FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

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Good morning ladies and gentlemen. There is surely no more appropriate place in the world for this meeting to occur than San Diego. It is a good place for this Society to gather for reappraisal, for a look at methods and attitudes and at analytical techniques. This is a good place because this is the home town of C. Arnholt Smith, the greatest swindler of them all. I hardly think it is necessary to point out that here, with the U.S. National Bank and with affiliated companies, Mr. Smith perpetrated virtually singlehandedly what is probably the most massive fraud in banking history.

It is surely true the smart crook who has control of a financial institution can fool the examiners for awhile, sometimes for a long while. But having been part of the tumultuous last four years in regulation, I am satisfied that eventually the crooks get caught. Now out here in California they just cannot seem to put them in jail. They had a lot of trouble getting Arnholt in jail. The poor man is bankrupt. He is living on social security in his penthouse on top of Westgate Little America and when he needs to get out for a breath of fresh air there is an 85 ft. yacht out in San Diego Bay. It does make you wonder.

I am mindful that I am speaking this morning to bank examiners and financial examiners other than banking examiners. I know from Christy Armstrong and from my colleague from Georgia, Bob Mohler, that we are talking about state and Federal examiners; we are talking about credit unions, savings and loans, thrifts and, particularly, insurance examiners.

I am going, however, to limit my remarks to bank examinations because it is really the only area of examination I know anything about. (If I went beyond that, I would be even more awash than I am already!) I like to think that those examiners and those regulators who are here this morning who are not involved in the bank examination process may find that some of the projections that I am about to offer are relevant to you also.

There once was a description of a member of this profession. I am sure most of you have heard it. It is styled as a description of a bank examiner but I think it is one, if you haven't heard it before, that you might look at and see if you think there is anything in it that is common to all examiners. It is by a famous midwestern humorist, Elbert Hubbard: "The typical bank examiner is a man past middle age, spare, wrinkled, intelligent, cold, passive, noncommittal with eyes like a cod fish, polite in contact but at the same time unresponsive, cold, calm, and damnably composed as a concrete post or a plaster of paris cast, a human pertrification with a heart of feldspar, without the charm of a friendly germ, minus bowels, passion or sense of humor. Happily they never reproduce and all of them go straight to hell."

Before I turn to matters of substance, I should make the necessary disclaimer that I am not representing any official FDIC views this morning.

Speaking for myself, let me say that in recent months our Projects and Planning Office at the FDIC (a part of our Division of Bank Supervision), along with a separate effort in the Office of the Comptroller of the Currency, have put together two studies using different techniques which demonstrate conclusively that <u>the examination process works</u>.

Both of these studies address the question of how many loans which are classified loss, or doubtful or substandard turn out actually to fit into those categories several examinations later. What that means, put a bit more simply, is how many turn out to be irretrievably loss, and how many turn out to be collectable and, in fact, are collected. It proves -- or disproves -- the examiners' judgment. The figures I am about to give you are from the FDIC study, and they reflect the net loss experience on the classifications. That is, take your chargeoffs out, add back your recoveries, include any adverse classifications which remain at the end of the cycle (and we are talking here about a three-examination cycle through the same institutions), and adjust any chargeoffs which have been levied against the remaining classifications. The study found that 10 percent of the substandard wound up as loss; 47 percent of the doubtful wound up as loss; and 73 percent of the loss wound up as loss.

You will want to know in assessing the meaning of these numbers that on the average there were 391 days between the first examination and the second examination and 408 days between the second examination and the third examination. You can see that this is a very considerable period within which to track these results. We have a large sample here and I believe that these are good, solid numbers.

Let me touch on several other matters which our study looked at. Consider the initial substandard classifications. During the period between the first and the third examinations, 48.1 percent of the substandard classifications had paid out (in other words, had been collected) and another 20 percent of the substandard had improved to the point where they were no longer adversely classified at all. That left 21 percent which stayed as substandard, and the remaining loans drooled off into loss and doubtful. The bottom line is that, as our FDIC report concludes, if you view the examiner's mission as a corrective one, then a high degree of success was obtained. The study shows that 68 percent of the initial substandard classification moved out and up -- either collected or no longer classified. These numbers, by the way, are very similar to what we have found in our Liquidation Division experience in the past few years.

