make loans to banks in trouble, particularly those facing liquidity problems. After considerable debate, the RFC published the names of banks that received loans despite objections that publication would amount to public disclosure that the banks were having financial difficulty. Ultimately, the opponents of publication were proved correct.

Banking regulation has as its primary objectives the maintenance of a safe and sound banking system and the prevention of failure. In light of the fear of bank panics, traditional bank regulatory systems have not used public disclosure of information regarding a bank's affairs to depositors and potential depositors, i.e., the public, as a major means of achieving regulatory goals. Instead, bank regulatory systems have been paternalistic in nature. Bank regulatory policy does not question the premise that a bank's affairs must be monitored, but because depositors cannot be trusted to act responsibly upon learning adverse information,

3. The Bank Panic of 1907-08 may have exacerbated public alarm about the story.
4. M. FRIEDMAN & A. SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES, 1867-1960, at 325 (1963). The RFC had apparently construed the Emergency Relief and Construction Act of July 21, 1932, to require publication, a conclusion that was not free from dispute. See id. Herbert Hoover maintained that he had been assured that the names of borrowing banks would be kept confidential. Id. n.33.
5. Friedman and Schwartz also maintained that the publication of the names of borrowing banks contributed to the RFC's inability thereafter to slow the bank failure rate and frequently resulted in runs after publication of the names and a reluctance on the part of and banks in need of assistance to borrow from the RFC. M. FRIEDMAN & A. SCHWARTZ, supra note 4, at 325.
7. Overby v. United States Fidelity & Guar. Co., 224 F.2d 158, 160 n.2 (5th Cir. 1955). The court cited the Affidavit of the Acting Secretary of the Treasury, who opposed the production of reports of examination made by national bank examiners under the Comptroller of the Currency in a suit against an examined bank:

It has always been the position of the Office of the Comptroller of the Currency that reports of examination of national banks and related correspondence and papers are confidential documents of the Treasury Department. It would be contrary to long established policy to make the reports public for any purpose other than enforcement of the National Bank Act . . . .

Reports of examination of national banks contain much information which, at the very least, if revealed to the public, would be misunderstood owing to inability to evaluate the relative importance of the matters criticized and discussed. This could not fail to adversely affect the banks concerned. These reports may contain information about violations of law, some important and others of negligible importance. Certain
the task of oversight lies with bank regulatory agencies.\textsuperscript{8} Bank regulators were given this task because of a belief that they are better suited to evaluate adverse information and to force a bank to take appropriate corrective action through regulatory disciplinary measures without jeopardizing the survival of the bank.\textsuperscript{9}

Confidential supervision and bank examinations form the cornerstone of the paternalistic approach.\textsuperscript{10} "Confidential supervision" means that supervisory activities are kept from public view, but in this Article the term includes the control of the flow of information regarding a bank's affairs by the bank regulators through restrictions on the quantity of information made available to the public and controls on the timing of the availability of the information that is released. Confidential supervision has meant more than the confidentiality of bank examination reports.\textsuperscript{11} Although some public disclosure is permitted, e.g., publication of call reports,\textsuperscript{12} banks traditionally have not been required by regulatory laws to make additional disclosures, and bank regulators have fostered an environment that has tolerated the discretion of banks in releasing information to the public.\textsuperscript{13} In 1964, the scope of federal securities regulation was expanded to require some banks to disclose more information than is otherwise required under bank regulatory laws.\textsuperscript{14}

Confidential supervision has not produced the effective results contemplated by bank regulatory policy. Record post-Depression bank failures,\textsuperscript{15} including the
failures of Penn Square Bank of Oklahoma City and the mammoth Continental Illinois Bank & Trust Company, have raised questions about the adequacy of the supervisory efforts of bank regulators and the ability of regulatory supervision to maintain the safety and soundness of the banking system. Questions pertaining to the maintenance of the safety and soundness of the banking system have forced the bank regulatory agencies to overcome their reluctance to consider the alternative of market discipline and its necessary concomitant, public disclosure, as a supplement to regulatory supervision of the banking system. Their alacrity has been fueled by the experience with disclosure under federal securities laws.

This Article examines traditional regulatory discipline,\textsuperscript{16} the development of a legal basis for confidential supervision,\textsuperscript{17} the role of the SEC and federal securities laws in the development of a public disclosure system for banks and bank holding companies,\textsuperscript{18} and the utilization of public disclosure to achieve market discipline as a major tool in preventing bank failure and maintaining the stability of the banking system.\textsuperscript{19} The scope of this Article is limited to the regulation of commercial banks, whether state or federally chartered, by the following federal bank regulatory agencies: the Office of the Comptroller of the Currency (Comptroller), the Federal Deposit Insurance Corporation (FDIC), and the Board of Governors of the Federal Reserve System (Federal Reserve).\textsuperscript{20}

\section*{II. TRADITIONAL REGULATION}

As noted above, under the traditional bank regulatory structure, bank regulators rather than depositors or the public in general (or the market) discipline wayward banks. It is implicit in this structure that critical information regarding a bank's affairs is disseminated primarily to or obtained by the bank regulators. This dissemination or acquisition of information is provided by bank examinations and periodic reports, the most significant bank regulatory tools utilized for information gathering. Portions of the reports must be published. If the information indicates extant unsafe, unsound, or illegal banking practices, the bank regulatory agencies may apply corrective or disciplinary measures. These measures include but are not limited to recommendations for corrective action and moral suasion,\textsuperscript{21} cease and desist orders,\textsuperscript{22} suspension or removal of officers,\textsuperscript{23} civil monetary penalties,\textsuperscript{24} termination of deposit insurance,\textsuperscript{25} and charter re-

\begin{footnotes}
\footnotetext[16]{See infra text accompanying notes 21-50.}
\footnotetext[17]{See infra text accompanying notes 51-76.}
\footnotetext[18]{See infra text accompanying notes 77-123.}
\footnotetext[19]{See infra text accompanying notes 124-90.}
\footnotetext[20]{The Comptroller regulates and charters national banks; the Federal Reserve examines state chartered banks that are members of the Federal Reserve system; and the FDIC examines state chartered banks that are not members of the Federal Reserve system.}
\footnotetext[21]{12 U.S.C. § 481 (1982) implies that the Comptroller will make recommendations or suggestions for corrective action where appropriate. In any event, the policy of the federal bank regulators is to seek compliance with its recommendations by agreement before resorting to formal enforcement action. \textit{Federal Response to Criminal Misconduct}, supra note 13, at 15-16.}
\footnotetext[22]{12 U.S.C. § 1818(b)-(c) (1982).}
\footnotetext[23]{\textit{Id.} at § 1818(c).}
\footnotetext[24]{\textit{Id.} at § 1818(i)-(j).}
\footnotetext[25]{\textit{Id.} at § 1818(a).}
\end{footnotes}
The exercise of any of these powers upon the discovery of an unsafe, unsound or illegal banking practice constitutes regulatory discipline.

A. The Examination Process

All commercial banks in the United States are subject to regular examinations by the Comptroller of the Currency, the FDIC, or the Federal Reserve.27 State chartered banks are also examined by appropriate state regulatory agencies. The frequency of examinations may vary because federal bank regulatory agencies are required to examine banks within their jurisdiction only as often as deemed necessary.28 Accordingly, banks with good track records may not be examined as often as those with known problems.29

Each federal bank regulatory agency is authorized to conduct a "thorough examination of the affairs of . . . [a] bank."30 A typical examination is conducted by a team of examiners, the size of which varies depending upon the examining agency, the size of the bank, and its reputation as a clean or problem bank. The team has access to such records of the bank as they request.31 The examination reviews all of the operations of the bank,32 including but not limited to loan practices, trust operations, internal control, checking and savings accounts, data processing, internal security, and personnel practices. The scope of the examination also includes the affairs of affiliate bank companies.33 Examiners interview

26. Id. at § 1818(o).
27. Id. at §§ 481 (examinations by the Comptroller of the Currency), 1820(b) (examinations by the FDIC), 325, 338 (examinations by the Federal Reserve).
28. Id. at §§ 481 (examinations by the Comptroller of the Currency), § 1820(b) (examinations by the FDIC), 338 (examinations by the Federal Reserve).
29. Under the steerage of the Federal Financial Institutions Examination Council (formed in 1979 and comprised of representatives of the Comptroller, the FDIC, the Federal Reserve, the Federal Home Loan Bank Board, and the National Credit Union Administration), the federal bank regulators now use a uniform rating system to describe the financial health of an examined bank. The rating system is known as CAMEL, an acronym for capital adequacy, asset quality, management ability and effectiveness, earnings quantity and quality, and liquidity, and the ability to meet demands for payment of obligations. Each category is rated on a scale of one to five, a "one" indicates a significantly better than average performance, whereas a "five" indicates the presence of critical deficiencies. FDIC Statements of Policy Uniform Financial Institutions Rating System, [1979-1980 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 98,110 (Nov. 26, 1979).

Banks with a CAMEL rating of "one" or "two" may be examined as infrequently as once every three years; a bank with a "three" rating, once every 18 months, and a bank with a "four" or "five" rating, once every 12 months. Federal Response to Criminal Misconduct, supra note 12, at 59. See also Letter from the Federal Reserve Board of Governors to Presidents of all Federal Reserve Banks and the Officers in Charge of Branches, 3 Fed. Banking L. Rep. (CCH) ¶ 35,311 (Jan. 18, 1981). Prior to 1980, 12 U.S.C. § 481 (1976) mandated that national banks be examined once every six months, but one such examination could be waived in a given year. Section 709(a) of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 188, revised section 481 to the current language, which is almost identical to the original language contained in section 54 of the National Bank Act of 1864, 13 Stat. 116 (1864). The change was presumably made with the idea that the Comptroller would have more examination resources available to examine problem banks more frequently. See Federal Response to Criminal Misconduct, supra note 13, at 59-60.

31. Id.
32. Id.
33. Id.
bank officers and nonmanagement personnel. If a bank is uncooperative, the
bank examiners may conduct a formal examination. A formal examination may
be conducted by interrogating bank personnel under oath34 and by using the
subpoena power.35

The examination focuses on the evaluation of capital adequacy, asset quality,
management ability, earnings, and liquidity. Bank examiners, however, do not
engage in the physical verification of transactions as auditors do or in following
paper trails outside of the bank.36 Nevertheless, the bank examination process
is designed to give bank regulators access to both material and routine nonmaterial
information as a basis for accurate assessment of the financial well-being of a
bank.

B. Reports to the Regulatory Agencies

The second major method traditionally used by bank regulators to obtain
information about a bank's financial condition is periodic reporting. Banks that
are examined by the federal bank regulatory agencies are also required to submit
periodic reports to the agency responsible for conducting the examination.37 The
basic reports are the Report of Condition and the Report of Income, both of
which must be filed at the end of each calendar quarter.38 In financial accounting
jargon, the Report of Condition and the Report of Income are similar to the
Statement of Financial Position and Income Statement, respectively. They are
known as "call reports" in bank regulatory parlance.

In addition, a bank regulatory agency has authority to require banks under
its jurisdiction to submit additional reports. This power has been used to require
reports of financial data on specific categories of transactions that are not
separately reflected in the Reports of Condition and Income. This power is quite
broad, and as discussed below, has served as the basis for the comptroller's author-
ity to promulgate disclosure rules.

Periodic reporting provides bank regulators with a continuing picture of a
bank's financial condition. Frequent examinations of all banks are not practical
because examinations are time consuming and costly in terms of personnel,
money, and disruption of a bank's business operations. Some of the additional
required reports were developed because of particular inadequacies of the Reports
of Condition and Income.

Congress has provided for public disclosure of some financial information
by requiring call reports. Banks are required by statute to publish the Report
of Condition in a newspaper in the community or communities in which the
bank is located physically.39 However, the primary purpose for requiring pub-
lication of call reports is not to provide information to depositors and prospective
depositors to use in deciding whether to make a deposit or leave a deposit in

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34. Id. at §§ 1818(n), 1820(c); see also Federal Response to Criminal Misconduct, supra note
13, at 62.
35. 12 U.S.C. §§ 1818(n), 1820(c) (1982); see also Federal Response to Criminal Misconduct,
supra note 13, at 62.
39. Id.
the bank; the purpose is to periodically demonstrate to the public that the bank
is financially healthy and thus preserve confidence in the banking system.\textsuperscript{40}

That Congress was not attempting to establish a systematic public disclosure
system directed at depositors is supported by the fact that only the Report of
Condition, but not the Report of Income, is required to be published.\textsuperscript{41} Generally,
in financial accounting the income statement is considered more important than
the balance sheet in evaluating the financial health of a business.\textsuperscript{42} Thus, if
Congress intended publication to serve as a systematic public disclosure system,
reports of income should be included in the publication requirement. Congress'
failure to require the publication of the Report of Income may reflect its belief
that such reports contain sensitive information. Such failure may also reflect a
fear that negative earnings information may result in an erosion of public
confidence in a bank. Reports of income are available to the public upon request,
but only to the extent that the bank regulatory agencies determine such release
is appropriate.\textsuperscript{43}

\section*{C. Regulatory Discipline}

It is presumed that bank regulators act to discipline banks when information
gleaned through the examination and reporting processes warrants disciplinary
action. At least that is the premise advanced by the Acting Secretary of Treasury
in his Affidavit in \textit{Overby v. United States Fidelity and Guaranty Co.}\textsuperscript{44} A weak
point of the traditional bank regulatory structure has been the unavailability of
enforcement tools that bank regulators will actually use. Bank regulators have
lacked disciplinary tools that cause a bank to take appropriate corrective action,
and at the same time, do not jeopardize the viability of the bank.

