The FDIC

BUREAUCRATS, AGENCY REORGANIZATION, AND HIDDEN AGENDAS

Address by

ROBERT E. BARNETT, Chairman
Federal Deposit Insurance Corporation

Before the

Western Independent Bankers, San Francisco, California, March 28, 1977

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I would like to take this opportunity to discuss the importance of people in the bank regulatory scheme, to comment on various agency reorganization ideas that recently have been openly presented and discussed, to comment on some that have not been openly presented, and to suggest an idea for reorganization of the federal banking agencies which, in my opinion, would benefit the banking system as a whole.

Let me begin by reciting my major premise — as important as organizational structure is, it pales when compared with the importance of the individuals who operate the organization. People operate the FDIC and the other bank regulatory agencies. The Corporation is a service organization which performs well if its individual employees perform well, and poorly if they perform poorly.

The regulatory system has performed well, especially in the context of the past few years so any consolidation of the agencies must be based on something other than past performance. In my judgment, any real benefits to be gained from consolidating the agencies do not outweigh the harm which such consolidation would cause. The main reason for this is that any consolidation would tend toward elimination of the competition in excellence that exists not only between and among the federal agencies, but also between and among the state agencies and the federal agencies.

At the same time, if a modest reorganization would result in some benefit and eliminate the excessive time spent directly and indirectly on the question of reorganization, I would not only not oppose it but would work to see it accomplished.

Whatever the case, I think it imperative in the spirit of Government in the Sunshine that all major reorganization plans be presented and reviewed fully and openly. As good as the ends might seem to their sponsors, it is more important that those ends not be reached incidentally or accidentally, or without full testimony and consideration.

First, with respect to the importance of people in bank regulation: Over two-thirds of the people employed by the FDIC are bank examiners who are examining banks on a daily basis throughout the country. They are college educated men and women of different races and backgrounds whose function is to discover the condition of the banks they examine. They are professionals as are the bulk of the other FDIC employees — lawyers, economists, accountants, systems analysts, liquidators, secretaries, etc. The job they do requires a great deal of subjective judgment, crucial judgment of difficult issues which involve both people and property. To a very great degree, bank examiners are their own bosses with respect to any particular assignment they have.

I think we have been lucky over the years, and particularly in recent years, with respect to the caliber of people involved in banking supervision. Presidents have not viewed the banking supervisory agencies as a convenient dumping ground for friends in need of dignified but innocuous employment. We are all familiar with allegations of Congressional and Executive pressure on presumably independent agencies to hire particular people. Such pressures have been very rare at the FDIC, and we have been able to resist them. In fact, during the 6½ years I've been with the Corporation not one person has been hired by the Corporation because of pressure from either the Legislative or Executive Branches of Government. In part, this may be a function of our independence from the appropriations process for our funding; more about that later.

I said that we have been lucky with respect to the caliber of people in the banking agencies. There are reasons for being concerned that our luck will not hold indefinitely.

We have, from time-to-time, lost people from senior positions whose continued presence at the FDIC would have been extremely valuable. Fortunately, that doesn't happen often. I am more concerned, however, about possible attrition at lower levels of the agencies and deterioration in the quality of those who apply for jobs in the first place. Bank Examiners, by the very nature of their jobs, have frequent contact with bankers, and are in a position where bankers can be impressed by their competence and capabilities. Examiners frequently receive job offers from banks, and many of them do join banks. That is not too distressing, in small numbers, since we are confident that an ex-examiner will usually be a good banker. I am concerned, however, that at some time there may be a great many examiners making that choice, or that it may be the particularly able and ambitious of the bank examiners who see greater opportunities for a long-run career in banking than in the bank supervisory agencies.

One of the several factors involved here is simply the matter of morale. We must consider the impact on employee morale of discussions about eliminating or consolidating agencies. We have had firsthand experience with that problem at the FDIC. There clearly was an impact on employee morale involved in our experimentation with withdrawal from examination in selected states. Many examiners saw that as a signal that an FDIC career might become a thing of the past, and only a considerable amount of top management effort could convince the examiners that in fact it was just an experiment. Had they not become convinced of that, we might have lost many of our younger examiners.