I believe some of you are aware that about this time last year we realized that the FDIC liquidation activities had grown to be the 49th largest company in the United States. We had acquired holdings of $2.6 billion out of the 40 or so failed banks that have failed over the past 40 or so months. That is down now, by the way, I am happy to report, to about $2.3 billion, but it points out that our liquidators have had a wealth of experience in what happens to loans in a receivership once the bank fails and the assuming bank doesn't take them.

The failed bank environment may skew the perception a little bit -- it probably does. But, I think the data remain significant. The results in the liquidation effort over a ten-year test period show that about 42 percent of the substandard classifications wind up as loss, about 63 percent of the doubtful, and about 78 percent of the loss ultimately wind up not to be collectable. That compares with the non-closed bank environment in the following way in the two most severe classifications -- doubtful and loss: our Projects and Planning survey showed 47 percent of doubtful went to loss; our liquidators say 63 percent. Our Projects and Planning survey says that 73 percent of loss stayed loss; our liquidation people say 78 percent stayed loss. What that shows is that it is harder to collect a loan out of a receivership than it is out of an open and functioning bank, and certainly anybody knows that. On balance, what these statistics spell out to me is that the numbers which the examination forces are sending back to their regional offices and then on to Washington are good numbers -- but they are not perfect. They are verifiably and demonstrably information on which very tough judgments can be made -- judgments which affect large numbers of dollars, large numbers of people and lots of reputations.

The Comptroller of the Currency has a similar survey under the auspices of a colleague of mine from Alabama whom some of you may know, Dr. H. K. Wu. According to the report: "Dr. Wu concludes that national bank examiner criticisms are reasonably accurate and are good measures of loan quality." The numbers in Dr. Wu's study don't line up with the numbers in the FDIC study because different methodological techniques were used as to what you measure, how you measure it, how long it took to measure it and so on. But, it is illustrative to point out that one of the Comptroller's conclusions is that 97 percent of the loans which were paid out in 1975 had never been criticized. I think that is important. I think it is important for bankers to know that a tremendous majority of non-classified loans are going to make it. I think it is important that they realize that classifications are not being made on a capricious basis and that when a loan is classified there is a pretty good chance that something in fact is wrong with it. And, that is really what these two studies demonstrate.

My point is that there are numbers which exist as a result of these studies which show that the examination and supervisory process works. That statement, "it works," is important to all of us here today. But it is important in a broader context. Take a look at the numbers involved in just the little corner of the world that I know anything about. For example, as of June 30 of this year, there were 15,207 banks and non-deposit trust companies in the United States with 34,568 branches. That is a significant number of banks to regulate. When you relate those numbers about the number of banks in the industry back to our study and Dr. Wu's study you can see pretty quickly that the examination process is growing in importance; it is growing in sophistication; and that examination techniques have advanced to such a degree that now we can measure not only how the bank is doing but we can also measure what sort of job the examiners are doing. It is about time that we had a measurement of how well examiners are doing. Obviously, we know from the events of the past few weeks that your profession is certainly growing in public recognition of its sensitive and delicate role.

I look at all of this from a peculiar point of view -- that of a user, a non-examiner user. Most of what many of you write, and I address this particularly to bank examiners because I don't know about everybody else, is designed, at least in the confidential section, for ultimate use by other examiners. Of course, the report eventually gets to the Comptroller of the Currency or gets to the FDIC Board. I am one of the people who ultimately use the report. One of my direct responsibilities to Chairman LeMaistre of the FDIC is dealing with problem bank situations. It helps, having these numbers that show the examination process works, when you come down to the bottom line in evaluating what we should do in a problem bank situation. The evaluation in the context that I am thinking of results in the death of the institution in question or perhaps its salvation through assistance from us or others. It is good to know that there are numbers that we don't have to be too afraid of because it is a very frightening thing to work for weeks on a problem bank situation knowing the very serious economic and personal consequences that will result from our decision and knowing that we must rely on numbers developed by an examiner in a far away place that we may never have met. We find it (I keep emphasizing it because it is new to us) comforting to know we are dealing with numbers that mean something.