Until 1966, the primary official enforcement tools available to federal bank
regulatory agencies were powers to terminate deposit insurance and to revoke
the bank's charter.\textsuperscript{45} These tools could not be used effectively because the bank

\begin{enumerate}
\item Rodkey, \textit{Banking Reform by Statute}, 32 Mich. L. Rev. 881, 889-90 (1931); see also
Bankers Association}, quoted in \textit{Hearings on H.R. 13873 Before the Subcomm. of the Comm. on
Appropriations}, 70th Cong., 2d Sess. 41-50 (1928): “The public must make use of banks but few
are in a position to distinguish between the strong and weak. Bank statements and other external
information relating to banks do not furnish an adequate basis for intelligent discrimination.” \textit{Id.}
at 43.

\item National banks are only required to submit Reports of Condition and such other special
reports as may be required by the Comptroller. 12 U.S.C. \textsection 161 (1982). The Report of Condition
is required under section 161(a) to include “in detail under appropriate heads the resources and
liabilities of the” national bank as of a specified date. \textit{Id.} Although the statutory provision expressly
uses the term “report of condition,” it only requires the “statement of resources and liabilities”
to be published. The Report of Income is a special report required by the Comptroller, who may
require a national bank to publish a special report. Section 161(a) expressly provides, however, that
the publication of special reports is not required unless ordered by the Comptroller.


\item The FDIC, subject to its right to withhold what it determines to be sensitive financial
information, has made call reports, including Reports of Income, available for viewing and pho-
\textsection 309.5). The Comptroller also routinely provides public access to call reports subject to its right

\item 224 F.2d 158, 160-61 n.2 (5th Cir. 1955).

\item \textit{Federal Response to Criminal Misconduct}, \textit{supra} note 13, at 142-43.
regulators were trying to preserve confidence in the banking system. It would make little difference to the "gullible" public that a bank went out of business because the regulators closed it for disciplinary reasons rather than insolvency. Thus, the use of these measures was not practical unless the bank was insolvent or insolvency became imminent. Accordingly, the bank regulators relied upon informal persuasion. 46

The federal bank regulatory agencies were given more practical enforcement tools under the Financial Institution Supervisory Act of 1966. 47 Specifically, they were given the power to issue cease and desist orders, assess civil penalties, suspend and remove officers, and conduct formal investigations with subpoena power. Theoretically, the agencies were able to threaten and actually use enforcement devices that carried substantial weight with the banks, but which had less severe consequences.

Again the bank regulators were confronted with a dilemma. The use of formal enforcement powers was more likely to result in disclosure of the bank's problems to the public than was informal persuasion. The concomitant publicity might lead to a run on the bank, a consequence that the bank regulators wanted to avoid. Therefore, the new enforcement powers were used sparingly. 48 In fact, the federal bank regulatory agencies continue to use informal persuasion as their primary mechanism for convincing a bank to take corrective action. 49 When formal enforcement action is taken, the agencies have been reluctant to make that information available to the public. 50 With the fear of disclosure as a constant consideration, bank regulators developed and maintained the policy of confidential supervision.

III. LEGAL BASIS FOR CONFIDENTIAL SUPERVISION

The historical lack of emphasis on public disclosure in the bank regulatory system, whether such disclosure is made by banks or the bank regulators, comes as no accident. This policy, however, has never been mandated expressly by Congress, but instead, was developed by the bank regulators apparently pursuant to their interpretation of statutory powers. Congress, however, has accepted implicitly and countenanced explicitly, but has not ordered, confidential supervision. In doing so, Congress has been less than clear regarding the extent to which public disclosure may be used as a bank regulatory tool and has created a conflicting disclosure policy in federal securities regulation.

In some instances, Congress has been presented squarely with an opportunity to prohibit or inhibit disclosure, but has refused to do so. For example, several

46. Id.
49. Id. at 142-46, 152-53.
50. Id. at 16. This is the essential paradox of confidential supervision, a proverbial catch-22 situation. Because banks are so fragile and important to economic stability, regulators must be cautious in supervising the industry lest the actions of the regulators cause bank failures and instability. Regulators, therefore, must be exceedingly prudent in invoking disciplinary actions. One of the most detrimental results that could occur from the regulator's point of view is that the public be made aware that a bank is on a potentially damning course because the public may act regardless of how improbable the occurrence of potentially damaging consequences.
bank runs, ignited or exacerbated by published statements, occurred during the panic of 1907-08. As a result, the American Bankers Association lobbied Congress and state legislatures to make the dissemination of untrue statements and rumors about the financial condition of commercial banks a criminal offense. Consequently, a bill was introduced into the first session of the Sixtieth Congress, which reads in pertinent part as follows:

That any person who shall make, circulate, or transmit to another or others any statement, untrue in fact, derogatory to the financial condition or affecting the solvency or financial standing of any national bank in the United States, or who shall counsel, aid, procure or induce another to start, transmit, or circulate any such statement or rumor shall be guilty of a misdemeanor, and upon conviction thereof shall be punished by a fine . . . .

These lobbying efforts eventually were successful in some of the state legislatures, but not in Congress. The proposed law would not have prevented a bank from disclosing information on its own, but would have had a chilling effect on persons, including bank officers, who had information that was not otherwise in the public domain and who were not certain that they would have access to sufficient evidence to support or corroborate the statements.

The implicit acceptance of the policy by Congress is evidenced by the fact that Congress was aware of confidential supervision, but did not challenge its use. In several instances, Congress has passed statutes that specifically permit federal bank regulators to provide other federal agencies with confidential access to information gathered through the examination process. The D.C. Circuit Court of Appeals, in Bank of America National Trust & Savings Association v. Douglas, found that the enactment of statutes of this nature, along with testimony before congressional committees regarding the policy constituted an implicit acceptance and approval of confidential supervision by Congress.

Furthermore, in the only instance in which Congress expressly authorized the public disclosure of information regarding a bank's affairs by bank regulators, other than through the call report process, prior to the enactment of the Securities Acts Amendments of 1964 (Securities Acts Amendments), the authority was essentially limited to blackmailing a bank into compliance with the Comptroller's curative demands arising from a bank examination. Section 28(a) of the Glass-
Steagall Act\textsuperscript{58} authorized the Comptroller "to publish the report of his examination of any national banking association or affiliate which shall not within one hundred and twenty days after notification of the recommendations or suggestions of the Comptroller, based on said examination, have complied with the same to his satisfaction."\textsuperscript{59}

The court in \textit{Bank of America National Trust} also relied on section 28(a) of the Glass-Steagall Act in determining that Congress had accepted the policy of confidential supervision.\textsuperscript{60} The statute reveals that the structure of the regulatory scheme promulgated by Congress generally did not contemplate public disclosure either by banks or the bank regulators, and implies that acceptance of the idea that the public disclosure of negative examination results is bad.\textsuperscript{61} If sufficient information were available in call reports or if the Comptroller had the general power to require disclosure, the power to publish granted under section 28(a) would have been unnecessary as well as futile.

Because the Comptroller was granted power to use disclosure for limited purposes, it is questionable whether the Comptroller even had the power to use public disclosure beyond those limited purposes. Furthermore, if the Comptroller did not have the power to use public disclosure beyond those limited purposes, his adoption of a policy that minimized the use of public disclosure would be consistent with the powers ostensibly granted by Congress. Finally, the enactment of a statute authorizing the Comptroller to use public disclosure under limited circumstances at a time when Congress was well aware of the use of confidential supervision by the bank regulators demonstrates Congress' implicit approval of the policy.

Although it may be correct that the Comptroller lacked the power to utilize public disclosure broadly, that view subsequently was rejected by the Comptroller. Prior to the issuance of the Report of the Special Study of the Securities Markets of the Securities and Exchange Commission,\textsuperscript{62} the Comptroller promulgated a regulation requiring the disclosure of certain information to shareholders by national banks with deposits of at least $25,000,000.\textsuperscript{63} The preamble to the

\begin{itemize}
  \item \textsuperscript{58} The Banking Act of 1933 is more commonly known as the Glass-Steagall Act, Pub. L. No. 96-221, 48 Stat. 192 (1982). Section 28(a) thereof is codified at 12 U.S.C. § 481 (1982).
  \item \textsuperscript{59} 12 U.S.C. § 481 (1982).
  \item \textsuperscript{60} 105 F.2d at 103 n.5.
  \item \textsuperscript{61} If something negative had not been discovered in the course of an examination, the Comptroller would not need to make recommendations and suggestions. Moreover, given the acceptance of the general proposition that the public disclosure of adverse results is bad, one would presume that Congress only intended that the Comptroller use this power in instances in which the bank's situation was serious. After all, the threat of disclosure is most ironic since it contemplates that disclosure will harm the bank and that a bank would rather comply than suffer the harm. The threat becomes even more ironic when one realizes that the Comptroller in trying to save the bank threatens to harm it in order to save it.
  \item \textsuperscript{62} The SEC was authorized in 1961 pursuant to section 19(d) of the Securities Exchange Act of 1934, as amended by Pub. L. No. 87-196, 75 Stat. 465 (1962), "to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations" and report the results thereof with recommendations to Congress. \textit{Id.} Although the language of the authorization is somewhat specific, the legislative history makes it clear that Congress intended the study to be broad in scope. H.R. Rep. No. 882, 87th Cong., 1st Sess., \textit{reprinted in} 1961 \textit{U.S. CODE CONG. & AD. NEWS} 2557, 2561 (1961).
  \item \textsuperscript{63} 27 Fed. Reg. 12,811 (1962).
\end{itemize}
regulation published in the Federal Register states that the authority therefor was contained in the National Bank Act, but no section is specified. The apparent statutory basis was the Comptroller's power to require special call reports in addition to the reports of condition. At the time, the Comptroller had not been given explicitly the power to prescribe rules and regulations; that oversight was cured by the Depository Institutions Deregulation and Monetary Control Act of 1980.

Despite the eventual acceptance by the Comptroller of the notion that Congress authorized the use of public disclosure as a bank regulatory tool, the statutory basis for that acceptance and the enactment of section 28(a) highlight the ambiguity of the congressional authorization. That ambiguity was amplified with the passage of the Securities Exchange Act of 1934 (Exchange Act), which required companies, including banks, that were members of certain stock exchanges to make substantial periodic disclosures of their affairs. As a practical matter, subjecting banks to the Exchange Act had no substantial consequences at the time because only a small number of banks were then members of the subject exchanges. In fact, the SEC promulgated a regulation shortly after passage of the Exchange Act exempting banks from the disclosure requirements.

