NEWS RELEASE

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THE FDIC: BANK EXAMINATION AND SUPERVISION

Chairman Robert E. Barnett, in speaking to the Missouri Bankers Association Directors Conference, discussed his views of the strengths and weaknesses in FDIC examination and supervision of banks, what changes are taking place, and what changes might be expected in the near future.

In emphasizing the change in FDIC supervision to one of increased attention to larger banks and to banks with supervisory problems, Mr. Barnett pointed out that an important factor in the FDIC's activity is the fact that the FDIC, the primary Federal supervisor of an increasing percentage of the nation's banks, has become an agency that supervises both small and very large banks. It now has primary Federal supervisory responsibility not only for three times as many banks with deposits over $100 million as the Federal Reserve, for example, but also for more banks with deposits over $1 billion.

In reviewing recent changes in the bank regulatory environment, Mr. Barnett cited the growth in the size of banks and the increased risks in some large banks, the sizable volume of consumer protection legislation which has added to the duties of the bank examiner, and the change from an atmosphere of confidentiality and secrecy regarding a bank's condition to one of disclosure and media analysis.

These changes have raised questions with respect to the examination and supervision policies which have traditionally included examination of all banks in basically the same manner regardless of size or degree of problem, insufficient formal follow-up on deficiencies revealed by the examination, inadequate emphasis on aspects of the bank other than loans, inefficient use of manpower in examining small banks, and questions about the best method of training examiners. These matters, Mr. Barnett points out, are already receiving attention.

The FDIC has recently adopted a new regulation regarding insider transactions, an area of significant abuses in many bank failures. Use of formal enforcement action has increased significantly, with 49 cease and desist orders having been authorized in the first ten months of 1976 versus only 13 actions in all of 1975. The examination and supervision process is being made more efficient through use of delegated authority to regional directors, experimental withdrawal from regular examination in three states, increased examiner training in EDP, and use of computerized techniques in examinations and by elimination of some routine activities from examination. The Corporation is also encouraging examiners to meet more frequently with a bank's board of directors and is giving attention to developing some personnel specialization in various aspects of the examination.

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Other changes in supervision include use of early warning systems, employment of financial analysis techniques, devotion of greater attention to earnings as an indicator of pending troubles, and uniform classification of participated national credits.

Among other supervisory issues touched on by Mr. Barnett were: capital adequacy and the leverage bank agencies can use when applications are filed; the questions to be resolved regarding the need for a Federal Bank Examination Council; the questions raised by the possibility of partial withdrawal of the FDIC from examinations; the need for more formal training of bank examiners; problems of supervision of bank holding companies; and the remaining questions of differing supervisory techniques for large as distinguished from small banks.

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THE FDIC: BANK EXAMINATION AND SUPERVISION

Address by

Robert E. Barnett, Chairman
Federal Deposit Insurance Corporation

before the

Missouri Bankers Association's
Bank Directors' Conference,
~~Tan-Tar-A Golf & Tennis Resort~~
Osage Beach, ~~Missouri~~ Mo.
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The FDIC examines and supervises 8,628 commercial banks and 331 mutual savings banks with combined deposits of over $285 billion. The Comptroller of the Currency examines and supervises 4,745 commercial banks with deposits of $450 billion. The Federal Reserve System examines and supervises 1,032 banks with deposits of $143 billion. While the number and size of banks examined by the Comptroller of the Currency have remained relatively constant in relation to the growing number and size of banks in the country, the number and size of those examined by the FDIC have increased faster than the averages, and those examined by the Federal Reserve have dramatically decreased. Over 60 percent of the deposits supervised by the Federal Reserve, for example, now are concentrated in only 22 banks.

The Corporation is thought of as the Federal agency that supervises only small banks; the Comptroller and the Federal Reserve are thought of as the agencies that supervise the large banks. This no longer is accurate. We now supervise three times as many banks with deposits over $100 million as the Federal Reserve and are approaching the number supervised by the Comptroller. We supervise more banks with deposits of over $1 billion, commercial and mutual savings combined, than does the Federal Reserve.