Another, more substantive reason that it is important is that in our assistance packages under section 13 (c) of our Act, we must be able to find that the bank in question -- if we give it money, or lend it money, or buy some assets from it, or put a deposit in it, whatever the power we want to use might be -- can then earn its way out and become once again a viable institution. The way we determine that, of course, is by asking the following questions, among others: what kind of management does it have? what does its loan portfolio look like after the assistance has been granted? We rely entirely on the Report of Examination for answers to those questions; it is the only thing we've got to go on.

There are those who don't share this point of view of these reports, at least as it relates to the supervisory process; and, I think they are really the same thing, examination and supervision. Let me read you two comments by people who don't agree that the process works.

> Given the intense public scrutiny into the banking practices of Bert Lance I believe the Congress now has a golden opportunity to correct some of the abuses in banking that for years have been swept under the rug. Perhaps the most serious problem in bank regulation is the cozy relationship between the three bank regulatory agencies and the banks that they regulate.

Let me read you another quote:

> The bill [the Safe Banking Act of 1977] is an affirmative step by the Congress to meet the public's demand for firmer and more vigorous federal regulation of financial institutions in place of the present timid, hesitant supervision which serves neither the interest of the public nor the banks.

The "cozy relationship" quote is from the Chairman of the Senate Banking Committee, William Proxmire of Wisconsin, and "timid, hesitant" quote is from the Chairman of the House Subcommittee on Financial Institutions and Supervision, Fernand St Germain of Rhode Island. There is, in my judgment, a pendulum swinging here. When Bob Mohler and I talked about this talk a few months back the workings of the pendulum were not as obvious to us, or I suspect to anybody else, as they have now become. Today it is obvious that the examination and supervision process is clearly under intense scrutiny. And because it is judgmental in nature -- that is, even with the Comptroller's study and with our study, you cannot measure its ultimate performance like you can measure how many wickets were manufactured last year -- it puts us all on the defensive. How do you prove that we do our job well?

Whether one agrees with the rightness or wrongness of the quotations which I just read is really immaterial because they are reflecting the state of affairs. I believe it is up to all of us to try to keep in perspective these swings of the pendulum and realize that anything which swings all the way over to one side, as is happening right now, will eventually swing back to the middle and go all the way back over to this side; and, when it goes over to this side, then it will be the other side that is unhappy instead of the present one. But as it stands today, what is the view from Washington? What does all of this mean? Where are we headed in the regulatory process?

It seems to me that there are a couple of ways to look at this. One is to focus on something like an internal point of view. What are we doing with our force of 2,500 or so examiners? What do we expect to do?

The other focus is the forces impacting on our examiners and on all of us from the outside, particularly the Congress, bankers themselves, consumer advocates and others.

The FDIC has adopted the position that the need for professionalism in bank examination has never been so great. We are acting on that need in a number of ways. Many of you may be familiar with our training facility in Rosslyn, Virginia, either from teaching there or going to courses there. We think it is without peer in the depth, sophistication and quality of its instruction in examination techniques. We are, however, within the next few days going to announce the initiation of a major study of that training center -- not because we think there is anything wrong with it, but because we think that bank examination is changing so rapidly that we have no alternative except to commit substantial economic and time resources to an appraisal of its adequacy. We don't know enough about its curriculum; we don't know enough about its instructional capabilities; we don't know things as simple as when should we take a young examiner in his career and first send him to that training center. Questions like that haven't been thought through recently. We are going to think them through again. We are evaluating how well one can measure an examiner's performance at the training center. Right now the examiner evaluates his instructors. By the time we get through, we are going to be evaluating the examiner's performance as well as the instructor's performance. How well did a student understand the course is a very reasonable question to ask, and we are going to start asking it.

