

*Consolidation file*

March 10, 1948.

Board of Governors

Proposal to Centralize

Mr. Cherry

Bank Supervision in FDIC

In the Audit Report to Congress covering an audit of the FDIC by the Comptroller General, it is recommended that full powers to examine all insured banks be centralized in the FDIC. It also recognizes that this question may be extended to cover the larger question of the concentration in the hands of one agency of all Federal supervisory powers over banking activities. It is interesting to note that the Comptroller General recommends that these powers be given to FDIC on condition that he be authorized to continue his annual audit of the Corporation. The report also recommends that Congress increase the members of the Board of Directors of the FDIC to five, one of whom should be the Chairman of the Board of Governors of the Federal Reserve System; that the prior approval of the FDIC be given before any insured bank reduces its capital stock and before it establishes a new branch; and that Congress adopt a uniform definition for "bank deposits" to be used throughout the Government.

This report has just recently been filed, and copies are not available at this time. However, I have examined the report and there are attached hereto excerpts explaining in further detail the proposals mentioned above.

The Senate Committee on Expenditures to which the Audit Report was referred has not taken action with respect to the legislative proposals. This office will keep in close touch with this matter, however, and advise the Board promptly of any developments.

*AKC*

Attachment

EXCERPTS FROM THE AUDIT REPORT TO THE CONGRESS COVERING THE AUDIT  
OF THE FDIC FOR THE FISCAL YEAR ENDED JUNE 30, 1946, BY THE  
COMPTROLLER GENERAL OF THE UNITED STATES

SUPERVISION AND EXAMINATION OF BANKS

3. It is our opinion that the bank examinations of insured banks by the Government should be centralized in one Federal agency. The main objective of centralization would be to create a uniform approach to the philosophy of examinations for deposit insurance purposes through the direct supervision by those familiar with such principles, and the establishment of a uniform examination which will incorporate a consistent policy for the appraisal of bank assets and management in every insured bank. Such examination should be made sufficiently inclusive to provide data necessary to determine if the insured bank is complying with the requirements of other Federal agencies in carrying out the Government's credit and monetary policies.

According to present Federal banking laws the responsibility for the examination of insured banks is assigned to three banking agencies, namely: the Comptroller of Currency, for 5,012 national and district banks; the Board of Governors of the Federal Reserve System for 1,872 State member banks; and the Federal Deposit Insurance Corporation for 6,642 State non-member banks. The only Federal agency having dealings with, and a vital financial interest in, the sound condition of each of the 13,526 insured banks is the Federal Deposit Insurance Corporation. The prime activity of this Corporation is the examination of banks in order to protect its resources, foresee its potential losses before they assume greater proportions, and sustain the public's confidence in the banking system as a whole with a view toward preventing its collapse at a time of financial stress. Therefore, with such a large responsibility the Corporation should be privileged to determine, at its discretion, the status of its deposit insurance risk without being subject to the administrative decisions of another agency.

After consideration of the main objectives of each of the agencies existing under the present Federal banking legislation, it is recommended that paragraphs (2), (3), and (4) of subsection (k) of section 12B of the Federal Reserve Act, as amended, be amended to provide the Corporation with full powers to examine all insured banks. (However, this recommendation would be contingent upon the adoption of our recommendation on p. 3 with respect to continuance of the audit of this Government-owned and controlled corporation.)

It is realized that the question of centralized examination of banks by the Federal agency may be extended to cover the larger question of the concentration in the hands of one agency of all Federal supervisory powers over banking activities, including deposit insurance.

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7. It is also suggested that the number of members of the Board of Directors might be enlarged from three to five members -- in conjunction with our recommendation to permit the Corporation to examine any insured bank, one of the two additional members should be the chairman of the Board of Governors of the Federal Reserve System--in order to afford the character of coordination with that banking activity that exists in the case of the Comptroller of the Currency, who is a member of the board.

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9. We also recommend that the Congress adopt a uniform definition for bank "deposits" to be used throughout the Government by those Federal agencies whose regulations are applicable to banking institutions. Our observations revealed that there is an urgent need for a uniform definition of bank "deposits" in order to relieve the confusion now caused by the application of existing decisions on the subject by the Federal Reserve banks for calculation of reserve requirements for member banks; by Federal Deposit Insurance Corporation for insurance assessment base purpose; and by the Bureau of Internal Revenue, Treasury Department, for the establishment of special funds in trust for the United States for withholding tax purposes. Up to the year 1943 the dollar liability for social security taxes withheld by the bank was not serious, but in recent years the requirement of the Current Tax Payment Act of 1943 to withhold Federal income tax has increased this liability. From an accounting standpoint, a considerable number of man hours are lost in recomputing the deposits for various needs of the Federal agencies and this situation could be avoided by application of a uniform definition of bank "deposits" for the use of all governmental agencies.