The trends over the past few years also support the growing importance of the FDIC as a Federal supervisor of banks. In 1956, 20 years ago, the Corporation supervised 6,983, the Comptroller 4,651, and the Federal Reserve 1,807. In 1966, 10 years ago, the Corporation

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supervised 7,724 banks with deposits of $108 billion, the Comptroller 4,799 banks with deposits of $207 billion, and the Federal Reserve 1,350 banks with deposits of $86 billion. Five years ago, the numbers showed the FDIC with 8,211 banks with $183 billion deposits, the Comptroller 4,600 banks with $316 billion deposits, and the Federal Reserve 1,128 banks with $112 billion deposits. If those trends continue, especially if the 22 large banks currently supervised by the Federal Reserve were to cease to be supervised by the Federal Reserve, either by withdrawing from Federal Reserve membership or by converting to national charters, there will be only two rather than three Federal bank supervisory agencies.

It is extremely important, therefore, that the FDIC make known its views on bank examination and supervision. The public, Congress and the banking industry should know what we view as the strengths and weaknesses in FDIC supervision, and what changes appear to be desirable, and perhaps even essential, in the near future.

I

Let me begin by saying that we expect bank examinations to continue. We recognize that an argument can be constructed that concludes that it would be cheaper and no more risky to eliminate all bank examinations and use the money saved to pay off the "few" additional banks that might fail, to increase the capital position of weak banks, etc. The most important response to these arguments at this time is simply to say that

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we have had bank examinations in this country for 147 years and that we see no sign that we'll eliminate them in the foreseeable future. The public expects banks to be examined by governmental agencies.

It is more fruitful for the Corporation to attempt to analyze weaknesses that may exist in our supervisory process, and to attempt to correct those weaknesses.

II

First, a quick review of the bank regulatory environment is in order. The 1960s and 1970s have brought changes which have important implications for the process of bank examination and supervision. One of these changes is simply the fact that banks have gotten bigger. As I have mentioned above, this is a much more significant change for the FDIC than for the other supervisory agencies. I don't think we have completely adjusted to our new situation yet.

Not only have banks gotten bigger, but banking has become more complex and a riskier business, particularly for these larger banks. Some years ago, we used to think that big banks could not get into serious trouble and that the real focus of bank supervision should be on the smaller banks. While there are many different ways to define the riskiness of different parts of the banking system, none of them perfect, it does appear that there has been an increase in risks in some large banks. One statistic which has received increasing attention in the last year or so has been the

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size of our "problem list." Although 97 1/2 percent of all banks are not on any problem list, we are concerned about both the number and the size of banks which are on the problem list, some of them larger banks. Let me say quickly that the problem list reflects the condition of banks when they are examined, not necessarily their current condition. There is a substantial time lag between the time that a bank is found to be in a "problem" condition and the time it appears on the FDIC problem list; in cases of large banks, the time lag may be as much as 10 months. To a great extent, therefore, our problem list reflects the condition of the industry some time ago. It is our judgment, for example, that the condition of the banking industry is much better now than it was at the beginning of the year, even though there were fewer banks on our problem list then.

Another important change in the banking environment has been the entry of the consumer movement into banking, the result of which has been a sizable volume of consumer protection legislation enacted by the Congress in recent years. The major part of a typical bank examination has been and still is loan evaluation. The bank examiner, however, is responsible now for many other aspects of banking than the extension of loans, and other aspects of the loan than its credit quality. The bank examiner must enforce truth-in-lending, equal credit opportunity, fair housing lending, home mortgage disclosure and several other consumer protection laws. The banking agencies have been criticized in recent months for devoting inadequate resources to consumer protection. I

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think some of this criticism has been justified and we are increasing our attention to these matters. But with limited time and resources, this has implications for our ability to do the job of examining the safety and soundness of banks with current techniques.

We used to carry out the process of bank examination and supervision in an atmosphere of confidentiality and secrecy. Banks felt no obligation to disclose bad news about their operations, and the supervisory agencies certainly did little to encourage the disclosure and publication of bad news -- in fact, just the opposite. There was such general acceptance of this as the appropriate approach in the banking field, I am told, that even if reporters or newspapers came across damaging information about banks, they did not think of publishing such information.