Nevertheless, because the disclosure requirements applied to companies that owned banks and because the Comptroller strongly protected the policy of confidential supervision, it was only a matter of time before the conflict between the policies of securities regulation and bank regulation was presented to the courts. The inevitable occurred in the case of Bank of America National Trust & Savings Association v. Douglas. Prior to July 15, 1937, Bank of America National Trust & Savings Association was a subsidiary of Transamerica Corporation. In August, 1937, Transamerica filed a registration statement covering over 11,000,000 shares of its capital stock. The registration statement included the financial statements of the bank filed with the Comptroller for the years 1934 through 1936. After the registration became effective, questions arose over

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64. Id.
65. The Comptroller "may call for special reports from any particular association whenever in his judgment the same are necessary for use in the performance of his supervisory duties." 12 U.S.C. § 161(a) (1982). Furthermore, "[s]pecial reports . . . need contain only such information as is specified by the Comptroller . . . and publication of such reports need be made only if directed by the Comptroller." Id. The SEC, in responding to the objections of the Comptroller in the debates over the Securities Acts Amendments, stated that the basis for the Comptroller's authority was the power granted under section 161(a). Memorandum of the Securities and Exchange Commission with respect to the Statement of the Comptroller of the Currency on H.R. 6789 and S. 1642, Hearings on H.R. 6789, H.R. 6793 and S. 1642 Before a Subcomm. of the Comm. on Interstate and Foreign Commerce, 88th Cong., 1362, pt. 2 (1964) [hereinafter cited as Hearings on Investor Protection].
68. Banks were specifically excluded from the coverage of the Securities Act pursuant to section 3(a)(2). No exemption is granted under the Exchange Act.
70. Id. (citing Exchange Act, rule 12a-1, then in effect).
71. 105 F.2d 100 (D.C. Cir. 1939).
the accuracy of the valuation of the bank’s assets contained in the financial statements.\textsuperscript{72}

Subsequently, the SEC requested, and the Secretary of the Treasury consented to, the SEC’s review and public use of examination reports relating to the bank. The bank then challenged the power of the Secretary of the Treasury to permit the SEC to review the examination reports and the proposed release thereof to the public by the SEC. After a thorough discussion of the lawfulness of confidential supervision, the court held that the Secretary of the Treasury was legally permitted to share the examination results with the SEC, but declined to permit the SEC to make the results public.\textsuperscript{73} The court, however, reached this result only after determining that Congress had established conflicting policies toward disclosure with respect to the regulation of banks:

\begin{quote}
[O]n the one hand the Securities Exchange Act vests in the Commission power to make examinations of registrants and their controlled companies without excepting banks and, as part of its power, to compel the production of their books, records, [and papers] for scrutiny by the Commission—whereas on the other, the National Banking Act, in deference to the delicate and sensitive interests involved, contemplates exclusive supervision of banks by the Comptroller of the Currency and the confidential treatment by him of the matters developed as to their internal affairs.\textsuperscript{74}
\end{quote}

Although a resolution was reached in that case, the conflict did not disappear, but rather, remained dormant until the debate over the Securities Acts Amendments.

In 1966, two years after Congress mandated public disclosure in the context of bank regulation pursuant to the Securities Acts Amendments, Congress passed the Freedom of Information Act\textsuperscript{75} (FOIA) and explicitly affirmed confidential supervision. Under the FOIA, federal bank regulatory agencies may refuse to provide public access to information “contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of [such agencies].”\textsuperscript{76} Importantly, Congress did not mandate confidential supervision, but permitted its continuance. Since that time, neither Congress nor the federal bank regulatory agencies have completely disavowed confidential supervision.

IV. CONTEMPORARY USE OF DISCLOSURE

The conflict in congressional purposes articulated in Bank of America National Trust & Savings Association resulted from the inclusion of banks in the coverage of the pro-disclosure Exchange Act. The intrusion upon bank regulation, though literally prescribed by the statute, may have been a historical accident. Banks specifically were exempted from the coverage of the Securities

\textsuperscript{72} Id. at 101-02.
\textsuperscript{73} Id. at 108.
\textsuperscript{74} Id. at 103-04 (footnote omitted).
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Act of 1933 (Securities Act), but no such exemption was granted under the Exchange Act. The exclusion of banks from the coverage of the Securities Act indicates that the inclusion in the Exchange Act was not inadvertent. The impact of each statute on bank regulation, however, forces a conclusion that both the exclusion and inclusion are consistent with a policy of confidential supervision. The Securities Act would have affected almost every bank in the country and subjected them to an additional regulatory apparatus.

On the other hand, the Exchange Act, as originally enacted, was directed at preventing abuses in securities transactions effected over national stock exchanges. At the time of passage, only a few banks were members of regulated exchanges, so the impact on bank regulation as a whole was insubstantial. Thus, inclusion under the Exchange Act did not indicate that Congress mandated the dismantling of confidential supervision. Banks may have been included within the coverage of the statute precisely for the reason that confidential supervision would not have been thus affected.

By the early 1960s Congress faced mounting pressure to deal with widespread abuses in securities transactions conducted in the "over-the-counter" market. Most bank securities were traded primarily in the over-the-counter market. A significant amount of pressure arose because of the victimization of traders in bank securities. As a result, Congress was forced to acknowledge a need for public disclosure within the context of bank regulation. Ironically, Congress, when presented for the first time with the question of whether confidential supervision must yield to some degree of public disclosure, answered in the affirmative. However, the intent of Congress was to protect the owners of banks rather than to protect depositors and preserve the stability of the banking system.

A. The Role of the SEC and Federal Securities Laws

Under the Securities Acts Amendments, Congress broadened the scope of the Exchange Act to extend the reporting requirements to reach companies, including banks, whose stocks or securities are sold over the counter. It is not

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77. 15 U.S.C. §§ 77a-77aa (1982). The Securities Act requires a company issuing securities to the public to register such securities unless subject to a specific statutory exception. Id.

78. Section 12(b) of the Exchange Act as originally enacted applied to all issuers of securities traded over specific national stock exchanges. Report of the Special Study, supra note 69, pt. 3, at 36.

79. The Securities Act applied to companies regardless of number of shareholders or asset size. The operative criterion was the offering, issuance, or distribution of securities in interstate commerce. If the Securities Act had been applicable to banks, it would have affected any and every bank that offered, issued, or distributed its securities in interstate commerce. It is generally recognized that the justification for exempting banks from the Securities Act was the belief that investors were sufficiently protected by federal bank regulators. Report of the Special Study, supra note 69, pt. 3, at 36.

80. Id.

81. Id.

82. The legislative history of the statutory authorization for the Special Study of the Securities Markets indicates that those who testified in favor of the study presumed that the need for such a study existed and focused primarily on the scope of the study. The Report of the Special Study contains detailed accounts of the abuses that were then occurring in the over-the-counter markets. See Report of the Special Study, supra note 69, at 38-39. For specific information about the lack of disclosure where bank securities were involved, see id.

83. Id. at 35-39.

surprising that Congress chose to open the door to public disclosure in bank regulation through laws governing securities regulation. This choice, however, does not reflect a disavowal of confidential supervision. It does not appear that Congress intended to mandate or foreclose the broad use of disclosure now being considered by federal bank regulators. Congress’ lack of intent will become clearer after a discussion of section 12(i) of the Exchange Act, as added by the Securities Acts Amendments, and the related debates in the legislative history.

The specific disclosure requirements enacted pursuant to the Securities Act Amendments amended sections 12, 13, 14 and 16 of the Exchange Act. The import of these provisions is that any company whose stock is listed and registered on a national securities exchange or which has total assets exceeding $1,000,000 and a class of equity security that is held of record by 500 or more persons must file periodic reports “for the proper protection of investors” with the specified regulatory agency. The purpose of periodic reporting is to maintain in the public eye the same information that must be disclosed upon registration under section 12(b)(1). Additional information must be disclosed in proxy statements under section 14. Accordingly, banks that meet the section 12(a) and (g) threshold criteria are subject to these disclosure requirements.

85. Pursuant to section 12(h) of the Exchange Act, 15 U.S.C. § 78l(g)(1)(A) (1982), as amended, the SEC was given the authority to exempt persons otherwise subject to the Exchange Act disclosure requirements from those requirements. Id. Accordingly, the SEC subsequently raised the threshold asset size standard to $3,000,000. 17 C.F.R. § 240.12g-1 (1985).

86. The threshold requirements are set forth in section 12(b) and (g) of the Exchange Act, as amended (codified at 15 U.S.C. § 78l(b), (g) (1982)).

87. Section 12(b)(1) provides that an application filed with the SEC shall contain information with respect to the following:

(A) the organization, financial structure, and nature of the business;
(B) the terms, position, rights, and privileges of the different classes of securities outstanding;
(C) the terms on which their securities are to be, and during the preceding three years have been, offered to the public or otherwise;
(D) the directors, officers, and underwriters, and each security holder of record holding more than 10 per centum of any class of any equity security of the issuer (other than an exempted security), their remuneration and their interests in the securities of, and their material contracts with, the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer;
(E) remuneration to others than directors and officers exceeding $20,000 per annum;
(F) bonus and profit-sharing arrangements;
(G) management and service contracts;
(H) options existing or to be created in respect of their securities;
(I) material contracts, not made in the ordinary course of business, which are to be executed in whole or in part at or after the filing of the application or which were made not more than 2 years before such filing, and every material patent or contract for a material patent right shall be deemed a material contract;
(J) balance sheets for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission [SEC] by independent public accountants;
(K) profit and loss statements for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by independent public accountants; and
(L) any further financial statements which the Commission may deem necessary or appropriate for the protection of investors.


88. Id. at § 78(n). Under the proposed Shareholder Communications Act of 1985, section
Under the original versions of the Securities Acts Amendments, the powers of the SEC to enforce and administer the Exchange Act with respect to securities issued by a bank would have been delegated to the federal bank regulatory agency that examined or supervised such bank, upon the request of the agency. Since a significant number of banks were to be affected, and the possibility existed that a federal bank regulatory agency might not request delegation, the American Bankers Association and the Comptroller strongly objected to the potential regulatory overlap and the substantial possibilities for confusion in attempting to comply with regulations promulgated by the federal bank regulators and the SEC. Accordingly, the final version of section 12(i) placed the regulation of the disclosures required of banks under the amended Exchange Act with the federal bank regulatory agencies.

The Comptroller alone, of the three federal bank regulatory agencies, waged a vigorous fight against subjecting banks to the coverage of the Exchange Act, although his objections were limited to national banks. His objections were not satisfied merely by the placement of enforcement authority in the bank regulators; the Comptroller did not want national banks subjected to the Exchange Act disclosure requirements. The Comptroller raised two basic points. The first point related to the proposed role of the SEC as the primary enforcement agency under the original bills. That state of affairs was opposed on grounds of unnecessary agency overlap and the resulting confusion:

As the Federal official charged with the enforcement of the present laws governing federally chartered banks, I regard this proposal as both unnecessary and unwise, so far as national banks are concerned.

As many commentators have noted, banking, and especially national banking, today suffers from an overdose of overlapping statutes and jurisdictions.

In addition to the three existing Federal agencies and the Department of Justice, a fifth agency, the SEC is introduced into the picture. Under this proposal, four of these agencies would be issuing regulations, not necessarily the same, all in enforcement of the same four sections of statute.

14(b) of the Exchange Act would be amended. H.R. 1603, 99th Cong., 1st Sess. (1985). The amendments would subject banks and thrift institutions to rules similar to those governing broker-dealers in connection with the dissemination of proxy materials to shareholders. The rules will be administered by the SEC. Id.

90. *Id.* at 1356-60, 1367-70, 1375-77.
91. *See infra* text accompanying note 101.
Second, the Comptroller hinted that the disclosure required under the Securities Acts Amendments would interfere with the traditional policy of confidential supervision. This argument had two prongs. First, it was argued that, although more public disclosure was needed in the banking industry to protect investors, the proposed amendments required more disclosure than was necessary in light of existing regulatory supervision.

We consider disclosure of great importance..., but we consider our direct supervisory power over national banks of even greater value to the investor. No one can denigrate the direct supervision of banks as an effective means of public control. The continuous internal supervision, regulation and examination of national banks by our Office provides a protection to investors in banks which is far greater than that provided by disclosure alone. . . . This supervision provides protection for depositors and shareholders alike which is not available to investors in any other type of corporation.94

The second prong, while conceding the subjection of national banks to the disclosure requirements of the Exchange Act, subtly questioned the extent to which confidential supervision would be accommodated. A number of questions were posed regarding the impact of the disclosure requirements of the Exchange Act on the supervisory powers of the Comptroller. Three of those questions were:

3. Would the sponsors expect the banking agencies to follow the same general standards of disclosure as does the SEC?
4. For instance, would the banking agency have the discretion to designate any reports it might require under the bill as nonpublic files?
5. Specifically, would the banking agency have the discretion under the bill to deny to an inquiring journalist any such report filed by a bank, which might be in temporary financial difficulty?95

These questions express a notion that in the course of bank regulation there will be conflicts between the need for public disclosure to protect investors and confidential supervision to prevent bank failure. Regulators who are experienced and knowledgeable in the needs of bank regulation, therefore, ought to be given the discretion to resolve those conflicts. Furthermore, and perhaps most importantly, such conflicts must sometimes be resolved in favor of confidentiality. The Comptroller was troubled that the proposed amendments to the Exchange Act would mandate disclosure in all instances,96 and that a pro-disclosure regulatory agency would be responsible for administering and enforcing such regulation.

Congress' response to the Comptroller is most interesting. Section 12(i) did more than place enforcement of the Exchange Act with respect to banks in the federal bank regulatory agencies. Federal bank regulators were given the power to use disclosure standards different from those used by the SEC.

