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THE PERPLEXING PAPER PATH

Address by

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Federal Deposit Insurance Corporation

before the

75th Annual Convention
Colorado Bankers Association

~~Broadmoor Hotel~~
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We are all frustrated by the extent to which government interferes with our businesses, and the extent to which we are required to complete government forms and maintain government records. I am just as frustrated about it as Chairman of a governmental agency as you are. What can be done about it?

The quantity of paper crossing my desk as Chairman of the FDIC is overwhelming. I have asked our Management Systems Office to review the paper flow across my desk and have discovered that I will receive to review and respond to, on an average, 28 letters, memoranda, reports, Congressional inquiries, Board of Directors cases, etc., each day throughout each year of my term. In addition, I will have 10 separate items per day for my signature and my secretaries will handle 75 phone calls per day, many of which will pass through to me. By itself, that's a large paper load; when you consider the problem created by an absence from the office for a few days, it's an overwhelming load. Clearly, something has to be done about the flow of work across the desk of the Chairman of the FDIC and I am in the process of doing something at the present time.

I know that each of your desks has more than enough work on it but I hope that you have had a better plan for resolving the paper load problem than we have had. I know you also generate paper since some of the paper I receive consists of letters from banks complaining about the volume and complexity of reports they are required to file with the FDIC. Some of it consists of proposals originating with our staff or with the Federal Reserve suggesting additional surveys to be collected from banks. Some of it consists of correspondence from the Office of Management and Budget and the Commission on Federal Paperwork asking what I am doing to meet my obligations to reduce the flow of Federal paperwork. The President has directed each agency head to reduce the reporting burden from the public by 10 percent this year. And some of it consists of letters from me to the chief executive officer of the nonmember banks in the country carrying a message about a new regulation or policy statement or some continuing request for data from the banks.

When I began writing this speech, I had in mind discussing my desire to reduce the amount of time and money banks have to spend complying with governmental regulations and reducing the paper banks have to submit to Washington. As I attempted to write this, however, I found that I could offer very little besides desire when it comes to reducing governmental regulations. Congress and the agencies are under great pressure from a great variety of groups (including banks) to pass legislation or promulgate regulations to correct real or perceived abuses. When legislation is passed by Congress, regulations frequently must be promulgated by the agencies to implement the legislation. The FDIC, therefore, promulgates regulations and issues policy statements, and will continue to, as will the Comptroller of the Currency, the Federal Reserve, the Federal Home Loan Bank Board, and everyone else. I wish I could be more optimistic, but I can't. Pressure groups are simply too well organized, concepts of appropriate business activity have changed, the government is accepted (rightly or wrongly) as the answer to difficult problems, and abuses in banking continue to surface.

I then decided to discuss some of the reports required by the FDIC; the utility of these reports to banks; what, if anything, the Corporation can do to reduce the number of reports submitted to it or to reduce the cost and difficulty of preparing them; and finally to make some comments about the inordinately high error rate, the tardiness of report submissions, and statutory penalties that the Corporation will begin invoking for continued grossly inadequate or tardy reporting. Since these comments are not all good either, I decided to wind up with a comment or two on ways the Corporation has attempted to speed its decision processes by delegating to our regional offices and by expediting handling within the Corporation. At least that should be good news.

Turning to reports, we should look first at the Reports of Condition and Reports of Income which comprise the major part of the FDIC's reporting and statistical operation. Each insured bank prepares Reports of Condition four times a year, and a Report of Income, starting this year, twice each year. This amounts to over 85,000 reports coming to Washington each year, or six per bank.

You are all familiar with these Reports since each of your banks has been submitting them for years and years and since the Reports resemble the financial statements which all of you must prepare annually for one purpose or another. Originally, the information on the individual Reports of Condition and Income was used primarily by the FDIC to monitor the collection of assessments of insured banks. For all bank regulatory agencies, State and Federal, they comprise the basic information we receive on individual banks between periodic examinations. If it were not for our ability to follow the progress of some banks on this basis, more frequent examination or other supervisory procedures would be necessary. This supervisory use has been increasing since these routine Reports of Condition and Income are the basic raw material for efforts at the FDIC and other agencies to design "early warning" or statistical surveillance systems. This increasing use as an ongoing supervisory tool demands accuracy and timeliness of the data.

In addition to our own use of these data, we have been able to prepare statistical reports for all banks -- e.g., providing data on a variety of operating ratios, comparing each bank with other banks in the same state or smaller geographic area, etc. -- that have been used by many others. These comparative reports have been received enthusiastically by the banks (particularly by the banks that come off well in the comparisons), and bankers seem to be making increasing use of these data for analysis of their own operations, the operations of correspondent banks, and the operations of banks they deal with in the Federal funds market. Again, these comparisons are valuable only if the data are timely and accurate.