That situation has changed. Banks are subject to disclosure under the securities laws, and the banking agencies as well as the SEC are prodding for increased disclosure. Whatever reluctance the media may have had to publish bad news about banks has certainly disappeared. Although I am not happy about the elements of sensationalism that have occasionally crept into some stories, I think the move toward broader disclosure is appropriate and desirable. But regardless of our feelings as to the desirability of increased disclosure, it is a fact of life and is going to remain with us.

These are some of the changes in the environment which have taken place in the past few years. I will discuss other changes in the

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context of specific changes we have made in our supervisory process to deal with them.

III

In the light of these changes, let me simply list what we at the Corporation have perceived as the most apparent defects of our examination and supervision policies:

1. The best run and soundest banks have been examined too often. They are on approximately the same schedule as poorly operated institutions. Over the past several years the record of examinations by all Federal authorities showed that two-thirds of the banks examined received almost no examiner criticism. The criticized banks tended to be the same banks year after year.

2. Large banks and small banks have been examined in much the same way, even though the differences in the banks may be such that an objective observer would argue that they are not even in the same business.

3. The weakest banks have not been examined often enough. Nor have the deficiencies revealed by examination always been followed up by the indicated degree of aggressive action. Fair banks become poor before sufficient pressure for changes is applied to management and the directors and then it is often too late.

4. Too small a part of the examination has been dedicated to an in-depth analysis of matters other than the loan portfolio.

5. Insufficient attention has been given to changes in liquidity, securities portfolio, and source of funds. A bank's liquidity may be quickly eroded by a change in investment policy or a change in liquidity needs.

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6. Insufficient attention has been given to current earning trends. Quarterly or semi-annual income data are becoming widely available for the first time, which will provide the basis for closer monitoring of earnings deterioration.

7. Too much of the examiner's time has been taken up on verification and audit type work. Insufficient emphasis has been placed on evaluating and improving internal controls.

8. Examination costs in travel and manpower are very high because of the great number of very small banks examined.

9. The training of a bank examiner has relied too much on an apprenticeship system, even though we have created during the past few years a superior educational and training program which uses the classroom as its training ground. In addition, our judgment as to how good an examiner is has been based too much on his ability to assess loans.

We appreciate that this is a lengthy list for a confessional. Nevertheless, we feel we have identified these weaknesses and we are attempting to deal with them.

IV

Rather than attempting a complete detailing of all the changes that have been made in bank examination and supervision in recent years, I want to highlight some specific changes which are significant and illustrative of the adaptation of supervision to changing conditions.

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Several months ago, we instituted a new regulation relating to insider transactions. We found that about half of our bank failures resulted from abuse of the bank by insiders. Some people would favor severe restrictions on or even prohibitions of insider transactions. We did not feel that this is appropriate because in many cases the bank's Board of Directors comprises the best sort of customers for the bank. Others favored the idea of broader disclosure of insider transactions, which are required in any event for registered banks. But we still have some concern for the confidential nature of individual customers' transactions and adopted instead an approach that requires Board of Directors' approval of all loans and other transactions of certain sizes with insiders. We think this approach puts the responsibility where it should be, with the Board of Directors, and does so without a blanket prohibition or widespread public disclosure of what are appropriately personal transactions.

Under Section 8 of the Federal Deposit Insurance Act, we have long had powers to take legal action against banks which are following practices we regard as unsafe and unsound. Traditionally, bank supervision has been a relatively informal process with the examiner, supervisors, and senior FDIC staff meeting and discussing with bankers the problems we see in their bank. That informality is still characteristic of most of the bank supervisory process, but there has been a perceptible shift to greater use of formal actions. In 1960, there were two Section 8 actions taken by the FDIC. This rose to four in 1965. In October 1966, the Corporation received cease and desist powers, and since then Section 8

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activity has increased with seven actions in 1970 and thirteen in 1975. Already during just the first ten months of 1976, the FDIC has issued or authorized our lawyers to begin the process of issuing forty-nine cease and desist orders. This is a reflection of our experimentation with these powers and our finding that there are some situations that call for formal action, and that the response we get from some banks in some situations is better with a formal action.