I think, therefore, that you can look without much doubt in our case, and I feel sure that this is true throughout the regulatory apparatus, for a much greater emphasis on professionalism and a much greater emphasis on specialization. From what I know of your organization those are changes that you all would welcome.

Most of you are probably aware of the tremendous manpower and knowledge crunch which the Congress has created through its rapid enactment of consumer legislation. We've gone at the Corporation to a system where, on a six-month detail basis, we are taking regular safety and soundness examiners and acquainting them with compliance examination techniques and consumer laws. We want our people to know their way around this burgeoning body of law and regulation, and we want our non-member bankers to know their way around it as well. Many of them tell our examiners when they come in on a separate compliance examination basis "How in the world do you expect me to know how to do all of this?" Our examiner has been in the field, say, for a week on a six-month cycle. He knows that truth in lending exists and that Regulation Z exists and that Regulation B exists, but his fundamental world view is safety and soundness. So he says "it is thóse people in Washington that expect you to know it. I am trying to learn about it and I am going to try to tell you everything I know about it."

It is a very difficult task. The amount of detail in compliance exams and consumer laws is tremendous; the ambiguities are tremendous; the difficulty in keeping up with Fed staff interpretations is tremendous. Because of the natural resistance of a lot of examiners who focus on safety and soundness, we sometimes have trouble getting people to do this kind of work. Presently, we are making a strong effort to make it a short haul deal -- working for six months, and then going back to safety and soundness examinations. This may not work; it could change. We may find enough people who are willing to take on this kind of consumer oriented task to justify a completely separate career path but it is just one evidence of increased specialization, whether it is on a "detail" basis or a permanent basis.

I personally would like to see permanent consumer examiners because the body of law involved -- and I speak now as a lawyer -- is so complex that without a permanent commitment to it as a vocation I don't really think anyone can assimilate it and stay up with it. I certainly couldn't. Everytime you do a six-month detail in any kind of beginning specialization you reinvent the wheel. There are not enough examiners -- financial examiners of any stripe -- to reinvent the wheel.

If on the other hand, it turns out that we are not able to attract permanent compliance examiners down the road, we may shift to nonexaminer compliance teams something like the creation of para-legals in the legal profession.

Under the general topic of specialization I would point out next that at the Corporation we have created a separate position for trust examiners. We have also been, as many of you know, in the electronic data processing business for quite some time. We have created a separate career for EDP specialists which I expect to grow, and grow dramtically, in the years ahead.

There are some problems in these changes -- some of them institutional and some of them people oriented. Let me focus on several of the problems with the hope that we might be able to think constructively about them.

We have one of the best Personnel Offices anywhere in government, in my opinion. We spend a lot of time thinking about how we should hire brand new examiners, and we get a lot of help from our personnel officials. One of the problems that we face in that area is what to do about increasing the number of qualified minorities and the number of women in our examining force. Of course, there are Civil Service constraints present in our environment which may not affect all of you; but, both under our former Personnel head and under our present one, we have made a tremendous effort to upgrade the number of both women and minorities. We have made some progress through college recruitment, through summer work, through co-op work and so on, but we have a long way to go, and, judging from the appearance of this crowd, you all have a long way to go as well. Bank examination and supervision probably should not always be conceived as a white, male club and I would recommend this problem of ours and of yours to the Society for its consideration.

A second area which has been affected by the growth of specialization and professionalism (I might say especially those areas which must receive training in the classroom) is the concept of on-the-job training or the "apprentice system". Many of you are familiar with what I am talking about. The reduction of on-the-job training has come about, in part, due to changes in mores, a new generation, new travel regulations which stress being able to go to and from the job in the same day, etc. The results of all these forces is that the number of nights spent with the examining crew in a motel somewhere over a bottle of Cutty Sark or Jack Black for too long and too late have been reduced in number and diminished in importance. With that diminution comes a diminishing of the transmission of knowledge in one way which I, at least, conceive to be of major importance to the examination process.