94. Id. at 1359 (emphasis added).
95. Id. at 1357.
96. Id. at 1356-60.
The Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation shall have power to make such rules and regulations as may be necessary for the execution of the functions vested in them as provided in this subsection and none of the rules, regulations, forms or orders issued or adopted by the Commission [SEC] pursuant to this title shall be in any way binding upon such officers and agencies in the performance of such functions, or upon any such banks in connection with the performance of such functions.97

The SEC, in responding the the Comptroller's objections, stated in no uncertain terms that the statutory language was designed to give the bank regulators unfettered control over disclosure requirements in the banking industry.98 The bank regulators were to have a free hand in developing disclosure standards that meshed with the objectives of bank regulation. The SEC's response, furthermore, clearly indicates that this power included the right to choose confidential supervision over public disclosure at times.99

Notwithstanding the Comptroller's apparent victory, if control over disclosure was in fact his goal, the language in the final version of section 12(i) was not the language sought by the Comptroller, who had proposed the following:

In view of the authority vested hereunder in the foregoing banking agencies, no rule, regulation, standard, interpretation, policy or pro-

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98. Hearings on Investor Protection, supra note 65, at 1362-63. The SEC responded to the objections of the Comptroller in its Memorandum:

The Committee also notes that the disclosure, proxy, solicitation, and insider trading provisions of the Securities Exchange Act of 1934 now provide, and would continue to provide under S. 1642, great discretionary authority for the administering agency to make appropriate rules, classifications, and exceptions. Under these provisions, the Federal bank regulatory agencies could adopt rules and forms differing from those of the Commission relating to companies other than banks, whenever the bank regulatory agencies deem it appropriate.

Indeed, . . . the Commission has disclaimed any desire to retain authority on bank disclosures.

. . .

In sum, the Commission has no desire, and is indeed reluctant, to take direct responsibility over bank disclosure in any respect.

Id. at 1363.
99. Id. at 1365. The SEC, in responding to the Comptroller's questions, stated:

The underlying purposes of the disclosure requirements of the proposed bills generally require that the information contained in required reports be made available to the investing public. Nevertheless, the Exchange Act expressly provides for confidential treatment in circumstances where the injury to the issuer caused by disclosure may outweigh the benefit to investors. Thus, section 24(a) of the act provides that nothing in the act shall be construed to authorize or require the revealing of trade secrets or processes. . . . Section 24(b) further provides that upon written objection to public disclosure of information contained in any such application, report, or document, the Commission may make such information public only if necessary in the public interest.

. . . Thus, pursuant to the provisions of section 24, such agencies could designate as nonpublic information contained in any reports required by it under the bills unless
procedure of the Securities and Exchange Commission issued heretofore or hereafter in connection with the enforcement and administration of the aforesaid sections shall be applicable with respect to any security issued by a national bank. 100

Under his version, the Comptroller was fighting for more than maintaining control of disclosure with respect to national banks in the Comptroller's office: the SEC clearly would have no role in the regulation of national banks. The Comptroller may have feared two possible consequences. First, disclosure, even for the protection of investors, would have a substantive impact on the regulation of banks. Second, that impact might be even greater if the pro-disclosure SEC were to play a significant role. The Comptroller was correct and lost both the battle and the war.

As one commentator pointed out shortly after enactment, the final version of section 12(i) gave the SEC a significant role in bank disclosure.

[Section 12(i) is not intended to affect the Commission's authority over bank securities existing prior to the Amendments Act. Thus, the Commission may enforce the antimanipulative provisions of section 9 with respect to bank securities. The Commission could also suspend trading in bank securities. . . . Furthermore, . . . the federal banking agencies are not vested with the Commission's rulemaking authority under section 14(b). . . . Moreover, the Commission seemingly has not lost its authority to impose conditions on exemptions from registration as a national securities exchange, even though the conditions may affect bank securities traded on an exempt exchange. 101

The debates in the legislative history did not dwell on the SEC's extant

it determined that public disclosure was in the public interest. Moreover, the bills would in no way affect the authority of Federal banking agencies to keep confidential reports required by it under any other law.

_id. See also supra text accompanying note 105.

The language used by the SEC dodged the Comptroller's question to some degree. The SEC seems to say that the federal bank regulators would have significant discretion to choose confidentiality over disclosure but the extent of that discretion is hedged. It uses terms such as "public interest" and "requirements" of other laws. The latter is interesting because, as previously discussed, the policy of confidential supervision is not required by any specific federal law unless, of course, the federal bank regulators' own regulations and practices constitute "other federal law." If the latter interpretation is correct, then the limitations on the discretion of the bank regulatory agency suggested by the SEC are not limitations at all.

Despite such semantic legerdemain, the SEC apparently could not avoid a definite response to Question 5 relating to an agency's discretion to deny disclosure to journalists.

Pursuant to the provisions of section 24(b) of the Exchange Act, Federal banking agencies would have authority to extend confidential treatment to deny an inquiring journalist access to a report filed by a bank pursuant to the bills unless it determined that public disclosure was in the public interest.

Hearings on Investor Protection, supra note 65, at 1365.

The "unless" clause does not reduce the significance of the concession made by the SEC, for the Comptroller was inquiring about instances in which a federal bank regulator deemed confidentiality to be in the public interest and disclosure to be detrimental to the public interest. 100. Id. at 1360.

role in the regulation of banks prior to enactment. As seen in Bank of America National Trust, that role included the power to investigate banks for violations of federal securities laws. Today, the SEC frequently conducts investigations after a bank has failed if it suspects the bank and its officers have disseminated false and misleading information about the bank’s financial condition to the public prior to the failure; those officers are prosecuted in appropriate cases. However, at the time of the debates, the impact of the SEC’s enforcement of federal securities laws violations may not have been perceived as significant. Moreover, the argument that violations of law should not be enforced by the SEC in bank cases, because enforcement would jeopardize the stability of the banking system, was assuredly a losing argument.

When Congress passed the Securities Acts Amendments, it formally opened the door for the use of disclosure; it did not call for the death of confidential supervision. This point is evidenced by the number of banks (600 of more than 13,000) immediately affected by the Securities Acts Amendments. A limited number of banks were affected because the amended Exchange Act, by virtue of its number of shareholder and asset size tests, only applied to relatively large banks. The limitations of these tests appear in the legislative history in a strong argument raised by the Comptroller. The Comptroller’s 1962 regulation that required disclosure used an asset size test which, according to the Comptroller, applied to 654 national banks. The Comptroller opposed application of the Securities Acts Amendments to national banks because the Exchange Act would require the Comptroller to apply its disclosure requirements to fewer banks. However, the Securities Acts Amendments did not have this effect. As the SEC correctly noted, the Comptroller remained free to adopt more stringent disclosure standards as well as to subject more banks to disclosure rules than required by the Exchange Act.

If Congress intended to abolish the confidentiality in confidential supervision (the Comptroller did not argue that Congress should), it could have mandated lower threshold requirements such as those used by the Comptroller in the 1962 regulation. It is quite possible that Congress realized that the regulatory objectives of the federal banking regulators and the SEC are different, both significantly and substantially. “The keystone of the entire structure of Federal securities legislation is disclosure” to investors so that they may make informed investment

102. 105 F.2d 100 (D.C. Cir. 1939). See supra text accompanying notes 71-74.
103. SEC v. Youmans, 543 F. Supp. 1292 (E.D. Tenn. 1982); see also Financial Corp. of America’s Auditor Questions Its Future as a Going Concern, Wall St. J., Apr. 2, 1985, at 2, col. 3 (revelation of SEC’s plan to investigate loan loss reserves); Midland, Texas, Bank Discloses Probes by U.S., Wall St. J., Oct. 6, 1983, at 2, col. 2 (disclosure that SEC was reviewing financial statements previously disseminated to public).
104. The SEC estimated that approximately 600 banks would be subject to the Exchange Act disclosure requirements as then proposed. Hearings on Investor Protection, supra note 65, at 1362. The source of the 13,000 banks figure is the Report of the Special Study, supra note 69, pt. 3, at 35 (a 300 shareholder test would have applied to approximately 1,000 of the more than 13,000 banks in the country).
106. See supra text accompanying note 63.
107. See supra text accompanying note 74.
108. Id.
decisions. A by-product of disclosure is an efficient market system. An efficient market occurs when buyers and sellers have full information. Thus, public disclosure is the means used to protect investors and provide efficient security markets. The SEC is not concerned that disclosure may cause a firm to fail or an entire industry to suffer. The SEC's job is to ensure that investors are able to minimize the harm to themselves by making informed investment decisions.

In contrast, the raison d'être of the Comptroller and other federal bank regulators is the maintenance of a sound banking system and the prevention of failures. It is universally recognized that public confidence in the banking system is absolutely essential to achieve those ends. The Comptroller, therefore, cares whether a regulated firm fails. If a bank regulator believes that disclosure of a bank's troubles will cause a bank to fail, when it might be saved by secretive maneuvering, then the bank regulator's duty to preserve stability and prevent failure dictates that the bank regulator seriously consider nondisclosure. An investor's inability to convert a poor investment to a safer investment because he lacks knowledge that the investment has deteriorated is an acceptable consequence to the bank regulator.

Actually, Congress handled these two conflicting regulatory perspectives in a very resourceful way through the Securities Acts Amendments. Congress, in essence, recognized that the SEC had thirty years of experience in regulating public disclosure, whereas the federal bank regulators had many years of experience regulating banks. A plausible explanation for the compromise contained in the Securities Acts Amendments is that Congress decided to let the bank regulators develop the use of public disclosure based upon what they determined to be the unique needs of banks. However, Congress also made it clear that it favored disclosure to protect investors.

The congressional compromise, however, did not close the book on the role of disclosure, or the role of the SEC in governing disclosure in the regulation of banks. In its wisdom, Congress vested the responsibility for regulating disclosure by bank holding companies in the SEC. This move does not appear

110. *Bank of America Nat'l Trust*, 105 F.2d at 104.
111. Confidential maneuvering is a fact of life for bank regulators. Most problems detected in the examination process by the federal bank regulatory agencies continue to be handled through informal agreements called Memoranda of Understanding that are not disclosed to the public. *Federal Response to Criminal Misconduct*, supra note 13, at 58. The FDIC takes the position that such agreements do not constitute material information. 50 Fed. Reg. 20,609, 20,610 (1985). The significance of that position is that even those banks that are subject to the Exchange Act are not required to disclose the agreements. The FDIC, in its capacity as enforcer of the Exchange Act disclosures by state-insured nonmember banks, does require the disclosure of the problems that led to the agreement. 50 Fed. Reg. 20,609, 20,618 (1985).
112. Section 12(g)(1) of the Exchange Act requires "every issuer," except the issuers of securities listed on national securities exchanges and certain other securities specified in section 12(g)(2), to register securities with the SEC, assuming jurisdictional prerequisites are met. 15 U.S.C. § 78l(g)(1),(2) (1982). Under section 12(a), it is unlawful for a member, broker, or dealer to effect transactions in any security on a national securities exchange, unless the security has been registered in accordance with section 12. *Id.* at § 78l(a). An "issuer" is defined under section 3(a)(8) as "any person who issues or proposes to issue a security . . . ." *Id.* at § 78c(a)(8). The term "person" is defined in section 3(a)(9) as "a natural person, company, government, or political subdivision, agency or instrumentality of a government." *Id.* at § 78c(a)(9). A bank holding company issuing a security on a national securities exchange, or issuing a security and meeting the section 12(g) jurisdictional
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to have been a point of debate in the legislative history. Neither the Comptroller nor the American Bankers Association objected to this decision. The absence of debate may reflect the fact that bank holding companies were the exception rather than the rule.113

Another disadvantage of section 12(i), raised by the Comptroller but not changed in the statute as enacted, was the possibility of the adoption of non-uniform disclosure standards by the federal bank regulatory agencies.114 After section 12(i) became law, the FDIC and Federal Reserve adopted regulations substantially similar to those used by the SEC.115 Only the Comptroller was out of step as he continued the use of his 1962 regulation modified to adopt the Exchange Act jurisdictional standards.116

The resulting state of affairs was predictable. Accordingly, Congress added the following language to section 12(i) in 1974:

In carrying out their responsibilities . . ., the agencies . . . shall issue substantially similar regulations and rules issued by the Commission [SEC] under sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16, unless they find that implementation of substantially similar regulations . . . are not necessary or appropriate in the public interest or for protection of investors, and publish such findings, and the detailed reasons therefore, in the Federal Register.117

This language was added, ironically, because of the confusion and the difficulty banks encountered in complying with the different disclosure requirements of the SEC and the Comptroller. By 1971, the Comptroller had received numerous complaints from practitioners and national banks concerning the difficulty of compliance with two sets of requirements.118 The growth of bank holding companies increased this difficulty.119 As a result, in 1971 the Comptroller proposed and adopted regulations that it considered to be substantially similar to those used by the SEC.120

If the SEC had assumed informally the dominant role in bank disclosure prior to the 1974 amendments, such action was now formalized with Congress’ blessing. The statutory language literally and structurally expresses a preference for the use of the SEC disclosure standards developed under the Exchange Act. If Congress did not intend to express such a preference, the “substantially similar” requirement becomes meaningless. Unless the disjunctive “or” in the

requirements, is subject to the section 12 registration requirements. Id. at § 78l(g). Securities issued by a bank holding company are not exempted under section 12(g)(2), and section 12(i) applies only to “securities issued by banks the deposits of which are issued in accordance with the Federal Deposit Insurance Act or institutions the accounts of which are insured by the Federal Savings and Loan Insurance Corporation.” Id. at § 78l(g)(2),(i). But see 15 U.S.C. § 78c(a)(34) where the “appropriate regulatory agency” for a bank holding company is the Federal Reserve for some purposes of the Exchange Act. Id.