We have taken several actions aimed at making the bank examination process more efficient. In some cases, these actions were necessitated by the fact that although the size of our examination force has increased, their responsibilities have increased even more rapidly. I mentioned earlier that the source of these increased responsibilities lies in the increased size of banks, the increased complexity of banking, and the increased responsibilities of the examiner for enforcement of laws and regulations not related to safety and soundness of the bank.

One of the most important changes we have made is a greater delegation of authority to our Regional Directors. A number of relatively routine actions can now be approved in the Regional Office without their being referred to Washington at all. This includes establishment of a new branch, moving an office, approval for a new issue of capital notes, and others. We have not delegated authority to deny applications and we have not delegated authority in certain difficult cases, but the change in the flow of paper and the burden in our Washington Office can be illustrated by the fact that in 1970, 527 applications for new branches were decided by the

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Board of Directors (after substantial analysis by Washington Office staff as well as field staff), while in 1975, only 137 such applications were decided by the Board of Directors. 368 were handled by our Regional Directors under delegated authority, with a savings in manpower we estimate of 9,000 man hours in 1975 alone.

Another attempt to be more efficient has been our withdrawal experiment. For the last three years, we have been carrying out an experiment in three states whereby the FDIC foregoes its normal examination of the safety and soundness of a certain number of banks, and instead leaves that examination to the State Banking Department. We went through a careful and detailed process before selecting the States of Washington, Iowa and Georgia for this experiment. There are some pluses and minuses to this experiment and we are not ready to provide a complete evaluation at this time. It may be that the responsibility for certain functions, e.g., audit-type functions in banks lacking adequate internal controls, can be delegated to State supervisors while our examiners concentrate on loan and management evaluation. It may be that we should withdraw from examining certain size banks, or certain banks of long-standing proven quality. It may be that we should withdraw entirely from examining in certain states. It may be that we should simply drop the experiment and judge it a good effort but unsuccessful. At any rate, the experiment has been one means by which we have attempted to deal with the pressure on our resources, the desire of some states to take a greater role in banking supervision, and the general concern over duplication and overlapping in Government regulation and supervision.

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Banking operations have become increasingly computerized over the last ten years or so, and so have bank records. Examination of the bank now involves analysis of files that consist of magnetic tape rather than neatly organized paper records. A whole new line of EDP courses have been created to train our examiners to use these new techniques. We have developed data processing packages to simplify the task of examining data centers and computerized banks. These are programs designed to work on a variety of computer configurations that produce the output needed by the examiner. This minimizes the disruption of a bank's computer center during an examination, and provides our examiners with the information in precisely the format they need.

In part because of these steps to make bank examination more efficient, some routine has been eliminated from examination. We are encouraging more discretion on the part of the individual examiner and the Regional Director. We have included some special pages in the examination report to be used when the Corporation feels they are needed for evaluating a bank's trust operations and nondomestic loans. We have tried to cut what seems least essential, and to rely on generally accepted sampling techniques rather than exhaustive reviews and counts. We don't believe there is any significant risk in our being less detailed, but it is correct that the examination is somewhat less complete than it used to be. We are experimenting with specialization among examiners, which has the potential for more sophisticated and streamlined examination procedures,

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as well as more thorough examination in the fields in which the speciali-zation is developed.

Some changes in the bank examination process have been the result of policy decisions rather than attempts at better management of existing functions. For example, we have changed our policy to encourage more frequent meetings between the bank examiner and the Board of Directors of the bank examined. A number of years ago, we introduced a policy of a meeting of the examiner and the Board of Directors at the conclusion of an examination. We found that represented a waste of time since most banks were in relatively clean condition and getting the Directors together for a meeting with no real substance represented an undesirable imposition on the Board members, so the policy was discon-tinued. In the last couple of years, however, conditions have changed. Now there usually is some matter appropriate for a discussion among the examiner and the Directors, regardless of the condition of the bank. Directors have been more eager to meet with our examiners. The Comp-troller of the Currency has recently changed his policy so that national bank examiners are required to schedule a meeting with the Directors immediately after each examination. We have not yet made such meetings a universal policy but have certainly encouraged more meetings between examiners and Boards of Directors.