Aggregate data compiled from these Reports (and many other reports) have been an important part of the financial information relied on by the

Federal Reserve in carrying out monetary policy. The aggregate statistics are also used by other government agencies for a variety of purposes. More recently, particularly since both Reports became publicly available in 1972, the use has multiplied. Now bank asset and liability and income information is also used by:

* banks that wish to know how their competitors are doing;
* financial analysts and market researchers in banks and universities;
* consulting firms, bank associations, and reporting services who buy computer tapes of these data, perform their own analyses and offer these analyses for sale;
* bank stockholders interested in their investments; and
* corporate treasurers seeking information on which to base their selection of banks as depositories or lenders.

Last year, for example, we filled 1,250 individual requests for Reports of Condition and Income involving a total of 24,000 documents. About half of these requests came from banks, but individuals (particularly lawyers) also asked for these Reports in sizable numbers. As of the end of May this year, we had filled 820 requests involving over 16,000 documents, significantly higher than the comparable period last year. Forty-three of these requests originated in Colorado and covered primarily Colorado banks. Clearly, there is interest in the Reports of Condition and Income.

I have been continually amazed at the volume of errors made by banks in completing these required Reports. Some of these errors may be due to the complexity of the reporting requirements, or to the inadequacy of our instructions, but neither complexity nor inadequacy on our part can explain the following amazing facts culled from State nonmember Reports filed for the December 31, 1975, Call:

* 112 Reports indicating that the banks were operating without any currency or coins or without common stock,

* 1,184 banks reporting that they were operating without any employees, and

* 2,400 banks indicating either that they had income on their Income Report from assets that their Report of Condition indicates that they did not have, or that they had no income from earning assets that their Report of Condition showed them as holding.

By far the most common errors in the Reports are mathematical or mechanical. That is, totals that do not equal the sum of the subtotals, or an item in the Report of Condition not agreeing with the same item in the Report of Income. For example, banks report total capital as of year-end in both the Income Report and the Report of Condition. Obviously, accurate reporting would find total capital the same in both Reports but we have hundreds of banks that report a different figure in the two Reports. Almost half of all errors handled by our staff are of this sort.

In total, out of the 8,600 insured nonmember commercial banks that submitted Reports of Condition and Income to us at year-end 1975, */ no less

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*/ National banks submit their Reports to the Comptroller of the Currency, State member banks submit theirs to the Federal Reserve System. The FDIC ultimately processes data from all the banks on its computers. Error rates for all banks appear to be about the same as the error rate for State non-member banks.

than 54 percent of all the Reports of Condition, and 84 percent of the Reports of Income failed to pass one or more of the initial tests in our verification procedures. The total number of edit messages (potential errors) came to 51,318 for year-end 1975 Reports of Condition and Reports of Income. Both the banking industry and the FDIC should be embarrassed by that number -- the banking industry because its members are submitting such sloppy Reports, and the FDIC because it has tolerated such reporting.

Let me emphasize that the largest single category of errors was mathematical or logical errors, errors which only a modest amount of care and concern on the part of the reporting banks could eliminate.

Not only is the information we get on Reports frequently in error, it is also frequently late. Currently, the Report of Condition is due within ten days after the Call date, and the Report of Income is due thirty days after the end of the reporting period, a backwards order for reporting if I have ever seen one -- more about this latter. For year-end 1975, 481 banks were delinquent in submitting one or more of the Reports at the end of January (the final Report did not come in until 73 days after year-end). Of course, the vast majority of banks do report reasonably promptly, but even a small number of delinquent Reports can cause serious delays in processing since errors are often found on the delinquent Reports, and that means further delays for corrections.

It makes very little sense for us to publish any data before we have received all of the Reports from all of the banks. As of the present time, data from our Condition Report and Income Report are published approximately four months after the date of the Call; if all banks were to report within thirty days correct information on both Reports, we could publish that data within fifty days of the Call, cutting the time lag in half and saving thousands and thousands of dollars.

I recognize that the reporting requirements of the Report of Condition and the Report of Income are rather complex, and they have tended to become more complex over time. To some extent, that is a reflection of some change in the use of the Reports from a statistical one to one of serving as the basic public financial Report of the bank. This has led us to change the accounting required in the direction of "generally accepted accounting principles." Some of these changes have added complexity, and have led to complaints from banks. We received quite a volume of complaints a few years ago, for example, when we required that banks with over $25 million in assets prepare their Reports on the basis of accrual accounting. Many banks in the affected size range complained that accrual accounting was just too complicated for them. I confess that I find it difficult to feel a great deal of sympathy with the management of a $25 million bank, that is in the business of making loans and analyzing the financial statements of borrowers, claiming that accrual accounting is too complicated.