I am of the school that what examining a bank or anything else is all about is JUDGMENT -- at least far more so than anything else -- and it is my opinion that judgment derives from experience, from a laying on of hands, from the transmission of information from examiners who have seen 1,000 examples of a problem to those who have only seen a couple of examples. The tricks of how you look at something, the short cuts, are elements of judgment which just cannot be taught very well in a classroom. We don't want our younger people to reinvent the wheel, and it is the responsibility of all of us to try and figure out some means to enhance professionalism and specialization in the 1970s context (where people don't expect to stay on the road for long periods of time) while at the same time not losing the enormous body of experience and judgment which can pretty well only be communicated after hours on a one-on-one or one-on-two or, at the most, one-on-three basis. The fact of the matter is that the results of all the studies on classification of loans which we have talked about earlier show that the old system works, and we want to keep as much of it as is valuable and useful. I hope that the Society will devote some time to the consideration of this issue.

Let me say that I don't want this last statement of mine about apprenticeship or on-the-job training to be construed as antediluvian and hopelessly reactionary because I certainly don't feel that way. I have been one of the earliest and strongest supporters of computerized early warning systems in bank regulation. I am sure you are all somewhat familiar with the sorts of ratios in question here and with the arguments which have raged around the country as to which of the ratios are most appropriate to determine whether a bank is in trouble before, as Jim Smith once put it, the bullet is already in the body.

We at the FDIC have come a long way in that regard. Over the years people in the Corporation have developed three or four different systems. Joe Sinkey did some very good work for us. Mary Mitchell, Ralph Hitchcock and Jack Edgington have all played important roles in early warning systems and so have numerous others. Now we have come up with an effort to take the best features of all the systems -- we call it the Integrated Monitoring System (IMS) -- and we are putting it on line so that the people in our Regional Offices can have it to evaluate banks based on call and income data, exam reports and so on.

In my talking about the apprentice system, let me emphasize that I think that it is only part of the puzzle and that the Integrated Monitoring System, for example, is a very important additional part of the puzzle. I would expect in the future to see a far greater reliance on the computer for analytical purposes than we have seen heretofore. In the same way that we now have electronic data processing packages to plug into a bank's system, I believe that we will see before too long mini-early warning system computers which every examiner will have and which he will carry around with him to deal with all the major measurements and ratios as he moves through a bank or other financial institution during an examination.

Whether or not my "black box" theory is pie in the sky, these computerized systems focus neatly on the breaking up of traditional roles in examination. We used to think of examiners as essentially "loan" examiners. Well, that is certainly not the case and it never was the case. It is just recently that we have become aware of how broadly gauged this business of yours really is. Take our 14 Regional Offices. We have just created the position of financial analyst to go in every one of these offices to assist in using systems such as the IMS. The position amounts to a translation function between the examiner and the computer to some extent, and it really fits no neat category that I know of. Like everything else in this business, it requires a broader gauging again. I should hope that in the inner councils of the Society, you all are focusing on this need for that broader gauged individual.

It certainly is clear to me that an increased emphasis on accounting practices, methods and techniques is part of the future. It is clear that an examiner has to know something about marketing before he can talk knowledgeably to a bank CEO or to a bank's Board of Directors. He certainly has to be trained in finance and investments before he can even comment on the way the bank manages its portfolio or its cash, and he has to know something about management per se or he is unable to talk to the people who run the bank about how well they run it. I have heard an awful lot of bankers around this country tell me "Why in the world should I let this fellow who comes in here to criticize loans tell me who I ought to hire or not hire?" Well, the answer to that is now apparent. There is more to banking and bank regulation than loan analysis, and I trust the Society's emphasis is shifting accordingly.

We have been talking about in-house, in the trade matters, and I cannot leave them without pausing for a moment to comment on matters which we think are important harbingers of things to come.