In addition to developing specialists among our examiners and expanding their training to make them more cognizant of recently enacted

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legislation, we are expanding the pool of people from which we hire our examiners. Our examination force now has by far more female examiners and members of minorities than was the case five or ten years ago. Some of this change results from the elimination of past policies which were based on a feeling that some characteristics of the job of bank examiner, for example, the constant travel involved, was such as to create problems for women. But more of the change is due to an affirmative action on the part of FDIC to recruit members of minorities and women for examination positions.

We have changed the policy of examining every bank every year, and now use various modifications of a full examination in different situations. Hopefully, this will permit us to spend more time examining banks that need the attention. As our newly revised examination policy states:

> "...the scope of the examination may be curtailed. Full use should be made of the bank's EDP and management reports, sampling should be utilized wherever possible, and proof and verification procedures may be eliminated or substantially limited unless circumstances indicate additional effort is needed in these areas. Additionally, the volume of loans subjected to analysis may be reduced, and less important branches need not be examined. Emphasis at these modified examinations should be placed on management policies and performance; the evaluation of asset quality, alignment and liquidity; capital adequacy; and compliance with applicable laws and regulations."

That policy goes on to say that, in certain circumstances, "fixed assets schedules may be omitted from these examination reports," examiners may "utilize the output of (the bank's) systems, cash counts and proof and verification procedures may be omitted, branch offices which do not have a

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significant volume of important assets need not be examined, the Corporation's automated bank examination programs and monitoring systems will be used wherever possible in an effort to provide increased efficiency and conserve manpower, and sampling techniques should be used wherever possible."

The changes I have described are significant and we are now in the process of developing additional training programs to ensure their complete integration into operations. I would like to turn now to some additional changes in the process of bank examination that are not completely integrated in operations today but which will be in a relatively short time.

V

First, a comment about the efforts of the Comptroller of the Currency. The Comptroller of the Currency is just starting to implement some substantial changes resulting from the review of the Office and its procedures by Haskins & Sells. It is difficult to summarize these changes but, to a great extent, they represent a reorientation of examination philosophy. Our present procedures start with a lot of detailed investigations of various aspects of the bank's activities and culminates in a meeting with top management of the bank to discuss overall findings and bank policy. The changes being made by the Comptroller's Office involve starting out with a review of selected statistical data in a bank to be examined followed by a discussion of bank policy with top management of the bank, that then followed by an attempt to evaluate how well the bank is implementing its own policies.

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This may well be the philosophy upon which bank examinations of large banks must be conducted, and we are watching the Comptroller's efforts very closely.

The future is going to see more use of the computer by bank examiners. I have already mentioned the packages developed by the FDIC for assistance in examining the computerized records of the bank, but we are going to see in the future more use of techniques that the computer makes possible. Work has been done at the FDIC and at a number of other places aimed at developing early warning systems for spotting bank problems. Development of early warning systems rests on the fact that we routinely collect massive amounts of financial data on the operations of banks. We have the computer capability to manipulate these vast amounts of data, and there are statistical techniques available which allow us to develop profiles of banks likely to become problems in the future, unless appropriate action is taken. These systems are becoming operational, but there are definite weaknesses in them now, the most distressing of which is the length of time required to process the reports. We must do better. In part, we feel that the fines we have levied on banks which have filed late reports will assist us in accelerating the processing, but we must, in addition, change some of our techniques.

Our early warning systems generate a list of banks that have similarities with banks that develop problems. These lists are circulated to our Regional Offices. In some cases, the regional staff is familiar with the bank's situation and knows that despite the ominous financial

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figures, there is really no cause for concern. In other cases, the lists include banks that the supervisory staff knows are problems and has been following closely. In some cases, however, the early warning system represents a new source of information to the bank examiners concerning potential problems.