119. Id.
phrase "in the public interest or for the protection of investors" also means the conjunctive "and," the language permits a bank regulatory agency to use a different standard if it determines that the SEC standard is not necessary or appropriate to protect either of two protected classes, the public interest and investors. Thus, an SEC regulation that was determined to be unnecessary or inappropriate to protect the public interest, although necessary or appropriate to protect investors, would be permissible.

However, it is difficult to imagine how such a case could occur. How could a regulation that was necessary or appropriate to protect investors not be necessary or appropriate to protect the public interest? The public interest, accordingly, must be measured by the effect on investors. The public interest may require more stringent disclosure standards than required by the SEC, or the public interest may require the classes of protected persons to be expanded, but it could almost never be in the public interest to adopt regulations that failed to protect investors adequately. Furthermore, the federal bank regulators may not adopt their own standards unless they publicly explain the reasons.

The 1974 amendment to section 12(i) may be viewed as Congress' recognition that the bank regulators were not experienced enough in the regulation of disclosure to have primary responsibility for its development, particularly because the structure of the banking industry was changing through the proliferation of bank holding companies. The 1974 amendment may also reflect that the risks to banking regulation, as the result of disclosure regulation developed by an experienced pro-disclosure regulator, were not as great as had been feared, a point acknowledged by the Comptroller in 1971. Congress, however, did not take the federal bank regulators out of disclosure regulation. Federal bank regulators retained their status as the primary administrators of bank disclosure regulation, but now were somewhat apprenticed to the SEC.

B. Development of Public Disclosure by Federal Bank Regulators

The Securities Acts Amendments required public disclosure in the context of bank regulation for the limited purpose of protecting investors. The use of public disclosure to protect depositors was delegated to the federal bank regulatory agencies to develop, if they so chose, in much the same way that the policy of confidential supervision evolved. The legislative history to the Securities Acts Amendments strongly suggests this freedom.

The Committee wishes to make it clear, however, that the provisions of S. 1642 are in no way to derogate from or to limit other provisions of law giving the Federal and State bank agencies authority to regulate banks within their respective jurisdictions. Thus, the bank agencies will have two statutory bases on which they can proceed.

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121. The converse does not yield the same result. It is conceivable that disclosure may not be necessary or appropriate to protect investors but would be necessary or appropriate in the public interest.
124. Hearings on Investor Protection, supra note 65, at 1362. The legislative history did not specifically focus on disclosure for the protection of depositors or other objectives of bank regulation.
Nevertheless, for nearly twenty years after the passage of the Amendments, the Comptroller and other federal bank regulators primarily directed their disclosure regulations to protecting investors.\textsuperscript{125}

Whether a market discipline oriented public disclosure system should be structured by the federal bank regulatory agencies or Congress becomes an important question. Congress does not seem to be disposed to take this task away from the regulators. Rather, Congress contently allows the bank regulators to assume the primary role in setting disclosure policies; Congress continues its role as a spectator, a role similar to the one played while the bank regulators established the policy of confidential supervision.

In light of the concerns about the effect of disclosure, allowing bank regulators, who have in fact gained considerable experience since 1964, to experiment may be a prudent decision. It may be difficult, if not impossible, for Congress to establish a comprehensive disclosure system for bank regulation that will not need frequent attention or remodelling. If Congress were to enact a very flexible statute, the federal bank regulators would have the same primary role that they now have. In fact, the authority of the federal bank regulators to experiment with disclosure may be considerably clearer than it was prior to the enactment of the Securities Acts Amendments.

One of the major advantages of post-1964 required bank disclosure is that federal bank regulators gained experience in developing compulsory disclosure in light of the needs of the banking system.\textsuperscript{126} Over the years the SEC has expanded the amount and types of information that bank holding companies (and indirectly the banks owned by them) are required to disclose.\textsuperscript{127} As the

However, when the Comptroller raised his straw argument about the Exchange Act limiting the Comptroller to requiring disclosure from fewer banks, the Comptroller and the SEC did debate the Comptroller's retention of power to subject a greater number of banks to the disclosure requirements than mandated by the Exchange Act itself. The focus of this debate, however, was on the includability of banks that would not otherwise be subject to disclosure under the Exchange Act rather than the protection of depositors and the preservation of the stability of the banking system.


\textsuperscript{126} See 36 Fed. Reg. 9522 (1971) (Comptroller acknowledges the experience gained concerning disclosure during the period 1964-1971). See also infra note 129 and accompanying text.

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SEC developed its bank holding company disclosure rules, it relied upon significant input from federal bank regulators, who generally have adopted substantially similar regulations with little deviation. In addition, Congress has expanded the degree and nature of information that must be disclosed in publicly available call reports.

Notwithstanding congressional action and the SEC's leadership, the erosion of confidential supervision by the federal bank regulatory agencies remains the most significant result of the experience gained by federal bank regulators with substantial systematic public disclosure. However, the existing disclosure systems, differentials, foreign operations and loan commitments and lines of credit. Required loan portfolio information includes information about lending practices that indicate unusual lending risks such as nonperforming loans, types of loans, foreign loans, maturities and sensitives to interest rates, industry concentrations, loans to foreign countries with liquidity problems, nonaccrual loans and troubled debt restructurings.


129. 30 Fed. Reg. 362 (FDIC), 396 (Federal Reserve) (1964). Two deviations were made apparent when the Comptroller amended the regulations to conform substantially to those adopted by the SEC after the amendment of section 12(i) of the Exchange Act. Pub. L. No. 93-495, § 105(b), 88 Stat. 1500 (1974) (codified at 15 U.S.C. § 78l(1) (1982)). First, national banks were not required to submit financial statements certified by independent certified public accountants. 40 Fed. Reg. 10,602 (1975). Second, disclosure of income and revenues according to material lines of business or material classes of similar products and services was not required. Id. The primary bases for the former deviation were the extensive supervision by the Comptroller, the relatively small number of banks affected and the significance of the cost of obtaining certification to these banks. Id. The Comptroller estimated that the cost of certification for a bank with $200 million in assets would approximate 1% of net income. Id. The primary basis for the latter exclusion was the limited number of lines of business which national banks could conduct by law. Id.

A problem that has been a historical source of deviation between the regulations adopted by the SEC and the federal banking regulators has been the format of financial statements. All FDIC-insured banks are required to submit call reports. 12 U.S.C. § 1817 (1982). The format of the call reports may differ in some respects from the financial statements that the SEC requires of nonbanking companies. For practical reasons, the federal banking regulators have refused to adopt the SEC approach in all circumstances. A recent episode occurred when the SEC amended its Regulation S-X, 17 C.F.R. § 210 (1984), in 1979 to require the use of a "net interest margin" format. The Comptroller, the FDIC and the Federal Reserve declined to follow the SEC and adopt the format for call reports. 46 Fed. Reg. 9618, 9619 (1981) (Comptroller); 45 Fed. Reg. 65,184 (1980) (codified at 12 C.F.R. § 206.7) (Federal Reserve); 45 Fed. Reg. 60,885 (1980) (codified at 12 C.F.R. § 335.7) (FDIC).


131. The current disclosure system for banks is two-tiered. The first tier consists of those banks that are subject to the Exchange Act disclosure requirements and accordingly that disclose considerable amounts of information directly to large numbers of investors, or through the information gathering mechanisms that are available in the securities markets, i.e., brokers and investment advisors, although not necessarily all the information that investors would consider material. See infra note 154. The second tier consists of those banks that are not subject to the Exchange Act disclosure requirements and that disclose considerably less information directly to the public. The information that is available is contained in published Reports of Condition and other call reports such as Reported Income, copies of which may be obtained from the federal banking regulatory
of which the federal bank regulators are quite proud,\textsuperscript{132} may be labeled more appropriately "public accessibility systems" insofar as banks not subject to the Exchange Act reporting requirements and their depositors are concerned. As a practical matter, depositors must take affirmative steps to obtain information from the regulators and banks.\textsuperscript{133} More information, in fact, must be given to shareholders (those who place wrongdoers and imprudent managers in a position to do harm) than to a large class of relatively innocent victims.\textsuperscript{134}

Without question, the federal bank regulators, particularly the FDIC and the Comptroller, are initiating the most interesting developments in bank disclosure systems today.\textsuperscript{135} The FDIC pioneered the use of disclosure to supplement traditional bank regulation with market discipline and the Comptroller is considering a uniform disclosure system as a major tool in its regulation of national banks. These developments have occurred because of the expanding exposure of the FDIC, the growing numbers of bank failures,\textsuperscript{136} the failure of confidential supervision to prevent a wave of bank failures unprecedented since the Depression, the perception that confidential supervision may have been a contributing factor,\textsuperscript{137} and the current significance of purchased deposits, relative to retail deposits, to the stability of the banking system.\textsuperscript{138}

1. The Federal Deposit Insurance Corporation

Spurred by the Penn Square Bank failure,\textsuperscript{139} the FDIC began the study and utilization of market discipline to supplement its traditional regulatory supervision practices.\textsuperscript{140} The market discipline doctrine contemplates that a bank that has

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  \item agencies. See 49 Fed. Reg. 28,566 (1984) (to be codified at 12 C.F.R. ch. 1) (proposed June 25, 1984) (Comptroller of the Currency); 12 C.F.R. § 309.5 (1985) (FDIC). In a further development, the Comptroller requires national banks, regardless of size, to disclose material information when making a public offering of securities. 12 C.F.R., pt. 16 (1985). The information required is similar to that made by nonbank issuers under the Securities Act. In any event, most information that is available to depositors can only be obtained by them or their representatives exercising their right of access to such information.
  \item 133. See supra note 131.
  \item 134. Banks are required to disclose information regularly to shareholders under the Exchange Act.
  \item 136. See generally Federal Response to Criminal Misconduct, supra note 13.
  \item 137. \textit{Id.}
  \item 139. The failure of the Penn Square Bank of Oklahoma City in 1982 had severe repercussions for numerous financial institutions such as Continental Illinois National Bank & Trust Company, Chase Manhattan Bank, N.A., Seafirst, and several other bank and thrift institutions that had participated in energy loans with Penn Square or placed deposits with it. The management of Penn Square and many of the participating banks had generally engaged in lending practices without adequate regard for the risks involved.
  \item 140. See Proposed Statement of Policy Regarding the Availability and Use of Financial and Other Information by Depositors and Other Creditors of Banks and Thrifts, 49 Fed. Reg. 26,809
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to disclose its troubles to depositors will take steps to prevent or minimize the occurrence of those problems. If problems do occur, the bank will take prompt corrective action in order to continue to attract and retain deposits. The discipline involved is the swift hand of depositors who decide to withdraw their funds or place them elsewhere based upon the depositors’ evaluation of disclosed data.

Unlike the purpose of disclosure in federal securities regulation, the protection of bank depositors and other creditors is a by-product of market discipline. Market discipline utilizes the informed depositors’ perceived proclivity to maximize profits and minimize losses to encourage bankers to engage in prudent banking practices, so that ultimately a safer and sounder banking system will emerge.

Market discipline depends primarily on depositors who have uninsured deposits.\textsuperscript{141} Theoretically, depositors with large uninsured deposits are at risk, and must rely on their own decisions to place or withdraw funds to protect themselves.

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\textit{The Corporation’s Board of Directors has determined that the public availability of the above-mentioned reports will assist in maintaining public confidence in the Nation’s banks. Such availability will also serve the salutary purpose of permitting equal access to basic financial information by all shareholders of insured State non-member banks and all depositors in such banks, whereas presently access to such information may be limited to a select group of insiders. Public access to the information contained in the reports will also provide greater competition . . . [and] greater incentives for banks with a consistently poor performance to correct their problems . . . .}
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\textsuperscript{141} The Comptroller has recognized functional similarities between traditional investors and uninsured depositors. “The Office [of the Comptroller] is concerned that the disclosure system for national banks provide adequate information to permit informed decision making by participants in the marketplace, including uninsured depositors.” 49 Fed. Reg. 28,566 (1984) (emphasis added).