FDIC folks know about our General Memorandum No. 1 and General Memorandum No. 2 which came out last year and this year, respectively, and which have been refined several times since then. These two documents are what you might call a mini-Haskins & Sells report, although I would not want to place too much emphasis on the Haskins & Sells comparison. We think the Haskins & Sells report for the Comptroller is constructive and provocative but it is not necessarily right for us. So we have been engaging in our own in-house efforts which are predicated on our own specialized needs.

General Memorandum No. 1 touches on the frequency of examination and addresses the notion of how you best utilize manpower; it tries to put the examiner where he is most needed. There is no point in examining a $10 million country bank with a satisfactory management rating, high earnings for years and a good capital position as often as you examine a four-year old $150 million bank in an urban setting where the bank has experienced rapid growth, deteriorating capital, a highly leveraged position, poor earnings and the like. There is just no point in treating these two institutions as if they were the same because they are not. For years, however, we did.

General Memorandum No. 1 reduces the frequency of examinations of a good institution and increases the frequency of examination at poorly run institutions, in terms of spot checks, visitations and full-scale examinations. We think this is a step in the right direction because it begins the process of moving away from the "3 yards and a cloud of dust" approach to examination and supervision and is of great significance for the Society, I would say, because it points up the emerging nature of the examiner as a "problem solver" and not just an annual criticizer. Also of downrange significance is the fact that one of the criteria which we have used to decide whether to bypass or go into an institution under this program is the existence of a first-rate internal or annual external audit program which we believe is essential and which creates new opportunities for people in the future.

General Memorandum No. 2 is a different animal. You might call it the "bank examiner on stage." What it does is to schedule meetings with bank directorates after just about every examination whether or not the bank "needs" the examination from a safety and soundness point of view. We don't know how well this program is going to work. We don't want our examiners put in the position of trying to think of something to say (where in the past, due to the sound condition of the bank, we would have not met with the directorate.) In that limited situation, the examiner is put in the role of teacher because if the bank is in good condition there is no doubt that the right kind of analysis can make it better. This development begins to place emphasis on the importance of examiners' ability to speak, to hold attention, to convey ideas, the kind of preparation that they are willing to do the night before, and so on. Once again this represents a rather fundamental change in the role of examiners; once again here is a requirement for a broader gauged individual than just a loan examiner and, once again here is an opportunity for the Society to weigh in now in a highly beneficial and constructive manner.

I would like to look at one additional internal matter before we leave this area and that is what I can see down the road as a much greater emphasis on the pooling of data and resources among all kinds of examiners and regulatory bodies.

Many of you are probably aware of our shared national credit program where, with the Comptroller of the Currency and the Federal Reserve System, we work together to classify credits which are participated among a number of different banks. This system is obviously fairer to the borrower, fairer to the banks, makes our job easier, etc. Here you have the three banking agencies pooling their judgments and I see a lot more of that happening in the future.

There are, as you probably know, proposals floating around which would vest all holding company supervision in the regulator of the lead bank, and proposals which are similar to that one, but I am doubtful how far they will really go. I see as more probable a good deal more emphasis on bringing our resources to bear so that the pieces fit together better. Holding companies are here to stay and there is a real need for this bringing together of resources which has not so far, in my judgment, been met. Right now you have the Fed dealing with parts of it; you have the Office of the Comptroller of the Currency dealing with parts of it; we are dealing with parts of it, the SEC is involved, and goodness knows who else is involved. This will work just fine when the cooperation level is a little higher than it is now. We simply need to get a look at the whole animal rather than the blind men and the elephant system which now afflicts holding company regulation, I would look for voluntary or mandatory coordination down the road (made mandatory by a professed and, in this instance, justified Congressional concern if action is not taken beforehand) and, therefore, I would see all of us in this room someday conceivably working on different aspects of the same problem and realizing as we do it that our own roles are part of a greater whole. The economy is so interdependent and the expectations of government involvement in financial regulation are changing so rapidly (according to my pendulum theory) that I think we will see more and more examiner cooperation from throughout the industries which we regulate.

