FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

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STATEMENT BY

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on the

1979 Administrative Budget
of the Federal Deposit Insurance Corporation

before the

Senate Committee on Banking, Housing and Urban Affairs
United States Senate

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Mr. Chairman, I appreciate the opportunity to appear before this Committee to discuss the FDIC's 1979 Budget.

The Federal Deposit Insurance Corporation was created by the Congress in 1933 during the most severe economic crisis of this century. It was established to restore public confidence in banks through the provision of deposit insurance that would protect, principally, the small depositor.

The FDIC began operations in January 1934. In October 1934 there were 15,700 operating banks, 14,100 of which were insured and 1,600 that were not. Today, there are approximately 15,200 operating banks, of which just over 14,700 are insured. Although the number of insured banks has not changed appreciably, the total assets and liabilities of insured banks have increased from $40 billion in 1934 to over $1,078 billion in 1978. Estimated insured deposits have increased almost forty fold from $18 billion in 1934 to $711 billion in 1978.

During its almost 50 years of existence, the FDIC's regulatory activities have expanded considerably within its legal framework. While deposit insurance remains the primary function of the FDIC, its regulatory philosophy, methods, and procedures have changed dramatically to meet increased statutory responsibilities in supervising the operation of banks and ensuring the soundness of the banking system in today's complex economy.

FDIC OPERATIONS

The safety and soundness of the banking industry is a major responsibility of the FDIC. The FDIC shares this responsibility at the Federal level with the Comptroller of the Currency, who supervises national banks, and the Federal Reserve Board, which supervises State-chartered banks that are members of the Federal Reserve System. The FDIC has Federal regulatory responsibility for the 9,100 insured State-chartered banks that are not members of the Federal Reserve System. This represents 62 percent of the Nation's 14,700 insured banks. These State nonmember banks hold assets of $438 billion, or 33 percent of the assets of all insured banks, including insured mutual savings banks.

Most of the FDIC's efforts and administrative expense is allocated to maintaining the safety and soundness of insured State nonmember banks. The primary tool in this effort is the bank examination. The examination, as well as general oversight of banks, is a people-intensive activity. The success of these activities depends upon the competence, training, and experience of agency employees. In light of these needs, 87 percent of the 1979 budget is allocated to salary and benefits, education and training, and travel expenses.

Where an examination indicates that a bank is engaged in practices that threaten its safety and soundness, the FDIC may resort to a formal administrative proceeding to obtain a cease-and-desist order against the bank. Where the condition of a bank has deteriorated substantially, the FDIC may initiate proceedings to terminate the bank's insurance. In recent years, the FDIC has been more aggressive in the use of its enforcement tools. During 1975, the FDIC initiated 13 enforcement actions. In comparison, 49 actions were initiated in 1976, 48 in 1977, and 53 in 1978.

The number of problem banks that must be closely supervised by the FDIC has decreased over the last 2 years. On December 31, 1976, 301 nonmember banks were determined to require a problem status. This number had dropped to 286 by the end of 1977 and 262 on December 31,

1978. The insured State nonmember banks determined to be in a problem status as of year-end 1978 represented 3 percent of the banks directly supervised by the FDIC.

Although safety and soundness is the FDIC's major objective in its supervision of banks, it devotes a considerable amount of time to the enforcement of laws promoting consumer protection and ensuring the availability of equal opportunities. These laws include the Truth-in-Lending Act, the Fair Credit Reporting Act, the Fair Housing Act, the Equal Credit Opportunity Act, and the Home Mortgage Disclosure Act. Because of the complexity of these laws and the specialized knowledge and training required to properly examine banks for compliance with them, the FDIC conducts separate compliance examinations. This is more costly than performing the review as a part of a bank's regular examination. These specialized examinations, however, offer the FDIC the opportunity to concentrate its resources and to assist banks in understanding the various laws and regulations. The FDIC's activities in consumer enforcement have increased steadily in recent years. In 1976, 3 percent of the FDIC's expenditures was devoted to consumer law enforcement; in 1978 approximately \$10 million or 10 percent of the FDIC's actual expenditures was in the area of consumer affairs. It is estimated that these expenditures in 1979 will total approximately \$12 million or 11 percent of the 1979 budget. This figure includes an estimated 44 employee years, representing approximately \$880,000 in employee salaries, allocated to the enforcement of newly enacted consumer legislation.

The continued expansion of responsibility and increased complexity of the laws and banking operations require extensive staff training.

In addition to examinations for safety and soundness and consumer compliance, the FDIC is required to examine the electronic data processing and trust operations of insured State nonmember banks. This also requires a considerable amount of specialized training. To provide much of this needed training, an Examiner Training School is conducted by the FDIC's Division of Bank Supervision. Last year, the Examiner Training School held sixty sessions and instructed over 1,600 students. In addition to the examination school, the Training Center offered a wide variety of other instruction programs. Included among these were workshops in trust and fair housing, courses in data processing, a one-week international banking seminar, and Community Reinvestment Act training.