But morale can be depressed more indirectly. I am concerned about the impact from unwarranted and unjustified aspersions on the integrity, dedication and competence of employees of the supervisory agencies. For example, I do not think that the steady drum of criticism of the Comptroller's Office in recent years can avoid having an impact on employee morale in that organization. Or, take another example — we recently went through a political campaign in which many candidates from both parties — Presidential, Congressional, state office seekers — campaigned in effect against the career government employees. That gets to be an old song pretty fast to a government employee who is working as honestly and diligently as he or she knows how. It has to affect adversely their attitude. Far be it from me to defend every action of every bureaucrat in Washington or in the field. My only point is that the success of our program of bank supervision is heavily dependent on those bureaucrats, and irresponsible attacks will, in the long-run if not the short-run, lead the more able of those bureaucrats to choose another line of work.

Of course, there are other factors leading the more able to choose another career. The most obvious is money. We have just gone through a period of over six years in which senior level career government employees did not receive any significant increase in pay. The highest paid civil service employee of the federal government was paid at the rate of $35,500 in 1969, received a $500 raise in 1971, and no further raises of any kind until 1975.

We have seen the absurd situation in which employees in the four highest levels of the Civil Service System receive exactly the same salary. Let me repeat that so that it is not missed. Not only was the highest paid civil service employee of the federal government receiving $39,600 a year in early 1977, but so did all of the next lower grade level, GS-17s, who reported to the GS-18s. And so did the GS-16s, who reported to the GS-17s. And so did many of the GS-15s, who reported to the GS-16s. During the last seven years, therefore, while the cost of living went up 55 percent, the salaries of the top career administrators in the government went up $4,095, or 11.5 percent. The salaries of those who are four management levels down went up $12,137, or *44* percent. Now tell me — is that any way to run a railroad, much less a government? No one would run a business that way, and I doubt that even the most socialistic of countries run their governments that way. Such grade compression is totally inconsistent with our country's economic beliefs.

The fault for this salary compression lies mainly with the Congress, although recent Presidents must share the blame. I am not able to judge how much a Senator or a Congressman is worth, although many that I know clearly deserve substantially higher salaries than they have been receiving. I can understand Congress being reluctant to raise its own salaries — that is a decision for the Congress to make. But what has been irresponsible has been the decision of Congress that, if their salaries are constrained at unreasonably low levels, so must the civil servant's salary and the salaries of those appointed by the President. The logic of that eludes me.

While we have just had an increase in governmental salaries, my concern remains. The illogical salary compression at the top levels of government still exists — even at the new salary levels.

The GS-18 still is not paid any more than most of the GS-17s and some of the GS-16s. A promising young examiner who has seen a salary lid placed at the top levels during the last six years can see it all happening again. This strikes me as a serious problem for the government, and particularly for agencies such as the FDIC with its heavy complement of professionals.

Let me repeat — the FDIC can only be as good as the individuals which together make the agency. I think they are a superior group of employees and I'm proud of their performance during these last few difficult years. If we continue to make the position of an FDIC employee one of which an individual will be proud, and if we pay the leaders in the agency what they are truly worth, we will have good bank supervision and regulation. Essentially, my position is that if we have good people in the banking agencies, banking supervision is going to be carried out in an efficient and quality manner. Without good people, changes in organization structure cannot help very much.

I have made many speeches and testified at great lengths about the performance of the banking agencies and the banking industry over the past few years. To summarize, I feel the agencies have done a good job of containing the problems in the banking industry which the recession made apparent. The agencies have been able to offer solutions for insider abuses, they have become more formal and litigious in their supervisory relationships with banks when necessary, they have adopted or are experimenting with computer-based early warning systems and examination, they have adjusted (albeit slowly) to their additional responsibilities beyond safety and soundness, and they have modernized their internal organizational arrangements. They have expanded their employee training and educational opportunities, they have sought greater disclosure from the industry and provided greater disclosure about themselves, they have racially and sexually integrated their own professional ranks, and they have experimented with state supervisors to see if a way can be found to eliminate any unnecessary duplication of examination and supervision effort. They have done this while the banking industry has expanded from $720 billion in assets in 1970 to $1.4 trillion in 1976. Very large bank failures and a great many smaller failures have occurred in the last few years and scare stories have appeared in many newspapers, yet the actual impact of these failures in the communities has been minimal, and the confidence of the public in the banking system remains undisturbed. In some respects, the confidence of the public may be stronger now than before these trying times, because we have demonstrated that the agencies can handle serious problems without undue disruption.