It may be possible to go further with this approach in the future. But I think that the emphasis in the future will be on greater use of financial analysis techniques to spot banks that deviate substantially from the average. The financial analysis techniques are needed to fill the gap between the output of early warning systems and the costly detail of a full-scale on-site examination. We think it will be possible to develop techniques whereby skilled financial analysis can review the information available concerning bank operations to determine which ones require closer attention, more frequent examination, or special kinds of review.

Incidentally, our work on early warning systems has reached the same conclusion of some leading bank analysts that income ratios and operating results frequently are very important indicators of future banking problems. The traditional bank examination has given primary attention to the balance sheet and capital ratios and our discovery that the income report and income ratios provide useful indicators of future troubles may well be extremely important in determining future directions of examination and supervision.

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There are some other changes in procedures which are starting to take place and which will become more important in the future. One of these worth mentioning is a system started by the Comptroller's Office to develop a uniform classification system for national credits. That is, when a large national firm is borrowing from a large number of banks, that credit should be classified in the same way at each bank that is lending to that firm. It is wasteful and inefficient (and occasionally embarrassing when different conclusions are drawn) to have the examiner in each of those banks do his own analysis of the financial position of the borrower. This responsibility can be centralized in one group of examiners which will produce a uniform classification of that loan for use by all examiners. We have participated in these reviews with the Comptroller when we have non-member banks which are participants in the credits. The Comptroller's Office, whose national banks have more of these national credits in their portfolios than others, has spearheaded this effort. But as nonmember banks become larger, they are making more of these loans, and the FDIC is planning to lead similar efforts.

VI

I would like to conclude by commenting on some, but certainly not all, of the other issues of examination and supervision which I have not discussed.

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The question that comes up most frequently in discussions between the FDIC and bankers concerning supervisory practices is that of capital adequacy. There is clearly not the time for a full discussion of the FDIC views on capital adequacy. I might just mention that there have been some analyses attempting to determine whether the supervisory agencies have much impact on the capital decisions of banks. Some of these suggest that we do not have much influence and that may be the way it should be. Our real efforts are aimed at nudging banks that we think have less capital than they should to raising more. I recognize that it is easier to prod than it is to actually raise the capital. In the last few years, both debt and equity markets have been difficult for banks to tap, and bank earnings have not been growing at a rate rapid enough to allow retained earnings to meet all capital needs. We do seem to have much greater influence on bank capital decisions when a bank is asking us for something, say, approval for a new branch. We do take advantage of this leverage and use these opportunities to require banks to raise additional capital. The Federal Reserve has done the same when bank holding companies have brought applications before the Board. There is some criticism of this practice, and some question as to whether it is fair and equitable that banks coming to us with applications should thus be subject to more effective pressure than banks that are not asking for something. This possible inequity troubles me, but not so much that I am willing to forego the opportunity to get additional capital from banks whose capital accounts are clearly below what they should be.

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The last Congressional session saw the introduction of a bill to create a Federal Bank Examination Council. This Council would be intended to provide uniformity and consistency of examination standards for all of the examining agencies. We can see some benefits and some problems with such an institution. Let me quote briefly from our letter to the Senate Banking Committee on this proposal:

> "While we heartily endorse the bill's objective of promoting 'progressive and vigilant bank examination,' we have serious reservations as to the need for nationally uniform examination standards and procedures. If there is any merit to the concept of separate Federal supervisory agencies, and to a dual banking system with State and Federal supervision of banks, the benefit would seem to be the opportunity to try different approaches and to have a diversity of examination and supervisory procedures. The possibility of useful innovation and improvement in the bank examination and supervisory processes is greater if there are several agencies trying different approaches than if every change in examination methodology required approval of all the agencies. The changes in the examination process now being made by the Comptroller of the Currency at the recommendation of his consultants are a worthwhile experiment that all supervisors will follow with careful attention. Implementing such changes should not, however, require the approval and commitment of each of the other Federal bank regulatory agencies."