APPROVAL BY FDIC OF PLANS FOR RETIREMENT OF CAPITAL STOCK, ESTABLISHMENT OF BRANCHES BY INSURED MEMBER BANKS, AND OTHER MATTERS

10. Under the provisions of paragraphs (4) and (5), subsection (v) of section 12B of the Federal Reserve Act, as amended, the Federal Deposit Insurance Corporation can require only State nonmember banks to obtain prior written consent of the Corporation before reducing the amount or retiring any part of their common or preferred capital stock or before establishing and operating any new branch. In conjunction with our recommendation to permit the Corporation to examine any insured bank, we recommend that the Corporation's power under the above provisions be extended to all insured banks.

11. It is our opinion that the Corporation should be equipped with the necessary authority to determine for itself, in any member bank, the adequacy of the capital structure, the future earnings prospects, the general character of management, and the convenience and needs of the community to be served by the bank and, in addition, should possess the power to enforce its

decision for the purpose of protecting the deposits in the insured bank. At the present time this authority vests in the Federal Reserve Bank System (for State member banks) and the Office of the Comptroller of Currency (for national banks), yet the desirability that the Corporation have an opportunity to pass upon these matters for itself must be recognized.

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5. The cooperation and coordination which exists with the Federal Reserve System in State member bank examinations and the Comptroller of the Currency in National bank examinations, including the adequacy and promptness of submission of pertinent data relating to problems in these banks.

In addition, our review covered a discussion with representatives of the Comptroller of the Currency and the Federal Reserve Board concerning operating procedures, mutual problems, and the manner in which such problems are coordinated with responsible personnel in the Corporation.

Our verification of the policies, procedures, and information obtained from the above conversations was undertaken by a study of the examination reports, review of memoranda of recommendations of the board of review, correspondence, bank progress charts, and other supporting data on selected bank examinations. We did not include a review of the mutual savings banks examination reports in our test, since the Corporation was in the process of changing the procedures on this type of examination. The scope of our review on each examination is outlined below.

Our selection included at least one of each of the following types of examinations:

1. Regular.
2. Application for deposit insurance.
3. Unsafe or unsound practices.
4. To reduce the risk of or avert a threatened loss to the Corporation.
5. Consolidations or mergers.
6. Retirement of capital.
7. Establishment of branches.

In our selection we included, in addition to operating banks, those closed insured banks which were selected for our examination of the Division of Liquidation. Both the operating and closed insured banks included national, State member, and State nonmember banks.

We selected eight nonmember banks and reviewed the reports of the original examination when the bank applied for insurance, and the reports of

regular examinations made at various intervals, to determine the quality of the reports submitted by the examiners, the problems disclosed, the examiners' conclusions and recommendations, and the corrective action taken. In this regard, we reviewed the correspondence to ascertain the degree of cooperation between the Corporation and the State banking authorities in solving the problems of the particular bank. On those banks which were closed, we reviewed the final examination report before closing to ascertain the condition and circumstances which caused the bank to be closed.

As stated on page 18 the Corporation derives its information relating to the condition of State member banks and national banks from copies of reports of examination made by the Federal Reserve System and the Office of the Comptroller of Currency, respectively. These copies of reports are loaned to the Corporation for the purposes of extracting therefrom information deemed essential to the Corporation for its purposes.

In order to determine the completeness and adequacy of the information obtained by the Corporation with respect to conditions prevailing in State member and national banks, we reviewed data extracted by the Corporation's review examiners and compared this information with the respective examination reports in the case of 8 State member banks and 12 national banks which were made available to us in the offices of the supervisory agencies.

In those cases where a review of examinations indicates the desirability for corrective action, the Corporation notifies the respective supervisory agency of such conditions either orally or by letter. We have been informed that the Corporation is notified orally of any corrective action taken but the Corporation has not been furnished with copies of correspondence to the member banks concerned. Any confidential reports prepared by the examiner of the supervisory agency are made available to the Corporation for their use.

Copies of such correspondence and these confidential reports were not made available to us for our examination and, consequently, we are unable to satisfy ourselves that the Corporation is exercising adequate control and follow-up of these segments of its insurance activities.

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