In fact, other than technical legal distinctions, there is virtually no difference. See also Friedman & Friesen, supra note 138, at 456-57, in which authors equate uninsured certificates of deposits to debt instruments issued by nonbank companies and argue that banks should be subject to the same disclosure requirements in connection with the issuance thereof as nonbank issuers.

The FDIC, on the other hand, concentrates on depositors in general and does not expressly target uninsured depositors.

Critical to the process of increasing marketplace discipline is an informed public. In order to work toward this objective, the FDIC proposes to issue a statement of policy that encourages depositors and other creditors to periodically request information that would facilitate prudent judgments in evaluating the financial condition of depositary institutions. The policy statement describes the minimum information that the FDIC believes relevant to the decisions of depositors and other creditors regarding the placement of their funds.

\textit{Id.} (emphasis added).

As a practical matter, however, because the FDIC approach places the burden on depositors to seek out information and be willing to pay for it, a burden one might more readily expect of depositors whose economic interests more closely resemble or are identical to owners or traditional investors, its policy also primarily contemplates uninsured depositors. Whatever notions the FDIC has had about a disclosure system providing equal access to all depositors, it is clear that market discipline as currently debated focuses on those depositors at risk in the banking system. Although the FDIC continues to refer to disclosure for depositors in general in its pronouncements of policy, 49 Fed. Reg. 28,566 (1984), its attempts to structure risks without toppling the banking system focus on uninsured depositors. 50 Fed. Reg. 19,088, 19089 (1985).
Insured depositors, on the other hand, are protected against loss by insurance, regardless of whether they resort to self-help. Another strong disincentive to participation by insured depositors is the transaction cost in time and money that would be involved in obtaining constant information and transferring funds from one bank to another. Accordingly, insured depositors probably would not participate in market discipline even if they received full disclosure in a timely manner. Historically, similar protection has been provided to uninsured depositors through the use of purchase and assumption transactions. If this protection were removed, uninsured depositors would have interests similar to those of shareholders and other investors protected under federal securities regulation.

It is essential to market discipline that uninsured depositors resort to self-help measures. Presumably, they will not do so unless they have sufficient incentive, \textit{i.e.}, they are at risk. Moreover, they must have an opportunity to take protective measures. Therefore, they must have sufficient timely information as a basis for deciding how best to protect themselves. The FDIC has attempted to develop and continues to study the development of appropriate risk levels for uninsured depositors, and a systematic disclosure system for banks whose deposits are insured by the FDIC. The systematic disclosure system is the focus of this Article.

The initial approach of the FDIC concentrated on increasing the amount of information flowing to the public, including both investors and depositors. This was accomplished by providing access generally to all portions of Reports of Condition and Reports of Income, including portions that are not required to be published by statute, but which are generally available to anyone willing to pay a search and photocopying fee. Public availability, nevertheless, was subject to the FDIC's right to withhold information that it believed to be too sensitive for public viewing or otherwise not permitted to be disclosed.

The FDIC has now begun upgrading the quality and nature of information disseminated in existing disclosure devices. In 1984, it issued a proposed policy statement "designed to encourage depositors and other creditors to request information about the financial condition of depository institutions" and "to encourage the public to use that information when making decisions regarding

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  \item[142.] Generally, a depositor’s deposits are insured up to $100,000. 12 U.S.C. §§ 1728, 1813 (1982).
  \item[144.] The FDIC has recently requested comments on two alternative proposals to impose market discipline on the risk-taking activities of insured banks. The first alternative is a modified deposit payoff system to be used in the case of a failed bank pursuant to which uninsured depositors would receive the present value of net receivership collections from outstanding loans at the same time as insured depositors were paid off. 50 Fed. Reg. 19,088, 19,089 (1985). If actual collections exceeded estimated collections, uninsured depositors would receive additional amounts, but if collections fell short, uninsured depositors would not have to reimburse the FDIC. \textit{Id.} The second approach calls for an increase in the capital requirement for insured banks over a number of years to about 9%. \textit{Id.} at 19,088, 19,090. The idea behind this approach is that a bank in good financial health would be able to borrow on a subordinated basis to meet the capital requirements. \textit{Id.} The effect of the first alternative is to increase the risk of uninsured depositors; in the second alternative, investors in subordinated debt are asked to assess the risk of investing in the bank.
  \item[145.] 47 Fed. Reg. 39,130 (1982) (codified at 12 C.F.R. § 309.5); see supra note 140.
\end{itemize}
the placement of their funds.\textsuperscript{147} The FDIC also indicated what it considered to be the minimum information relevant to the decisions of depositors regarding the placement of their funds.\textsuperscript{148}

The proposed policy statement primarily relied on the use of call reports and other reports already prepared for the federal bank regulatory agencies. Thus, the preparation of new reports by a bank would be minimized. The policy encouraged voluntary bank disclosures that would be triggered by requests from depositors and other creditors. In addition to information already provided in call reports, banks would be requested to provide a narrative discussion relating to capital adequacy, asset quality, earnings, liquidity, concentration of risk, interest rate sensitivity, foreign lending exposure, formal administrative enforcement actions and informal supervisory actions taken by a bank regulatory agency, and transactions between a bank and related parties.\textsuperscript{149} The proposed policy statement as of this writing had not been finally approved and was still under consideration.

2. The Comptroller of the Currency

The Comptroller currently is studying changes to the disclosure system applicable to national banks. He has requested comments on four major areas: general characteristics of an effective disclosure system; types of information not currently disclosed that should be disclosed; whether administrative enforcement actions should be disclosed; and cost and benefits of increased disclosure.\textsuperscript{150} The stated motivation for the Comptroller's action is that the traditional bank regulatory scheme inadequately handles the challenges presented by technological advances, deregulation of the banking industry, and the offering of expanded financial services by national banks.\textsuperscript{151}

Similarly to the FDIC, the Comptroller also concludes that some dosage of market discipline may cure the deficiencies of the supervisory oriented regulatory scheme. However, the Comptroller may not agree with the FDIC on the size of the dosage. The Comptroller does agree that market discipline means the increased use of disclosure in the context of bank regulation.\textsuperscript{152}

However, the Comptroller is much more cautious regarding the implementation of market discipline. In his Request for Comments, the Comptroller raised a number of questions already addressed by the FDIC. The questions for which the Comptroller sought answers focused on whether the banks or the bank regulators should have the duty to make information public; the appropriate form and method of disclosure; the timing of disclosure; the economic impact on banks, particularly small ones; and the disclosure of specific types of information, the most notable of which is information regarding administrative enforcement actions.\textsuperscript{153} This Article does not attempt to provide definitive answers


\textsuperscript{148} Id.

\textsuperscript{149} Id. at 26,810.

\textsuperscript{150} Id. at 28,566.

\textsuperscript{151} Id. at 28,567.

\textsuperscript{152} Id. at 28,566.

\textsuperscript{153} Id.
to these questions. Instead, proceeding free of the assumption that market discipline provides the proverbial physician's prescription, this Article examines issues that may affect critically the viability of the use of disclosure to achieve market discipline.

3. A Market Discipline Oriented Approach

Market discipline and public disclosure may be very good ideas, but the use of public disclosure for the primary purpose of effectuating market discipline presents some troublesome problems in designing the disclosure system. The ultimate objective of market discipline is the enhancement of public confidence in, and the stability of, the banking system. That objective, rather than the protection of depositors, is also implicitly the objective of the use of public disclosure. Furthermore, disclosure experience in the context of securities regulation may prove to be inadequate not only because of differences in regulatory objectives, but also because of structural differences between the bank deposits market and the securities markets. Accordingly, the builders of a public disclosure system must find answers to several perplexing questions if public disclosure is to become a viable tool in preserving public confidence and the stability of the banking system. These issues may be overlooked by policy makers and others who find the need for public disclosure obvious, and therefore, no longer question the need. Four of the more critical questions are discussed below.

The first critical question relates to the use of the perceived proclivity of uninsured depositors to protect themselves. The hypothesis underlying this role of uninsured depositors assumes that the placement of fund decisions by uninsured depositors and similarly situated other creditors will provide sufficient market discipline to maintain appropriate levels of stability in the banking system. This hypothesis, although readily accepted, remains untested. Could the dependence on uninsured depositors and other creditors result in the aggressive pursuit of insured retail and brokered deposits by banks to reduce the impact of market discipline? Will insured depositors unwittingly short circuit the process by acting hastily on rumors because accurate information has failed to reach them or because of their uncertainty about the information that they do receive?

It is not necessarily a disadvantage that current regulatory developments appear to be directed at uninsured depositors. In addition to the conventional wisdom that insured depositors have little incentive to participate in market discipline, policy makers may not target insured depositors because of logistical considerations in disseminating information to insured depositors. In the securities markets, brokers and investment advisors perform information gathering functions for both sophisticated and nonsophisticated investors. The average insured

154. See Friedman & Friesen, supra note 138, at 455-57, in which the authors are willing to accept abandonment of the nondisclosure approach where large commercial banks are concerned, something Congress did in 1964, as discussed elsewhere in this article. Large commercial banks are already subject to periodic disclosure because federal bank regulators play a significant role in determining what matters are sufficiently important to be deemed material so as to require disclosure. For example, Memoranda of Understanding entered into between a federal bank regulatory agency and a bank are still considered not to be material information by bank regulators. See infra note 160 and accompanying text.

155. Comment, Broker Investment Recommendations and the Efficient Capital Market Hypothesis: A Proposed Cautionary Legend, 29 STAN. L. REV. 1077, 1078, 1081-83 (1977); see also infra note 156.
bank depositor generally does not use intermediaries to place deposits or provide financial advice in connection with the placement of a deposit. Thus, a disclosure system directed at such depositors would have to ensure that a considerable degree of material information was disseminated in a manner that did not require substantial effort by depositors. Such a system could be quite expensive to operate.

There are, however, other reasons for not targeting insured depositors. One such reason may be a belief that such depositors eventually will attain access to publicly available information through media coverage of material disclosures. Furthermore, policy makers may be influenced by the notion, based upon intuitive cost considerations, that a disclosure system need not guarantee insured depositors immediate access, at least in the developmental stage, because of the fact that they are insured.

If insured depositors are to be targeted, placing the responsibility for disclosure on the regulators offers one means of providing disclosure to them. Two advantages of regulator-effected disclosure are that the prospective recipients of disclosure would not have to find the information on their own, and the costs of the system would be borne either by the taxpayers or among all banks. A significant problem with requiring the regulators to disclose, however, is that regulators may be exposed to liability for having failed to disclose information that subsequently is found to be material. Nevertheless, liability might be

156. Even if a public disclosure system were designed to channel information to insured depositors, the absence of an exchange and trading system in the bank deposit markets like that available in the securities market may result in transaction costs of a magnitude that prevents the participation of insured depositors on a regular basis. However, participation on a regular basis is probably not desirable. Participation by insured depositors may be desirable only in those cases where matters have gotten out of hand or where a bank may circumvent the market discipline process by reducing its exposure in uninsured deposits.

A deposit brokerage system currently exists, but only in the developmental stage, particularly with respect to uninsured depositors with less than $100,000. Seward & Zaitzeff, Insurability of Brokered Deposits: A Legislative Analysis, 39 Bus. Law. 1705, 1712-13 (1984). With respect to the placement of deposits for uninsured institutional investors, deposit brokers do, perhaps, serve an information-gathering function. Seward and Zaitzeff indicate that those depositors have been served by deposit brokers since the early 1960s but only placed money in relatively large banks and thrifts. Id. at 1713. An explanation for that result is that it was easier for the brokers to obtain information about those financial institutions. They further indicate that after the removal of interest rate ceilings on deposits in excess of $100,000, it was possible for deposit brokers to serve depositors, not by gathering and evaluating information before placing deposits, but by splitting deposits into insurable units and depositing them into several institutions so that all of the funds are insured. Id. at 1713. This ability attracted both institutions and individuals desiring safety and high interest rates.


158. Generally, the statutory duty of supervision conferred upon federal bank regulatory agencies does not impose a duty of care running in favor of the supervised banks, their shareholders or depositors. First State Bank of Hudson County v. United States, 599 F.2d 558, 563 (3d Cir. 1978); Harmsen v. Smith, 586 F.2d 156, 158 (9th Cir. 1978); In re Franklin Nat'l Bank Sec. Litig., 478 F. Supp. 210, 215 (E.D.N.Y. 1979); Social Sec. Admin. Baltimore F.C.U. v. United States, 138 F. Supp. 639, 640 (D. Md. 1956). The rationale in these cases has been that the purpose of bank examination and the supervisory process is primarily the general protection of the public, the national economy and the FDIC insurance fund. In re Franklin Nat'l Bank Sec. Litig., 478 F. Supp. at 215.