I mentioned earlier our experiment in which we have withdrawn from some parts of bank examination in three states. We are facing the issue of whether this experiment should be put into more general operation or be simply terminated. That is, should we certify that certain states are able to take over the bank examination process and thus allow

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the FDIC to drop that function and responsibility? If we are to do this in certain states, how are we to determine which states? Or should we do this in all states? That is, should the FDIC get out of the bank examination business and leave it completely to the states? We do not feel that many states, if any, have adequate bank examination capability at the present time, but it is possible that if we simply stopped examining banks, and that left a real unfilled need, perhaps the states would move to fill that need. Or should we, as I mentioned before, withdraw from part of the banks -- i.e., those which contribute the least risk to the deposit insurance fund? The other side, if you will, of that coin is for the FDIC to examine national banks or state member banks.

I mentioned earlier the interesting characteristic of the training and development of bank examiners by the use of the apprenticeship system, modified in recent years by a substantial classroom training program which is clearly the best among the agencies. Essentially, all of our examination personnel have developed as generalists through this type of training. This was an ideal approach when our examination mission consisted of examining the safety and soundness of mostly small banks, with examiners having few other responsibilities. Now, as I have indicated, our responsibilities have broadened and the types of banks and activities we are examining have diversified. For the most part, however, we have viewed the bank examiner as the Jack or Jill of all trades, able to examine competently all aspects of banking activity.

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We have made some modest moves in the direction of specialization. We have recently set up specialists in trust examinations in several of our regions, though these specialists are bank examiners and not lawyers. Some examiners have received special training to enable them to examine computer facilities. Again, these are bank examiners trained in data processing and not computer professionals trained in banking. We have been giving consideration to, though have yet taken no steps to implement, the possibility of having a special examination force to examine for compliance with consumer protection laws. The possibility of increased reliance on financial analysis techniques in bank examination also may require different expertise and specialization than the traditional apprentice training route to the general bank examiner.

We may have to consider different career paths for different specializations or perhaps the hiring of bank examiners at different levels and with different backgrounds to fill particular needs rather than relying on our traditional hiring and training system.

The development of bank holding companies has been an important facet in the growth of banks and the increasing complexity of banking activities. The holding company movement obviously creates some problems for the process of bank supervision. Some of those problems have been delegated by the Congress to the Federal Reserve to worry about, such as the question of allowable activities for holding companies, for example, and the passing on specific applications of specific holding companies. We are more concerned with the relationship between the bank

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holding company and the bank and other affiliates of a holding company. We have seen in some recent major failures, e.g., American City Bank & Trust Co. in Milwaukee and Hamilton National Bank in Chattanooga, how a series of transactions with a holding company affiliate brought down a bank. The FDIC already has some authority to examine bank holding companies and the affiliates of insured nonmember banks. We have not generally exercised this authority, however, and we are now wrestling with the question of whether we should do more examination of bank holding companies than we do. It may well be that we should urge Congress to pass bank holding company supervision and examination to the agency with the responsibility for supervising the lead bank.

Perhaps the most important issue in the future will be the treatment of large and small banks. I noted that we still examine large and small banks in much the same way. I think this is inappropriate, but I am not sure in which direction we should move. Since it is mostly small banks that fail, and small banks are most likely to be in need of advice and suggestions about operations, it can be argued that we should devote a greater effort to examination of small banks. Large banks have access to competent management and advice, and generally can be assumed to know what they are doing, and hence, it may be argued, need our examination less. On the other hand, we have found that there is not much public concern about small bank failures. Part of the FDIC's responsibility is to maintain confidence in the banking system, and even a sizable number of small bank failures appear not to shake that confidence. A few large bank failures might, however.

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This would make the case for more detailed investigation of large banks. Certainly, the deposit insurance fund covers more insured deposits in the approximately 2,000 banks over $50 million in deposits than in the 12,700 under $50 million. We have to think this through, and we have not reached any conclusion. At this point, however, I am leaning in the direction of the view that the FDIC should concentrate its examination efforts and resources on a more detailed investigation of large banks with a resulting less frequent emphasis on small bank examinations. That is the current thrust of our examination policy, and I believe it is a step in the right direction.

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