All in all, I think the agencies have done a good job.

It is true that in the last few years we have had a somewhat larger number of bank failures than has been the case in years of lower inflation rates and a more stable general economy. It is also true that the recent bank failures have involved larger banks* than those in earlier years, a fact that is probably the major reason for the increased Congressional interest in oversight of the banking agencies. But I fail to see the connection between bank failures and need for restructuring the banking agencies. Let me emphasize this point. If the American public and the Congress so determine, we could probably supervise banks in a way that would almost assure no, or very, very few failures with our present supervisory structure. As a matter of fact, our average number of failures per year during the past twenty years has almost been at that point — slightly over 5 banks per year out of 15,000 that exist. To go from 5 to 2 or 3 a year would require a massive and conservative set of ground rules under which banks would operate, and a more pervasive supervisory presence in the banking business. The result would, in my judgment, be an undesirable one from the point of view of the availability, adequacy, cost and innovativeness of banking services to the public, and would involve a degree of government interference in the financial markets and processes of our economy that I would be reluctant to see. But we can do it if the Congress so decrees, and we could make it very unlikely that a bank would fail — all without changing the supervisory structure at all.

Even those who most believe in the need for reorganizing the banking agencies have not been willing to indicate clearly their desire to eliminate bank failures. I think they recognize the point made by the former Chairman of the House Banking Committee, Wright Patman, in his speech dedicating the FDIC building in 1963 in which he criticized the FDIC and the other banking agencies, not because of ***too many*** bank failures, but because there were ***too few.*** He recognized bank failures as an unavoidable sign of a vigorous, competitive banking system. While the critics of the present banking supervisory system will not concede that they are opposed to all bank failures, they do express their unhappiness about each bank failure, or at least about each large one.

Of course, it may be that it is not the failure of a bank that generates criticism, but rather the losses suffered by customers when a bank is closed. Depositor losses, as I'm sure you all know, are extremely modest under the present system. In the 16 bank failures in 1976, for example, nearly 98 percent of all deposits were immediately available to the depositors, and another 1 percent (making the total over 99 percent) was available in a few days. The remaining 1 percent may or may not be a loss depending on the results of the liquidation. But even these very low losses can easily be eliminated within the present structure. We could adopt 100 percent deposit insurance or, with relatively modest changes in the Federal Deposit Insurance Act, we could have a system in which the FDIC would always find a sound bank or group willing to take over all of the liabilities of the failing bank. We could even provide investor insurance if that is what is wanted — we could take all or a substantial part of the risk out of investing in bank stocks. Under such a system bank customers and investors would be totally unaffected by the failure of a bank in their community. Again, I am not claiming that these changes would be desirable; in fact, I believe they are extremely undesirable. I am only saying that they could be accomplished without any significant change in the structure of banking supervision.

The call for reform of the banking agencies then must be based on something more than the existence or impact of occasional bank failures. It may be based on concern that the present supervisory structure does not prevent failures that could be prevented under some other structure. The claim is frequently made that the present organization leads to breakdown of communication and coordination among the agencies. I cannot speak from personal experience with the distant past, but I am familiar with the

*It should not be overlooked, however, that banks have grown dramatically in size. A billion dollar bank would have been the 24th largest bank in the country 20 years ago; today it would be the 133rd largest. A $500 million bank would have been the 60th largest bank 20 years ago; today it would be the 265th.

handling of the sizable bank failures of the last five or six years. There is no case of which it can be said with any accuracy that lack of coordination or communication among the banking agencies contributed in any way to the failure. Let me repeat that because I believe it is so important. No bank failed during the past six years because of a failure of coordination or cooperation between the bank regulatory agencies.