It was adherence to generally accepted accounting principles that led us to require a breakdown of the loan loss reserve into a valuation portion, a deferred liability portion, and a contingency portion. There I concede that the accounting and the accompanying tax calculations have become complicated. We have also added additional detail on types of loans and maturity distribution of securities that have increased the reporting burden on the banks. For the most part, however, I feel that the information required in the Report of Condition and the Report of Income is information that the banker should have in order to run his bank effectively. Some bankers complain, for example, about our requirement that the bank, even if it is operating on a cash basis, must estimate the taxes due on its current year's income. It seems reasonable to conclude, however, that in order for the bank to make correct investment decisions, it should know what its current tax position is and what the tax implications of financial decisions are.

The situation I am describing has existed for a long time. In the past, for whatever reasons, the FDIC has overlooked this problem. But now, when much more intensive use is made of these financial data, both within the banking agencies and outside, we feel that it no longer can be overlooked.

Recognizing that we must continue to receive Reports of Condition and Reports of Income, we plan to schedule the reporting in a logical way and to give the banks sufficient time so that we can reasonably expect prompt and accurate Reports. One of the difficulties for the banks is our current requirement that the Report of Condition be submitted within fifteen days after the end of the quarter -- a rather tight schedule. We give banks thirty days to complete the Report of Income, which appears to be more generous, but the conscientious banker recognizes that a Report of Condition as of year-end cannot be completed accurately until after the bank has completed its Report of Income. That is, there are many year-end income adjustments that must be reflected in the year-end Report of Condition. These requirements are illogical, and I see no reason to continue them. Effective with the June 30 Reports, I am proposing that we set a uniform date for submission of both Reports, thirty days from the end of the reporting period. Both the Report of Condition and the Report of Income, therefore, for the June 30, 1976, period will be due by the end of July. I believe that is a reasonable period, and if banks are delinquent in meeting that requirement, we intend to pursue the penalties provided by the Federal Deposit Insurance Act which authorizes us to levy a fine of up to $100 per day for each day a Report is delinquent. The Comptroller of the Currency recently announced his intention to follow this procedure, and indicated that a fine of $6,600 had been levied on a national bank that was flagrantly and repeatedly late in submitting its required Reports.

Some action must also be taken to reduce the number of errors in the Reports of Condition and Income, and we intend to take the following steps to improve the accuracy of Reports submitted:

1. Improve the format and instructions of the Reports. We are considering, for example, whether it would be productive to have different instructions for smaller banks (those $25 million or less in assets) or whether it would be productive and reasonable to have different Reports for such banks.

2. We have contacted the Bank Administration Institute and are trying to arrange for meetings involving our staff and their officers to solicit their suggestions for improving the instructions and forms.

3. We plan to solicit comments from all banks through a questionnaire mailed with the June Reports.

4. We are installing a toll-free telephone number that a bank may call for assistance in completing or correcting Reports.

5. We would like to consider, although we recognize the extreme difficulty of this, adopting an agreement among all the bank agencies that there would be no change on the Reports more frequently than every five years. Banks would have the benefit of working with the same forms for an extended period, and suggestions for changes by the agencies would have to stand the test of the passage of a reasonable period of time. Frankly, the possibility of getting such an agreement seems slim to me, although I personally would support it, at least until an exception came along that I'd like to make.

We believe all of these suggestions or actions would minimize the cost both to banks and the agencies by reducing the time spent on completing and correcting these Reports. Obviously, it would also put the data into the public domain much faster. If those carrots don't work, however, we will consider either fining those banks up to $100 per day whose error rate is so high as to constitute no filing, or proceeding against such banks under Section 8 of our statute.

The FDIC and the other agencies cannot be successful without the help of the industry. Banks must believe it is important to complete the Reports accurately and promptly.

To summarize, we suggest that some major steps for improvements in the quality of the Reports of Condition and Income are needed at this time. The errors in the Reports submitted appear to be primarily the result of carelessness, but the design of the forms, the instructions given, the assistance provided, and the attention given to promptness and accuracy by the agencies may have a bearing on the matter.

I have reviewed other reports required to be sent to the FDIC in addition to Reports of Condition and Income. While preparing these other reports and the surveys occasionally taken does involve some burden and some staff time, I think the burden is exaggerated by most banks. First of all, many of our surveys are conducted on a sample basis. This may not be much consolation to the bank included in a sample, but we have different samples for each survey, so that if your bank is included in one, it is probably not included in several others. Only a total of about 42 banks in Colorado, for example, are included in any of our sample surveys. Others, of course, may be included in the surveys by other agencies.

Second, in many of our surveys, the information is relatively simple for the bank to provide, though I recognize that just typing up the report form is some burden for some banks.