The collection, compilation, and dissemination of bank statistics represents another major activity of the FDIC. Much of the collection of information, such as data in reports of condition and reports of income, is necessary for FDIC supervisory and insurance purposes. Other data are collected on behalf of other governmental units and the Congress. Information collected for the FDIC, other Government agencies, and Congress generally is made available to the public. It is often used by the public for academic research, investment services, and market planning.

In addition to routine data collection, several major studies were conducted in 1978. These included an Interagency Task Force study of interest rate controls and housing credit, a cooperative investigation with the Federal Home Loan Bank Board on the Home Mortgage Disclosure Act, and an independent FDIC study of the lending patterns and practices found in Brooklyn, New York, as they relate to the Home Mortgage Disclosure Act and the Community Reinvestment Act.

Although the foregoing activities represent areas in which the FDIC is primarily engaged, many other activities are being pursued that, although not as prominent, are costly. For example, the FDIC spent over $1 million in 1978 for publications. Much of this expense was incurred in publishing reporting services, data and annual reports, and similar issuances. Also much of the publication expense was for the printing and mailing of instructions, policy statements, and proposed and final regulations to insured State nonmember banks. These mailings are necessary to keep banks informed on the application of new regulations and policies and to ensure their compliance with laws and regulations.

State bank supervisory support is also provided by the FDIC. A large part of this support is provided through the training of State bank examiners. In 1978, 190 examiners from 48 States attended sessions of the FDIC's bank examination school. Two hundred and twenty (220) State examiners are expected to attend the school in 1979. The FDIC also provides report of condition, income, examination and other forms for the use of State agencies. In some instances, State examiners share the FDIC's field office facilities.

Liquidation activities represent another major function of the FDIC. The FDIC's Division of Liquidation administers a large portfolio of assets of closed banks, either directly or as the receiver of a bank. Currently, that Division is handling 79 open liquidation cases. Of these, 8 are administered from the Washington office and 71 from 49 field liquidation offices. As of December 31, 1978, there were 75,400 assets in open liquidation cases with a book value of over $2 billion. Much of the cost of the liquidation activity is borne by the specific liquidations or the deposit insurance fund and is not a part of the FDIC administrative budget. Liquidator salaries and expenses, legal fees, appraisal fees, and rental fees are charged to specific liquidations or directly to the deposit insurance fund as an insurance expense. Only the expense of the Washington office of the Division and a small portion of the liquidation field expenses (such as training) are charged to the FDIC's administrative budget. During 1978, the FDIC contracted with a major accounting firm to develop an accounting and reporting system for the FDIC's Liquidation Division. In 1979, we plan to begin implementing the new control system and integrate Liquidation Division expenditures into the FDIC's budgetary process.

1979 BUDGET

To maintain greater control over the development of its budget, in February of 1978 the FDIC established a Budget and Management Committee. The Committee is responsible for reviewing, within a long-range planning context, existing and proposed projects, programs, and operating procedures. During 1978, the Committee reviewed the proposed budget of each of the FDIC's Divisions. This review covered: (1) the relationship of each proposal to the FDIC's mission and objectives; (2) the cost effectiveness of the proposals; and (3) the relative urgency and priority of resource allocation in each aspect of the proposals. As a result of the Committee's review and recommendations for reductions, on December 20, 1978, the Board of Directors of the FDIC adopted a 1979 administrative budget of $109,848,964, representing a 6.1 percent increase over actual 1978 expenses.

The largest share of this budget, $76,012,024, (or 69.2 percent), is for personal services. This share represents a $5,687,924 or an 8 percent increase over the 1978 budget. Over 70 percent of this increase, however, results from the mandatory 5.5 percent Federal salary adjustment provided to FDIC employees. The remainder of this increase is for promotion and in-grade salary increases. The personnel budget takes into account the President's hiring freeze as well as employment ceilings contained in the Civil Service Reform Act of 1978.

Two noteworthy increases in the 1979 administrative budget are in the budgets of the Division of Bank Supervision and the Office of Consumer Affairs and Civil Rights. They are indicative of the FDIC's increased responsibilities with respect to the safety and soundness of insured State nonmember banks, as well as to our efforts to evaluate banks' compliance with consumer oriented legislation. The budgets of these two Divisions were respectively increased by 6.1 percent and 124.7 percent over their 1978 expenditures.

NEW PROGRAMS

Considerable banking legislation was enacted in late 1977 and 1978. Much of this legislation will require the FDIC to engage in new and costly operations in 1979. Also, several new programs developed to implement earlier statutory mandates will impose additional costs on the FDIC's operations. Some of the more significant new Acts are the International Banking Act of 1978, the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRIRCA), and the Community Reinvestment Act (CRA).