If the bank regulatory agencies were required to disclose material information in their possession about the banks that they regulate for the use of depositors, uninsured or otherwise, courts may
avoided if regulators lacked discretion in making the disclosures or if they were given a statutory shield from liability. Unless the information to be disclosed was specified to limit the discretion of the regulators, regulators might disclose too much meaningless information at an unnecessary cost or they may fail to disclose information that they believed should be disclosed but was not specified. Disclosure of information not specified would open a window of discretion and potential liability.

The possibility of regulator abuse may be a more significant problem with a regulator-effected disclosure system. Bank regulators could use the process to punish banks that do not get along very well with the regulators, or to persuade banks to accept recommendations of regulators without resistance, regardless of the merits of the recommendations.59

In any event, policy makers should not underestimate the potential viability of insured depositors in market discipline. Insured depositors may be just as interested as uninsured depositors in making prudent placement of fund decisions, especially in light of the insufficiency of the FDIC insurance fund to cover more than a fraction of all deposits in the banking system.60 The fact that direct disclosure to all depositors may be more costly or more difficult to effectuate is no reason not to consider it in developing a market discipline mechanism. While it may be appropriate to reject the development of a system on that basis, it is not appropriate to overlook the insured depositor because of notions of costliness.

The second critical question is whether all banks will be required to make disclosures or whether distinctions will be drawn on the basis of size. The Exchange Act, as noted above, uses an asset size and shareholder number test, thus requiring disclosures only from relatively large, publicly owned corporations. In addition, the Comptroller’s 1962 regulations prescribed a $25,000,000 asset size test that applied to a significant number of national banks (but far less than all national banks).61 The FDIC’s Proposed Policy Statement would apply to all insured banks. That policy, however, merely encourages depositors and other creditors to seek information and banks to provide depositors with in-

be willing to impose liability. Even though the overall purpose of the disclosure would be for the protection of the public, the economy and the banking system, the specific objective of disclosure would be to enable depositors to protect themselves through prudent placement of deposit decisions. The depositor, who makes placement-of-deposit decisions based upon information disclosed by a bank regulatory agency that did not disclose information that a court subsequently determined to be material, certainly has a strong policy argument for liability. The courts have, in fact, suggested that there may be exceptions to the general rule. Id. at 216. Although the misled depositor does not necessarily fall into categories of suggested exceptions, the equities involved may make such a case an attractive setting in which a court would make an exception.

160. Insured banks are assessed an annual premium for insurance coverage, payable in semi-annual installments. Premiums are based upon deposits. Consequently, the FDIC’s insurance fund, even with earnings, is only a tiny fraction of the amount of deposits held by insured banks. The current assessment rate is 1/12 of one percent of a bank’s deposits as of the date of assessment. 12 U.S.C. § 1817 (1982). More than 80% of all domestic deposits held by insured banks are actually insured. 50 Fed. Reg. 19088 (1985).
161. 27 Fed. Reg. 12,811 (1962). Any test excluding banks from a disclosure system on the basis of size would result in a debate over the appropriate cutoff point. If the idea is to protect small banks, policy makers must grapple with the definition of a “small bank.” One may question whether the Comptroller’s old $25,000,000 asset test is still an appropriate measure.
formation beyond that required to be made public or otherwise available to the public by bank regulatory agencies. The FDIC’s policy with respect to the disclosure of final administrative enforcement orders, however, applied only to those banks to which the FDIC has the power to issue them: insured state-chartered nonmember banks. The Comptroller, as previously stated, sought guidance on the issue of whether distinctions should be drawn between banks with respect to disclosure requirements.

A disclosure system that applies to all banks would be consistent with the concept of market discipline. If the objective of market discipline is to preserve the stability of the banking system and prevent failure, a compelling justification must exist for excluding any bank from the system. Likewise, if depositors are to make informed placement of fund decisions, providing them with information about some banks, but not others, can only be justified by reasons of similar weight. A disclosure system that does not provide information about small banks, while providing information about large banks, could result in less public confidence in small banks and, therefore, the loss of deposits.

Notwithstanding the value of including small banks in a disclosure system, a system that requires them to incur substantial compliance costs may be unduly burdensome, a factor that Congress requires the bank regulatory agencies to consider. If the Comptroller or the FDIC uses its rulemaking authority to restructure the disclosure process for market discipline, the Regulatory Flexibility Act would require them to evaluate the impact of such regulations on small banks. Unless an agency can certify that a proposed or final rule will not have “a significant economic impact on a substantial number of small entities,” the agency must perform a small business economic impact study, an endeavor akin to an environmental impact study. Thus, to the extent that a disclosure system utilizes devices in addition to or different from those in the current system, Congress has mandated that federal bank regulatory agencies be especially mindful of the impact on small banks.

Profitability and soundness problems resulting from burdensome compliance costs may occur even though bank management engages in sound banking practices. The general benefits of disclosure to the banking system in such cases would be outweighed by the harm to the stability of the banking system. Small banks are particularly vulnerable to this effect. Such banks need not be excluded, however, from disclosure requirements that do not require them to incur burdensome direct costs. The FDIC’s approach in its Proposed Policy Statement utilizing existing disclosure mechanisms does not appear to impose substantial additional costs on small banks or banks in general. Regulator-effected disclosure is another possibility.

The third critical question relates to uniformity. The Comptroller objected to the Securities Acts Amendments because of the possibility of nonuniform regulation, a result that might occur because each of the federal bank regulatory agencies would have the authority to develop its own, and perhaps unique,
disclosure system. The Comptroller's own experience with disclosure regulation, pursuant to the Securities Acts Amendments, demonstrated that the lack of uniformity among bank regulators can be both an inefficient means of achieving regulatory goals and an imposition of additional compliance costs on the regulated entities.

Although the bank regulators (and the SEC) cooperate with each other with respect to Exchange Act disclosures, the policies and approaches of the federal bank regulatory agencies may still vary. For example, the FDIC's Proposed Policy Statement and its new policy of disclosing final administrative enforcement orders were proposed unilaterally. Under the Proposed Policy Statement, national banks and state banks, respectively regulated by either the Comptroller or the Federal Reserve, were also affected. On the other hand, the policy regarding administrative enforcement orders applied only to state nonmember banks. Moreover, the Comptroller continues to develop a separate public disclosure system for national banks. If the federal bank regulators continue to develop disclosure regulation in this manner, the result may be one of confusion, higher compliance costs, and ineffective disclosure.

Many questions regarding uniformity may be solved by adopting the recommendations of the Task Group on Regulation of Financial Services relating to the reorganization of the federal bank regulatory apparatus. Under the recommendations, the number of federal bank regulatory agencies would be reduced to two, primarily based upon whether a bank is state or federally chartered. A new "Federal Banking Agency" which would include the Comptroller and the FDIC, would regulate national banks, and the Federal Reserve "should be responsible for federal regulation, supervision and examination of state-chartered banks." Although overlap would be alleviated significantly, a costly compliance situation could occur if substantially different systems resulted so that the quality and format of disclosure depended upon whether a bank was state or federally chartered. Moreover, the SEC would still control disclosure by bank holding companies with respect to securities regulation.

The Comptroller and the FDIC, the federal bank regulators with the most expertise in disclosure regulation, would be in one agency; thus a uniform disclosure policy between those two agencies would be assured. However, the

166. Hearings on Investor Protection, supra note 58, at 1359. The problem of nonuniform disclosure requirements continues to be very real. Two commentators have pointed out that not only is it possible to have nonuniform requirements among the federal bank regulatory agencies, but within a single agency as well. Coombe & Lapic, Problem Loans, Foreign Outstandings, and Other Developments in Bank Disclosure, 40 Bus. Law. 485, 490 (1985). They also point out that the Federal Financial Institutions Examinations Council has alleviated problems somewhat by facilitating the adoption of uniform reporting requirements by the federal bank regulatory agencies. Id. at 491. See also supra, note 29.


171. Id. at 71.

172. Id.

173. Id. at 76.
Federal Reserve traditionally has followed those who have the expertise in the particular disclosure area, i.e., the SEC with respect to disclosure for the protection of investors. In addition, if the Federal Banking Agency developed disclosure regulations to achieve market discipline, the Federal Reserve’s past history indicates that it would follow the Federal Banking Agency’s lead. Because the market discipline approach remains in a formative stage among federal bank regulators, the Federal Reserve might play a substantial role in its development.

The Task Force attempts to resolve many areas of overlap among the federal bank regulatory agencies, but it apparently leaves unresolved the historical disputes between the federal bank regulators and the SEC regarding financial reporting requirements. Under current law, a bank holding company subject to the Exchange Act reporting requirements must submit financial statements to the SEC in accordance with SEC rules, while the subsidiary bank must submit Reports of Condition and Income to its bank regulatory agency under the rules of that agency. This dispute underlines the fact that the extant disclosure systems for banks have developed by accident in a piecemeal fashion.

The fourth critical question of the market discipline oriented approach asks whether all or substantially all material information should be disclosed. The current debate over the disclosure of administrative enforcement proceedings exemplifies this issue. Historically, bank regulators have been reluctant to resort to formal administrative enforcement powers, even after Congress granted more expedient powers in 1966. That reluctance may also be explained in terms of the traditional fear of bank panics. The mere initiation of administrative enforcement proceedings amounts to a determination by bank regulators, at the very least, that a bank is being operated in such an unsound, imprudent manner that if it is not now in unhealthy financial circumstances, it soon will be. Indeed, it would be a surprise if any enforcement proceeding initiated by bank regulators ever ended without a final order or action adverse to the bank involved. Thus, the confidentiality of such proceedings and actions would be consistent with and expected under a policy of confidential supervision.

Attention is focused on administrative enforcement actions because the disclosure of such actions results in more than the provision of information to depositors for them to evaluate. Such disclosure constitutes an announcement by the bank regulatory officials that they have determined that a bank is operating in such a manner that the risk of loss of deposits, by uninsured depositors at least, is unacceptably high. Depositors need not evaluate the health of the bank upon receiving that message. They should proceed to impose discipline by withdrawing their funds from the bank. The FDIC now takes the position that market discipline should be triggered in such circumstances upon commencement of formal enforcement proceedings.

174. 46 Fed. Reg. 9618 (1981); 45 Fed. Reg. 65,184 (1980); 45 Fed. Reg. 60,885 (1980). Since the call reports are now publicly available, the question remains whether two sets of financial statements prepared under different formats confuse or enhance the public’s ability to evaluate the bank and bank holding company.
176. The announcement amounts to regulatory discipline rather than market discipline. Depositors who withdraw their funds at this point are helping the regulators effect discipline upon the bank.
The FDIC, in compromise to vigorous criticism of its proposal to disclose administrative enforcement proceedings upon issuance of the notice of initiation, decided to disclose only final enforcement orders. This compromise, as well as the decision not to disclose the names of banks that enter into Memoranda of Understanding, and therefore are able to avoid formal action, raises the question of whether a disclosure system that does not disclose, or appears not to disclose, material information will maintain public confidence in the banking system. One of the major objections to the FDIC policy was that the public, upon hearing that one bank was in trouble, would attribute those troubles to all banks in a community. Such attribution may be more likely if the public perceives that all material information has not been disclosed.

The handling of this issue by the FDIC, the Comptroller, other federal bank and financial institution regulators, and, perhaps, Congress will tell much. Under current practices and proposals, examination reports and Memoranda of Understanding are not disclosable. The regulators face the challenge of convincing depositors and the public that the available information provides an adequate basis upon which to make prudent placement of funds decisions. Unless the regulators meet the challenge successfully, depositors may perceive correctly that the degree of information available about a bank depends upon arbitrary factors such as the bank regulatory agency supervising it, the type of enforcement action taken, the bank’s size, and similar factors. Depositors may form the opinion that adequate information is available about some banks but not others. Banks on which adequate information is not available may incur fatal withdrawals in the short run before the regulators can correct the situation. The federal bank regulators or Congress could help solve this problem by clearly delineating the extent of confidentiality so that depositors would know the nature of the information being withheld.