Third, much of the data we are asking for in these surveys is information the banker should have to manage his bank effectively and, therefore, probably does have or can find profitable use for once it is prepared. While we ask the banker to report the information, for example, we think there is great utility to him in knowing the maturity distribution of his municipal portfolio, or the amount of his time deposits in different maturities, or the market value of his trust department's assets. Since he probably already has and uses such data, it's not onerous to report it to the FDIC.

It is a mistake to assume that all surveys and statistical reports are imposed by the agencies on a reluctant and resisting banking industry. There are some reports and surveys which we conduct which the banking industry has either initiated or strongly supported. Let me mention just a couple of these. Several years ago, the American Bankers Association commissioned a sizable research project, carried out by Arthur D. Little & Company, to investigate the ability of the banking system to handle the rising volume of paper checks in the future. Subsequent to that survey, the ABA asked the FDIC to conduct follow-up surveys, which we did and have continued to do. While this information is of some interest to the FDIC, it is not considered vital by us and we could reduce the burdens which we are putting on responding banks by elimination of this survey. We do plan to reduce the frequency of this survey to every second or third year.

Another example is a survey we did a couple of months ago on the volume and rate structure of IRA and Keogh accounts. Many bankers have been very unhappy about the current interest rate ceiling structure which has been applied to IRA accounts as well as all other accounts. This rate structure, as you know, gives savings institutions a quarter percent rate advantage. In an account that is going to be maintained for 20 or 30 years, a quarter point interest rate differential is very significant. Commercial bankers feel they are unable to compete with savings institutions for IRA accounts, and that their customers are put at an unfair disadvantage as compared with customers of savings institutions. To determine whether the bank share of such accounts is really being adversely affected by the interest rate differential, the banking agencies conducted a survey of both banks and savings institutions. We got strong support from the banking industry for conducting this survey, and I might add, a very rapid response. This seems to be illustrative of the fact that where bankers can see some payoff to their institution from a survey, there is support for it and a willingness to cooperate. We hope to encourage the same support and rapid response for all of our reports.

Some reports are collected for the use of other agencies. For example, we collect detailed and extensive monthly data from a sample of banks on the volume of mortgage loans extended. These data are collected as part of the government-wide program coordinated by the Department of Housing and Urban Development. Again, this is a survey which we could dispense with as far as the FDIC is concerned, but I am convinced that the survey would continue to be taken by HUD or the ABA.

The Federal Government has been aware of and sensitive to this general problem of governmental paper, although not very successful yet in solving it. The National Commission on Productivity in its analysis of the financial industry gave considerable attention to the question of whether reporting requirements of Federal agencies imposed a burden that adversely affected productivity in the financial sector of the economy. There is now a Commission on Federal Paperwork with responsibility for attempting to minimize the flow of paper both within the government and between the government and the private sector. I am hopeful that the Commission will be able to make significant progress, though there is some initial burden of reporting to the Commission on Paperwork.

Apart from government-wide efforts and concern, the FDIC and the other banking agencies have been giving attention to this matter for some time. Several years ago, a joint banking agency/industry task force began work on a project now called ISBAR (Information System for Bank Agency Reporting). This is a system designed for use by large, automated banks with substantial agency reporting requirements. When it is fully implemented, it will allow banks to report bits of information on magnetic tape which will then be processed by the agency without the need to fill out printed report forms. While it will be a long time before any bank is actually using the system to meet a substantial fraction of its reporting requirements, we have already experimented with receiving some reports in tape form. This is an example of joint agency/industry forward planning on a long-range problem rather than simply reaction to an immediate crisis.

Within the FDIC, we have reduced the flow of paper into Washington and back again and have reduced the time during which you must await our decisions by delegating certain responsibilities to our Regional Directors.

These delegations include decisions on branch applications, office relocations, offering of trust services, continuation of deposit insurance after withdrawal from Federal Reserve membership, and others. The Regional Director has the authority to approve, but not deny, such applications in the majority of instances. We have allowed banks to determine whether they wish to have their unmanned cash dispensers or automated teller facilities considered as branches or not. If the bank decides that the facilities should not be viewed as a branch, then we have dispensed with our branch application procedure, and require only a brief information notification. As a result of these delegations and other efforts within the FDIC, there has been a substantial improvement in the speed with which we process applications. We estimate that a banker receives an answer from the FDIC to an application for merger approval, insurance, new branches, etc., a month sooner than he would have three years ago.

Let me return to the beginning. I had in mind pointing out to you today ways the FDIC could remove some of the burden of Federal regulations and reporting requirements. My analysis of the situation, however, is that regulations will continue to be promulgated, and you will be required to continue to submit reports. Hopefully, we can make the preparation of reports easier and less costly for you -- perhaps we can make them more useful. Whatever the case, we are going to insist on timely and accurate submission of reports because we feel that only if they are timely and accurate can they be useful to us in our supervisory responsibilities.