I think this is especially true when you view that idea against the backdrop of emerging electronic funds transfer systems and see the potential interdependence which will flow from EFTS, say in 10 years: when insurance companies may be banks, and banks may be supermarkets, and supermarkets may be mailboxes, and mailboxes may be savings and loans, and savings and loans may be credit unions, and credit unions may be holding companies, and all of us may be basket cases! But conceive the relationships outlined above in a less hyperbolic manner. Put them on a 50-state basis and link them together by a sophisticated automatic clearinghouse and whatever new technology is available, and see if you do not think that the adjectives which we now put before the word examiner will all be dropped and then an examiner will be an examiner without need for prefix and suffix.

Now let me move outside the internal in-the-trade areas which we have been discussing and look in a crystal ball which picks up a few events of the recent past and then look forward for just a few minutes.

Let me remind you of Mr. St Germain's view of our performance which I mentioned earlier -- our timid and hesitant supervision. Mr. Proxmire's notion of a cozy relationship between the agencies and the banks that they regulate goes hand in hand with his colleague on the House side. Well, if you believe that, what I am about to say will seem entirely apologetic. But if you think that the record of our performance over the recession, if you think that our record with regard to classifications and their accuracy, if you think that this record demonstrates an effective insulation of the nation's economy from the traumatic shocks of the past few years (which I believe to be the bottom line which determines the effectiveness of examination and supervision), you might have a little trouble with the Congressional statements being totally accurate.

You might find them to be merely more political talk by those who have never been through the agonizing, wrenching experience of a bank failure and who have not seen at first hand the tremendous impact that the actions of certain dishonest individuals can have on a community. There are those who say that bank regulation should keep people from being dishonest. Or if that is too unrealisitc for even those pious souls who say it to believe, then the funcion of regulation should at least be to catch them earlier. I think catching crooks earlier is a laudable goal, but I think that what we are hearing from Capitol Hill these days really has nothing to do with giving us the tools to do that; it sounds much more like good headlines; it sounds much more like a bastardization of Talleyrand's old admonition, "Please, Mister, above all, no facts."

It does not matter, as I said before, whether you think these statements are accurate or not because the pendulum is swinging to such an extent that, at the moment, the premises about truth or falseness have changed. We have a world of learning to do about the meaning of the Lance affair. Whether it signals open season on bank regulators and bank examiners or not, it certainly does signal a greatly enhanced awareness of the significance of the supervisory process. As such, it raises the stakes of confidentiality beyond what they have ever been in the past, and in my judgment they have been high in the past. It is nearly impossible right now to see clearly what all of this does mean.

I think, however, we can generalize about it just a little bit. All of it is a reflection of the cynicism of the past few years, of the cynicism of Vietnam, the cynicism of Watergate, or, for that matter, just the mathematics of the baby boom -- there are so many more investigative reporters who have to compete for headlines harder and more sensationally than ever before simply because there are so many more people of that age than there have ever been before. All of these factors come together to create the situation that we currently have. Right now they are cynical about government and naive about financial matters. Put that perfectly normal and anticipated combination together with larger numbers of people -- reporters, Congressional staff -- working on these matters and you have a dynamite combination which is neither intrinsically good nor bad in my opinion -- it just exists.

In light of the Lance affair, there come now efforts to prohibit rather than regulate. It is the peculiar nature of the American political animal, as de Tocqueville observed so long ago, to move in Draconian, Gordian knot ways to "reform" something -- anything -- once that particular bug bites. Our old moralism comes up from time-to-time and occasionally in the pious echos of Jonathan Edwards ringing from the windy heights of Capitol Hill one does see, if you will forgive the terrible mix of metaphors, the baby going flying out with the bathwater.