Of the three Acts, the CRA will require the greatest funding for implementation. This Act directs the FDIC to encourage the institutions it regulates to help meet the credit needs of their communities, including low- and moderate-income communities. The FDIC is required to assess each institution's record in meeting the credit needs of its community and to take this record into account when evaluating any application submitted by an institution. As a part of the regulation promulgated by the FDIC to enforce the Act, each FDIC-supervised bank is required to prepare CRA Statements delineating the bank's local community and identifying the types of credit needs within that community that the bank is prepared to serve. FDIC examiners will evaluate the institution's record of performance during regular compliance examinations and the results of these evaluations will weigh heavily in FDIC decisions concerning any structural applications by a bank.

Increased costs and added burdens will also be imposed on the FDIC's operations by the International Banking Act and FIRIRCA. The International Banking Act provides for the Federal regulation of foreign banks in domestic financial markets. Specifically, this Act provides foreign banks the option of establishing a Federal branch, with the approval of the Office of the Comptroller of the Currency, in any State where the establishment of a branch or agency is not prohibited by State law and where the bank does not presently have a State-chartered branch or agency. Deposit insurance is mandated for certain specified deposits held in the domestic branch of a foreign bank, but is also available on an optional basis. FIRIRCA represents a comprehensive package of legislation affecting a number of areas relating to bank supervision.

Included among its provisions are expanded enforcement powers, restrictions on insider lending, and restrictions on interlocking directorates. Also included among its provisions is the requirement that insured State nonmember banks provide the FDIC with 60 days' notice before a change of control occurs. During that time, the FDIC may disapprove the change. During 1978, approximately 521 changes in ownership occurred in insured State nonmember banks that would have required the submission of advance notice to the FDIC under the new Act. We estimate that a similar number of changes will occur in 1979, thereby requiring notice to the FDIC and review by the FDIC staff.

We estimate that during 1979 operation under the International Banking Act, FIRIRCA, and CRA alone will require at least 62.5 employee years, representing salary costs of approximately $1,250,000.

New legislation will not be the only cause of increased responsibilities at the FDIC during 1979. Two new programs instituted to more effectively enforce earlier legislation were established in 1978. The first of these was intended to provide a more effective fair housing enforcement program under the Fair Housing and Equal Credit Opportunity Acts. The program establishes recordkeeping requirements for banks. These records are monitored by FDIC employees to ensure compliance by insured State nonmember banks with the two Acts. The second new program was established to ensure compliance by insured State nonmember banks with the Truth-in-Lending Act. Under this program, the FDIC will monitor bank records for Truth-in-Lending violations. Where a sampling of a bank's records indicates a possible pattern or practice of violations, a thorough review of the bank's records will be performed. We estimate that operation under these two programs will impose a significant additional claim on examiner time in 1979.

The added costs of these Acts and programs will be off-set to some extent by cost savings in FDIC operations. However, these savings may not be sufficient to offset all of the costs of the new programs. Accordingly, there will be a reallocation of some resources away from traditional bank examinations.

The anticipated cost savings will result from more efficient resource allocations. An example of this improved allocation is increased reliance on State examinations. The FDIC participates in a Divided Examination Program with the States of Georgia, New Jersey,and Missouri. Under this program, problem banks, other banks in need of special supervision, and banks with assets of $100 million or more are examined by both the FDIC and the State supervisor at least once each year. About one-half of the remaining banks is examined by the State; the remainder is examined by the FDIC. The supervisors then alternate examination of these banks annually.

To more effectively concentrate limited examiner resources on those banks presenting financial risk and supervisory concern and to have sufficient personnel available to perform other assigned functions, the FDIC has expanded the number of banks which may be examined under a modified examination process. Rather than the detailed review of a bank's operations that occurs during a full-scope examination, a modified examination emphasizes management policies and performance. Prior to 1979, the FDIC's policy required that all commercial banks with assets of $100 million or more receive a full scope examination once every 18 months. All other commercial banks were examined on either a full scope or modified basis at least once in every 18-month period and where a modified examination was conducted the succeeding examination had to be full scope. For 1979, the $100 million limitation has been removed and for banks which do not represent financial risk or supervisory concern the requirement that a full-scope examination follow modified examinations has also been eliminated. Banks presenting supervisory concern shall, at a minimum, receive a full-scope examination at least once every 18 months with additional examinations or visitations scheduled as they are needed.

A pattern of increased examiner efficiency and greater retention of examiners also is resulting in cost savings. Of the three Federal banking agencies, the FDIC has the highest retention level for its examiners. This high retention level not only increases the efficiency of the examiner corps but reduces the need for basic training.

During 1979 the FDIC will continue to review its operations in order to develop ways to further reduce expenditures and increase efficiency. Cuts in expenditures will not be made merely for the sake of reduction. Instead, our goal is to ensure that necessary programs and operations are provided, but with a minimum of expenditure.

I believe the FDIC's budgetary procedures and practices will continue to improve the productivity and effectiveness of the FDIC. I also believe the 1979 administrative budget reflects the effectiveness with which the budgetary procedures and practices will operate. It is a budget that utilizes cost savings from operational changes to provide for increased responsibilities without increasing authorized employee strength and with a minimal increase over actual expenditures for 1978.