That is not to say that the agencies never made any mistakes. Mistakes are a function of people, mistakes have happened under the present structure and could happen under any structure. It is possible, for example, that the problems of the United States National Bank could have been detected earlier. Given the size and sophistication of the fraud involved in that bank, however, it is hard to believe that any reasonably earlier detection of its extent would have prevented its failure. I don't know anything which suggests that simply reorganizing the agencies would lead to an earlier detection of fraud. It is possible that the resolution (not the discovery of the problem) of the Franklin National Bank situation could have been handled more rapidly with a reorganized structure, but I think there are solid reasons for believing that a quicker resolution might have produced a less desirable result. In fact, if there were only one agency involved in such a situation, it is possible (although I must confess, not probable) that it might try to conceal the status of the bank to avoid answering questions about its failure. In neither Franklin nor U.S. National did the Comptroller shirk from his responsibilities. Had he been a different kind of individual and inclined to cover up the mistakes of the agency, he would have had a very good chance of doing so in a single-agency regulatory structure in which he was the Chairman. In any event, in neither Franklin nor U.S. National did problems of interagency coordination adversely affect the final outcome.

In my recent testimony before the Senate Banking Committee, I traced the series of extremely unusual and unlucky economic developments that beset the banking system over the last several years — problems such as the energy crises, double-digit inflation, the worst recession since the 1930s, the move to floating exchange rates, and the related economic problems of the LDC's. Looked at in this context, the banking industry has come through in surprisingly good shape.

I would have to conclude, then, that the performance of the banking agencies has been good during the past few years, and any reorganization would have to be based on some rationale other than poor performance of their duties.

There are other reasons sometimes advanced for changes in supervisory structure. It is sometimes said, for example, that there would be cost economies that might result from consolidation of the agencies. While there is some merit to this argument, sizable savings cannot be expected. There would still remain the same number of banks to examine, the same assets to be liquidated, and the same series of banking and financial problems to solve. The best discussion of the arguments for and against consolidation of the banking agencies which I have seen can be found in the testimony of Frank Wille, then Chairman of the FDIC, before the Senate Committee on Banking, Housing and Urban Affairs in December of 1975, and I commend it to you. In that part of his testimony addressed to the pros and cons of a single banking agency, Mr. Wille does point out that some modest savings could be expected from such consolidation. No one, however, including Mr. Wille, has suggested that those savings would be sizable, or that the possible harm might not outweigh them.

One has to turn to some other explanation, therefore, and I am not sure I can provide that explanation. It may just be that advocates of consolidation may simply wish to eliminate one or more of the agencies with which they are dissatisfied for any of a number of institutional reasons. It may be that Congressional advocates feel that they have not been able to exercise their oversight responsibility well because of the number of agencies and their diverse responsibilities, although I feel that recent GAO audit activities have reduced some of that fear. Whatever the basis, the desire still remains among some to consolidate the banking agencies.

After saying all this, logic suggests that I would be opposed to any reorganization of the banking agencies. The fact is, I am not opposed to all change.

I do not think that reorganization is necessary. I do not think it should be an important problem facing Congress, the agencies or banking supervision, and I certainly don't think it should take as much time from other more important matters as it already has. Clearly, I don't think it will accomplish a great deal which will benefit the public.

But maybe there are some small changes which can be made which will provide some modest benefits for the public without resulting in some more sizable disadvantages. If such changes will, at the same time, put behind us the time-consuming consideration of agency consolidation, they would be desirable. For these reasons, I would be prepared to support a modest proposal for agency reorganization.

Before setting out that proposal, however, I would like to discuss significant reorganization effects that would flow from the adoption of ideas or legislation designed primarily for other purposes.

As a first principle, I believe that if reorganization should come, any changes should be made directly and openly after a full discussion of the merits and costs of such change. Change in the structure of banking regulation should not be made accidentally while trying to solve other problems. There should be no hidden agenda in our discussions of banking regulation. This may seem obvious, particularly since Congress so overwhelmingly passed the Government in the Sunshine Act, but I mention this explicitly because there have been some proposals in the Congress that, whether intended or not, would have substantial effect on the structure of banking supervision.