4. The Need for Public Disclosure

Most of the current debate on market discipline accepts the utilization of public disclosure as a primary tool in bank regulation and centers on the specifics of potential disclosure systems. Another presupposition is that such disclosure will be achieved through a mandatory systematic and continuous disclosure system. The development of such a disclosure system would, after all, be a logical extension of the federal bank regulators’ tutelage under the SEC. Nevertheless, the proponents of market discipline and mandatory disclosure, unlike

178. Id.
179. Id.
180. Id. at 20,617. In addition, federal bank regulators do not disclose or require a bank to disclose that it has been recommended for “problem bank status.” Problem bank status means that a bank is placed under close supervision. The basis for not requiring disclosure is that the circumstances causing the bank’s troubles are material but not the fact of recommendation. FDIC Releases PR-104-77 (Dec. 21, 1977), PR-28-78 (Mar. 21, 1978), [1973-1978 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 97,380. The same logic applies in connection with the lack of disclosure of Memoranda of Understanding. The circumstances leading to the enforcement action are material but not the enforcement action itself. 50 Fed. Reg. 20,609, 20,617 (1985). Oddly, the FDIC encouraged depositors to ask for, and banks to disclose, the existence of formal and informed enforcement actions in its Proposed Policy Statement. 49 Fed. Reg. 26,809, 26,810 (1984) (proposed June 25, 1984).
the supporters of the 1930s securities legislation, should be compelled to demonstrate the need for both. Market discipline, after all, is founded upon many empirical assumptions, not the least of which is that the fear of disclosure of negative news will result in more prudent banking decisions.

While market discipline may be inevitable, its effectiveness is less evident. Policy makers should not underestimate the revolution in bank regulation that market discipline will ignite. Perhaps the most underestimated issue in the development and enforcement of market discipline oriented disclosure is the extent to which bank regulators will continue to consider the principal premise justifying confidential supervision: the fundamental imperativeness of public confidence to sustain the stability of the banking system. Bank regulators indoctrinated with that idea have developed a paternalistic psychology that may have to undergo drastic change as a prerequisite for the effectiveness of market discipline oriented disclosure. Realistically, bank regulators, charged with responsibility for the stability of the banking system, are unlikely to willingly implement harsh penalties to compel a bank to make disclosures for the sake of disclosure.

Those who expect market discipline to be a panacea for the ills of the banking system may be disappointed. Recent events have demonstrated the validity of the fears that led to the development of confidential supervision as well as the need for more public disclosure. Public disclosure of a bank’s troubled financial condition does not cause the bank’s troubles; the troubles necessarily must have begun before disclosure. Nor will public disclosure save a troubled bank. Public disclosure can and does result in rapid and substantial withdrawals, thereby accelerating the deterioration of the bank’s financial condition.

The First National Bank of Midlands and Financial Corporation of America.

183. “In the early 1960’s the banking industry and the bank regulators enjoyed a far more informal, even symbiotic, relationship that grew out of the banking collapse of the Depression.” Federal Response to Criminal Misconduct, supra note 13, at 142. In the debates over the FOIA, the federal bank regulators supported the exemption for bank examination reports set forth in 5 U.S.C. § 552b(c)(8) (1982).

But the problem of public confidence in fiscal soundness was not the only one brought to the attention of Congress. Mr. Bloom [Chief Counsel to the Comptroller] also stressed that disclosure of “examination, operation, and condition” reports would “be grossly unfair and in violation of basic principles of competition,” that it would jeopardize the privacy of bank officials, and that it would “make bankers most reluctant to cooperate with our examiners and seriously hamper the Comptroller in the exercise of his assigned duties.”


185. Financial Corporation of America (FCA), the parent company of the giant, but troubled,
debacles illustrate the problems caused by rapid withdrawal. In each case, a steady but not overwhelming withdrawal of funds began before full disclosure of the institution's financial condition. Immediately after full disclosure, those institutions incurred substantial (and in the case of First National Bank of Midland, fatal) withdrawals of deposits. Although Financial Corporation of America did not fail, it lost millions of dollars of deposits over a relatively short period of time.

In spite of the problems that may arise after the public disclosure of adverse news, rumors cannot be stopped. That rumors cannot be stopped has been demonstrated by the First National Bank of Midland\textsuperscript{186} and Continental Illinois Bank & Trust Company\textsuperscript{187} failures. Thus, the fact that rumors cannot be stopped provides a compelling reason for the use of systematic public disclosure in the banking system, but not necessarily for the use of market discipline. A bank finds it virtually impossible to operate without something about its operations falling into public view. For example, if a bank suddenly increases its borrowings from the Federal Reserve, that fact becomes public information. If a major borrower files for bankruptcy, the bank will be identified as a major creditor in court documents available to the public. In such instances, the argument that the public does not need the complete picture because of its general inability to evaluate the full facts becomes meaningless. In all probability the public does try to evaluate the bank's situation in such circumstances. If the public is not given full information, the likelihood of a flawed evaluation becomes much greater than when the public has complete information.

American Savings & Loan Association (AS & L), was required by the SEC in August 1984 to restate its earnings for the second quarter of 1984 as a $79.9 million loss instead of a $75.3 million profit. The SEC disagreed with the method adopted by FCA in accounting for approximately $2 billion of mortgage-backed securities. AS & L had bet the rent that mortgage interest rates would go down and entered into fixed rate mortgages. When interest rates continued to rise AS & L's cost of funds exceeded its return on its mortgages. Over $500 million was withdrawn in July 1984 prior to the SEC action, perhaps fueled by the Continental Illinois National Bank & Trust crisis. See infra note 187. In April 1985, FCA posted a $512 million loss for the fourth quarter of 1984. For details of the severe drain on deposits and financial health of FCA, see Financial Corp. of America's Auditor Questions Its Future as Going Concern, Wall St. J., Apr. 2, 1985, at 2, col. 3; Financial Corp. of America May Receive a Federal Guarantee for All Depositors, Wall St. J., Aug. 30, 1984, at 3, col. 2; New Top Lineup Set by Financial Corp. of America, Wall St. J., Aug. 23, 1984, at 2, col. 2; Financial Corp. of America Debt Put on Credit Watch, Wall St. J., Aug. 22, 1984, at 6, col. 3; Financial Corp. of America Sells Large Holding, Wall St. J., Aug. 21, 1984, at 2, col. 2.

186. See supra note 184.

187. Continental Illinois National Bank & Trust Company (CINB), one of the ten largest banks in the United States, had been battered over a two-year period due to the hard economic fortunes of its major borrowers, its exposure on loans to Latin American countries, and the Penn Square nightmare. Despite considerable public disclosure on CINB's part, there is some question about whether it fully disclosed the extent of that battering. In any event, rumors of its imminent demise started in the spring of 1984 and then the roof came tumbling down. CINB blamed the rumors for its problems, but information regarding the full extent of its problems tended to confirm the rumors. Institutional depositors began a major run on the bank by withdrawing certificates of deposits prior to maturity or by not renewing them as they matured. For details, see FDIC, in a Bail-out of Continental Illinois, Would Buy $4.5 Billion in Problem Loans, Wall St. J., July 24, 1984, at 3, col. 2; FDIC Will Get Nonvoting Stock in Continental, Wall St. J., July 23, 1984, at 3, col. 1; The Continental Scare, Newsweek, May 28, 1984, at 52; Continental Decline Not Swift, Am. Banker, May 21, 1984, at 24, col. 3; Continental Seals Its Lips on Rumors, Am Banker, May 11, 1984, at 1, col. 3.
Public disclosure must be systematic and continuous because disclosures made after adverse news has reached the public domain are more likely to confirm the severity of the adversity. Sudden disclosure may then accelerate the deterioration of the bank's condition because depositors increase their withdrawals upon the confirmation of adverse effect. The bank may have to confirm that its condition has deteriorated after information first reached the public domain, but before full disclosure, as a result of withdrawals by depositors acting on the leaked or rumored information.

Moreover, rumors founded upon incomplete and inaccurate information in the public domain can be more dangerous than systematic disclosure. If a bank fails as a result of a rumor-created run, depositors may speculate that the entire banking system is not telling the truth. Fearing the unsoundness of the entire system, depositors may withdraw funds from the system itself, rather than merely transfer funds from one institution to another.

Even if a systematic and continuous disclosure system is utilized, how depositors, insured or uninsured, participate in market discipline can also be affected by other regulatory policies, particularly those pertaining to deposit insurance. A sudden disclosure may result in the ultimate discipline of institutional death because depositors are unwilling to allow a bank the time to cure its problems. Depositors, including insured ones, may react in a similar manner if they perceive that deposit insurance will not cover their funds.

The Ohio savings and loan moratorium and the Maryland savings and loan deposit withdrawal restrictions were imposed as the result of depositor uncertainty regarding the ability of state deposit insurance funds to pay off insured deposits in state-insured savings and loan associations. The Ohio situation occurred when Home State Savings Bank failed as the result of a run following a public disclosure that it would incur substantial losses from transactions with E.S.M. Government Securities, Inc., a Florida securities dealer that was closed by the SEC. When Home State Savings Bank failed, the potential deposit payoff to its depositors by the state deposit insurance fund would have almost exhausted the fund. Depositors in other state insured thrift institutions began a run on their institutions. The Maryland deposit restrictions resulted from runs on its state-insured savings and loan associations as a reaction of depositors to the Ohio crisis.


189. See supra note 188.
In the final analysis, the issue really is how are bank regulators to retain public confidence, an essential ingredient in the stability of the banking system, while informing the public of bank problems? This is a short-run problem. Market discipline, if it is to have the desired effect, will be effective as a long-run proposition. Sudden disclosure of a bank's ills will not prevent its failure. Market discipline can effectively complement traditional supervision only through systematic and continuous disclosure (whether voluntary or mandatory). It will then be effective only if the resulting depositor reaction to disclosure causes management to adjust its policies and practices to maintain the confidence of its existing and potential depositors.

It is entirely possible, and perhaps likely, that once market discipline oriented disclosure systems are in place, they will result in the revelation of heretofore unknown problems in many banks, particularly those not subject to the Exchange Act. The public may not only withdraw funds from those institutions but may also believe that the problems are endemic to the whole banking system and withdraw funds from the system itself resulting in a contraction of deposits similar to the events of the Depression. If only the problem institutions are to fail, their failure must be managed very carefully to prevent a collapse of the system. With that thought in mind, the FDIC is giving careful consideration to its crafting of the risk to which depositors are to be subject.190

V. Conclusion

Confidential supervision, created by federal bank regulatory agencies and embraced by Congress, is no longer the linchpin of bank regulation in the United States, although it has not yet been replaced by market discipline and full disclosure. The jury has merely begun its deliberations on whether bank regulators who have been oriented toward a paternalistic supervisory system, the major purpose of which is to prevent failure and preserve stability, can reconcile enforcing public disclosure in a system that must tolerate some failure in the short run. Federal bank regulators have now obtained a significant degree of experience in regulating disclosure to protect investors under the guidance of the SEC. However, fifty years have passed since Congress first decided that banks ought to be required to disseminate information about their affairs to investors for their protection. Congress has never mandated the dissemination of information to depositors. Neither Congress nor the federal bank regulatory agencies have articulated clearly the appropriate mixture of public disclosure and confidential supervision, if indeed there is one.

If market discipline and its necessary usage of public disclosure are to enhance the stability of the banking system, the policy makers who craft those tools must determine finally the extent to which confidentiality is necessary to achieve public confidence, the bedrock of stability. Attaining public confidence in the short run becomes critical because market discipline is a long run proposition and will not prevent failure in the near term. Perhaps the proper role of public disclosure in bank regulation is not the effectuation of market discipline but the generation of public confidence in a sound banking system.191

190. See supra note 144.
191. Immediately prior to the publication of this article the Comptroller of the Currency and
On October 30, 1985, the Office of the Comptroller published for comment model comprehensive disclosure rules. 50 Fed. Reg. 45,372 (1985). The proposed rules provide for annual and quarterly reporting by all national banks without regard to size. In addition, the proposed rules would require banks to disclose certain specified or other material events within fifteen days after they occurred. Id. at 45,373. The rules are patterned after the existing rules for banks and bank holding companies subject to the Securities and Exchange Act of 1934. It should be noted that the Comptroller adopted the final amendments to its Securities Exchange Act disclosure rules which became effective on December 30, 1985. Id. at 45,276.

The Comptroller hoped that improved disclosure would "serve to decrease the likelihood that rumors would have a significant impact on banks." Id. at 45,374. In addition, investors and depositors may gain a better understanding of the banking system, the manner in which banks operate, and the financial soundness of banks.

The Comptroller’s summary discussion referred to investors and depositors, but did not otherwise distinguish between insured and uninsured depositors. With respect to administrative enforcement proceedings, the rules would require the disclosure of both final orders and the issuance of notices of administrative enforcement actions against banks, their directors, officers, employees, agents, or other persons participating in their affairs. Id. at 45,374, 45,384.

Subsequent to publication of the Comptroller’s proposed rules, the FDIC delayed the effective date of its policy on the disclosure of final administrative enforcement actions until July 1, 1986, in order to work with the Comptroller on a uniform disclosure approach. Id. at 52,557.