FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

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Statement on

GAO Study of Federal Supervision of Banks

Presented to

Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and Urban Affairs
House of Representatives

and

Subcommittee on Commerce, Consumer
and Monetary Affairs
Committee on Government Operations
House of Representatives

by

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Federal Deposit Insurance Corporation

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Mr. Chairmen, I welcome the opportunity to appear before your Subcommittees today to present the views of the FDIC with respect to the General Accounting Office's recent study relating to the Federal supervision of commercial banks in this country. In general, we believe that the GAO has done a commendable job with an extremely difficult task, made more difficult by a relatively tight time frame. We feel that its comments as an impartial professional observer should be studied carefully in an atmosphere of cooperativeness and receptiveness. In that vein, I would like to comment briefly on a few points relating to the report and then attach to my statement, for the record, a more detailed critique prepared by FDIC staff in response to specific items covered by the GAO report.

To begin with, I would like to point out that in comparing the supervisory procedures of the three Federal bank regulatory agencies, it must be borne in mind that the day-to-day relationship which the FDIC has with state banking supervisors is extremely important in our supervisory effort. Unlike the Comptroller of the Currency, but like the Federal Reserve Board, we supervise banks who are operating under 50 state laws as well as the Federal Deposit Insurance Act. Those banks are chartered by 50 different state supervisory authorities and the manner of supervising those banks at the Federal level differs as a result from state to state. It is also important to realize that the FDIC is the sole Federal regulator for the entire mutual savings bank industry, a $100 billion industry. While we appreciate that the GAO report is directed only to commercial banks, it is essential to take into account the FDIC's activities with respect to the mutual savings bank industry in order to understand its supervisory effort.

As to flexibility in examination techniques, we wholeheartedly concur with the GAO in the need for such flexibility. As a result of a continuing study going back a number of years, we amended in early November of 1976 the basic memorandum which governs our examination policy. This amended General Memorandum No. 1 (see Page 7-1 of attachment hereto) is quite consistent with the thrust of the GAO report and we believe that a full discussion of it should have been included in that report. We like to think that the philosophy outlined in this memorandum, which we have tested during the past few years by experimenting in different FDIC regions, is the best philosophy for the FDIC to pursue in the examination of nonmember banks. Since it is so central to our operations, and since it is a relatively new statement of a flexible examination policy, we would have liked to have had the benefit of the GAO's in-depth comments about it.

We also agree, as the report recommends, that more administrative enforcement proceedings should be undertaken in the supervisory process by the Federal regulators. We have attempted to pursue that policy, particularly since late spring and early summer of 1976, and have requested from the Congress additional supervisory powers.

In this connection, the GAO report notes the large number of violations of law found during a typical examination. We were pleased, however, to note that the GAO pointed out that some of the laws and regulations are complex and that some of the violations were of a technical nature that would in no way affect the soundness of a bank. It is the experience of our Division of Bank Supervision that the major portion of violations of laws set forth in reports of examination does not affect the soundness and safety of a bank. All violations of laws or regulations are a matter of concern, of course, but it is the particular responsibility of the bank regulator to consider each violation in terms of whether it was intentional or willful, the consequences flowing therefrom, the likelihood of continued violation, and other similar matters, and then to take the appropriate corrective action.

The GAO also recommends that the Federal bank regulatory agencies develop greater uniformity and cooperation with respect to the definition of problem banks and improving the supervisory process. Both recommendations seem to have a common theme, namely increased homogeneity among the agencies. Undoubtedly, there is merit to the proposition that problems common to the three agencies should be resolved through closer coordination and cooperation. There is, in fact, at present a substantial flow of information between and coordination among the agencies. If, however, 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, among those benefits would seem to be the opportunity to try different approaches and to have a diversity of examination and supervisory procedures, thereby enhancing the possibility of useful innovation and improvement in bank examination and supervision.

Furthermore, the need to develop common criteria for determining problem banks is not obvious and may not be appropriate. Our experience is that the accurate designation of a problem bank does not lend itself to the application of simple mechanical formulae that can be universally applied. While we do apply certain screening devices as initial tests, we believe the actual designation of a bank as a problem should only be imposed on a case-by-case basis after a comprehensive, in-depth analysis of the entire bank. We also believe it is appropriate for the FDIC, as insurer, to view what constitutes a problem situation from a somewhat different perspective than the other two Federal regulatory agencies, namely from the standpoint of undue risk to the insurance fund.

Finally, the report implicitly suggests that FDIC examiners should be criticizing loan policies before bad loans are made. We certainly agree that a closer review of loan policies is important, and criticism of such policies in advance of their implementation should be made where the policies will obviously lead to an unsafe or unsound condition for the bank or to violations of law. Most written loan policies will be written in such a way, however, that a reasonable examiner will find it difficult to find something significant in them to criticize. We believe that the written policies themselves are not the problem -- it is rather the implementation of these policies that is.

The FDIC Division of Bank Supervision has prepared extensive detailed comments concerning recommendations and comments made in the GAO report, which I have attached to my statement for your Subcommittees' consideration. While they are lengthy and detailed, we believe those comments reflect the thoughtfulness with which we have reviewed the GAO report.