Be that as it may, the politically popular mood seems to be one of prohibiting transactions in the financial community which may or may not be good for the American banking public. I fear there is little chance that these measures will be considered in a reasoned atmosphere. One or two examples:

There are several bills in Congress now to prohibit insider dealings within banks. Speaking only for myself, I have a lot of problems with this notion of prohibition rather than regulation. We went to a lot of trouble at the FDIC to put together a fine insider regulation. We had a lot of input from examiners. We had some fine legal work, especially that of my colleague, Chuck Muckenfuss, Counsel for Chairman LeMaistre. We think that by requiring disclosure to the bank's board, gaining their approval above certain limits of borrowing, and making sure that the examiner has access to the records of the transactions, the insider has satisfied the test of fairness and equitableness.

We think this system works, It is not perfect and we are analyzing it now to see how it might be changed for the better. But an absolute prohibition on insider dealings, either individually or through business entities controlled by the insider, means that the Board of Directors of a bank has no economic incentive to serve because "prohibition" makes impossible the creation of those proper relationships where a sound bank and a sound company are mutually profitable, one to the other. It means that a company's CEO who would normally serve on a bank's board in order to foster those relationships now will serve only for eleemosynary purposes, if he will serve at all, just as he might serve on the board of a hospital or of a college.

The difference between his eleemosynary activities and serving on a bank's board is, of course, the tremendous liability he is faced with while serving on the board of the bank -- from shareholders, depositors and in extremis, even from us. In short, prudent men simply might not serve at all. If that turns out to be the case, then you have boards of directors who, inasmuch as they would have no particular concern about profit, might be termed "public interest" directors.

I think we could live with that situation, if that is what the American people want, but I think we would have to change our view of what supervision is all about quite a bit. Banks would be, in this scenario, essentially public institutions, owned by the public, with profit only a secondary consideration. This would tend to remove the restraint created on safety and soundness grounds now by the need to make a profit, and would presumably involve all of us much more in the day-to-day extension of credit from the institutions.

Apparently, Senator Proxmire does not totally hold back from such an approach. I am reading from his press release again on his new bill to restrict insider loans where he says, "For starters, I believe an aggregate limit of 20 percent of bank capital [loaned to insiders] would strengthen the safety and soundness of our banking system and would lead to a <u>fairer allocation of credit</u>." Well, how you react to that depends on how you see the safety and soundness issue and how you feel about credit allocation. I merely at this point flag it for you because if Mr. Proxmire prevails it is obvious that examination and supervision will be radically different in the future.

As I wind down here, let me just point out to you the schedule of the Senate Banking Committee for 3 weeks beginning September 16 and running through October 6 and 7 of 1977. On September 16 through 19, hearings on reorganization of the bank regulatory agencies. On September 21, mark-up of the Truth in Lending Simplification legislation. On September 22 and 23, hearings on financial privacy legislation. On September 26 through 28, the oversight hearings on bank regulatory issues arising from the Comptroller's report on Bert Lance. On October 3, 4, and 5, hearings on legislation dealing with consumer protection aspect of EFT systems, and on October 6 and 7, oversight hearings on alternative mortgage instruments.

Well, that is one committee -- that is three weeks -- that is a tremendous amount of legislation to be considered, legislation that could affect all of us very dramatically depending on how much actually passes. But it is obvious that the pendulum is in motion which will involve examiners in what have heretofore been considered management decisions and I think it is obvious no matter where you personally stand on this issue, that the Society needs to be gearing up for that eventuality.

I cannot help before totally closing mentioning again my concern that the younger examiners around the country receive the benefit that most of you received as you came along from older and more experienced examiners. It will mean that all of you must go to some trouble to accomplish it. In my travels around the country I have heard many of the younger examiners discuss what they consider to be the drudgery of the profession, and to state that they really see none of the excitement that is contained in the issues we have been talking about here for the past hour or so. I think it is important that you all take the time not only to explain that drudgery is part of becoming a professional, which it certainly is, but to point out also the tremendously far reaching and important issues of the profession you and they are involved in. You owe it to them and we will all be the better for it.

Well, I have covered a lot of territory here and I think that is enough. My thanks for the invitation and please drop by when you are in Washington.