Last year, and again in this session of Congress, a bill has been introduced entitled "Competition in Banking Act of 1977." Part of the bill (S. 72) relates to restrictions on bank mergers, and it is this section of the bill that has received the most attention. But other parts of the bill give substantial new supervisory responsibility over banks to the Federal Reserve. One section of the bill would extend the authority of the Federal Reserve Board to determine capital adequacy of all banks that are part of a holding company regardless of whether the banks are national banks or even members of the Federal Reserve System. In many respects, capital adequacy remains the heart of banking supervision so this appears to be an enormous grant of power to the Federal Reserve. When we consider that most sizable banks are now subsidiaries of holding companies (holding company banks account for 64 percent of total bank assets in the U.S.), it is clear that this represents a significant increase in the Board's supervisory power over banks and a significant diminution in the supervisory powers and the effectiveness of the Comptroller and the FDIC. Some analysts have concluded that this grant of authority alone might accomplish indirectly the consolidation of the bank regulatory agencies that the sponsor of this bill has indicated he favors.

Another proposal that I have already alluded to may have a similar impact. These are the proposals to subject the FDIC and the Comptroller to the appropriations process. I consider this a very serious mistake from the point of view of confidence of the public in the banking system, as well as the quality of banking supervision in the U.S. In fact, one of my first speeches as Chairman of the FDIC was directed to this particular issue.

From the standpoint of the impact on agency reorganization, it is important to note that Senator Proxmire's proposal would subject the FDIC and the Comptroller to the appropriations process but not the Federal Reserve. This probably would tend, over time, to improve the quality of programs and personnel at the Federal Reserve vis-a-vis the Comptroller and the FDIC.

I want to make clear that I am not suggesting that the banking agencies or any federal agency should be independent of the Congress. The FDIC is a creature of the Congress and obviously subject to control by the Congress. Congress has and should have the power to make any changes it sees fit in FDIC powers and operations. Those changes should be made openly, however, and not indirectly through provisions tacked on to an appropriations bill, as part of a process of political pressure during discussions of budgets, or as an exchange (albeit subtle) of something the agency wants for a job for a friend of the Legislative or Executive Branches.

A third example of indirect reorganization is the proposal for a "Federal Bank Examination Council." This is theoretically aimed at promoting "progressive and vigilant bank supervision," but goes about it by imposing uniform examination standards and procedures. This bill would create a council composed of the Comptroller of the Currency, the Chairman of the FDIC and the Chairman of the Federal Reserve Board, with the Federal Reserve Chairman as chairman of the Council. The designation of the Federal Reserve Chairman to the top position on a bank examination council is obviously a major weakness in that the Federal Reserve now supervises far fewer banks with far fewer assets than either the FDIC or the Comptroller. Bank supervision, while important, is not the major reason the Federal Reserve exists. Some statistical proof of this is that less than 4 percent of the employees of the Federal Reserve System are bank examiners; check clearing and monetary policy account for the largest number of personnel in the Federal Reserve System, and certainly monetary policy is the most important responsibility.

While a rotating chairmanship of such a Council might eliminate some objection to it, it would not eliminate the objection to mandated uniform examination procedures. If there is 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 experiment with the diversity of examination and supervisory techniques. The possibility of useful innovation and improvement of the bank supervisory process is greater if the several agencies are free to experiment individually with new supervisory methods than if every change in examination methodology requires approval of a majority of the federal regulators. We believe that the objectives of the bill could be achieved without further consolidation of authority in the Federal Reserve and without empowering the Council to mandate uniform examination standards and procedures. Nevertheless, I cite this legislation here as another example of agency reorganization that would take place incidentally or accidentally if certain legislation is passed.

One further example of an effect on the structure of supervision by indirection might be mentioned. There seems to be some support in the Congress and elsewhere for a package of legislation that would involve nationwide NOW accounts, Federal Reserve payment of interest on reserve balances held with Federal Reserve Banks, and perhaps mandatory Federal Reserve reserve requirements for all banks. This package has many important implications — implications for consumers, bank earnings, the U.S. Treasury, and monetary policy. I feel that it also has strong implications for agency reorganization, particularly when read in conjunction with the other legislation I have mentioned, namely:

- the Federal Reserve to determine capital adequacy for all holding company banks;
- the Federal Reserve to chair a mandatory bank examination council;
- the Federal Reserve to be free of the appropriations process, while the FDIC and the Comptroller's Office would be subjected to it.

All of this, of course, must be read against a background in which the Federal Reserve is the sole federal regulator for all bank holding companies, and can set its own rules for lending to both member and nonmember banks.

The result of all of this would be a very strong Federal Reserve and a relatively weak FDIC and Comptroller's Office. Now maybe that is what we want and maybe it is in the public interest, but that ought to be determined directly rather than appearing as an unexpected side effect of legislation adopted primarily for other purposes.

Let me repeat at this point that I am not in favor of substantial consolidation or centralization of banking supervision. I do not think that the reasons advanced for it outweigh the disadvantages. While I feel that the present system of bank supervision works well, my objection to consolidation is not based just on the view that if something is working all right one should leave it alone, but also on the view that there are positive benefits from having several different banking agencies.

First, the public is benefitted from the alternative approaches to problems that arise from having more than one banking supervisory agency.

Second, one advantage of a system containing more than a single agency is that it provides Congress, and the agencies themselves, with an informed group of potential critics (the other agencies who have no vested financial interest in the outcome of a particular course of action). This is a luxury that has not always been available in the case of other government regulatory agencies whose critics generally have come only from the industry being regulated.

Third, differences in agency policy, sometimes influenced by the hint of a shift in supervisors, have performed a positive role in limiting unreasonable, inflexible or arbitrary behavior on the part of one or more of these agencies. Not all agency shopping has been contrary to the public interest, and almost none of the competition among agencies is competition in laxity. There are instances where the initial agency has not been sufficiently receptive to public need or changing practices, or where it was too strongly influenced by the existing banking establishment as, for example, in chartering or branching policies. In such instances, a change of supervisory authority by the dissatisfied bank or its organizers may well have been in the public interest. The availability of a choice among supervisory authority has, of course, been the lifeline of the dual banking system of this country.

This leads me to a rather modest proposal which I think has the merit of achieving in a more formal way some of the increased coordination that many seem to want without eliminating the diversity and opportunity for innovation which I believe is important. I suggest that the Office of the Comptroller of the Currency be reorganized as a three-man board. The Comptroller's Office over the years has received a good deal of criticism (most of it, in my opinion, undeserved), as reflecting the arbitrary whims of the one individual responsible for the Office. I believe that reorganization as a board would alleviate some Congressional concern on that score, without interfering with the ability of that agency to perform its long-standing responsibilities of bank supervision.

I would then propose that the Comptroller be removed as a statutory member of the FDIC Board of Directors, and that the Chairman of the FDIC or his designee serve as a member of the Comptroller's Board and also as a member of the Federal Reserve Board, (whether a voting member or a nonvoting member seems immaterial). This is in accord with a suggestion made in our Annual Report for 1976 when I pointed out that "the FDIC might know more about all the banks it insures if it had a representative in the offices or on the boards of the other bank regulatory agencies." This seems more logical to me than the existing arrangement in which the Comptroller is a member of the Board of the FDIC. From a personal standpoint, I have found both Comptrollers with whom I've shared membership on the FDIC Board of Directors to be helpful, responsible members who contributed substantially to the Board's performance; it is not for personal reasons that I suggest these changes.

Deposit insurance is really the cornerstone of our system of bank supervision. Virtually all banks in this country are insured, and the insurance provides immeasurable confidence for the banking system. Academic experts as varied in their viewpoints as Milton Friedman and John Kenneth Galbraith have stressed the importance of the FDIC. Its representation on the boards of the other agencies would provide a means of assuring that appropriate information on the activities of the other agencies is considered by the FDIC and that the FDIC has the opportunity to make its viewpoint known in the deliberations of the other agencies. This proposal appropriately provides for some of the additional interagency coordination that seems to be desired and seems to be appropriate. It provides for the better flow of information concerning the condition of all banks to the FDIC, and even earlier notice of problems than we now receive.

Let me conclude by emphasizing that I am not necessarily opposed to reorganization or to all possible changes. I am opposed, however, to reorganization simply for reorganization's sake. The quality of bank supervision depends upon ensuring a plentiful supply of good and talented bureaucrats who are proud of a career in bank supervision and who can see an increasing financial reward as their careers progress. Changing our present supervisory structure is unlikely to improve significantly the quality of banking supervision, so any changes that might be made should be modest ones.

FEDERAL DEPOSIT INSURANCE CORPORATION
550 17th Street, N.W., Washington, D.C. 20429

SP-3-28-77