Remarks of

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Over the years, NABAC has acquired a well-deserved reputation for its contributions to banking. Its reputation has been based not only on its competent and highly professional approach to various technical aspects of bank operations but also on its educational programs, such as this NABAC School for Bank Audit, Control, and Operation. Even more important has been NABAC's willingness to change and adapt with the times as reflected in the steady broadening of the scope of its activities. The ablility to move with the times is the hallmark of a dynamic and progressive organization. NABAC fits this description well.

Tonight I would like to comment on several issues that are of particular interest to bank officers with control, audit, or operating responsibilities. They are issues that are closely related to the need for banks and bankers to keep pace with the changing times. They also have broader ramifications for banking as an industry and for the economy as a whole.

First, however, I should like to discuss the relationship of a bank supervisory agency, such as the FDIC, to bank management. Bank supervisors and bank managers share many areas of common concern and interest. Nevertheless, the functions of each are--and should remain--separate and distinct, if our banking system is to prosper in basically the form and substance in which it exists today.

The Federal Deposit Insurance Corporation from the very beginning of its operations in 1934 has devoted much time and thought to defining its role as a Federal bank supervisor in relation to the managements of

individual banks. Essentially, the question is one of delineating the respective boundaries of primary responsibility rather than a detailed listing of specific duties.

Oftentimes, in periods of rapid change, such as the one through which we are currently passing, some confusion tends to develop concerning the proper role of the supervisory authorities and of bank managers. Banks may find themselves seeking the assistance of the bank supervisory agencies in matters that should be the prerogative of management alone. The individual bank may be tempted to shift responsibility for certain activities or decisions to the supervisory authorities. When market rates of interest eased earlier this year, for example, a number of banks in effect indicated a willingness to delegate to others their responsibility for adjusting rates on time deposits to market conditions.

A pluralistic banking system such as ours functions as an effective mechanism only when the responsibility for management is lodged in the individual institution. A major element of strength in our banking system today is the diversity stemming from the multiplicity and variety of individual bank managements exercising individual judgment within the parameters established by the supervisory authorities. Bank supervisors should therefore confine themselves to prescribing standards for the conduct of banking within broad limits in order to give bank managers the necessary latitude in the performance of their activities. Possibly even more important, the bank supervisory authorities can perform a most useful function by helping banks to adjust during periods of rapid change and innovation.

Now I would like to turn to a discussion of some areas which relate to various facets of your responsibilities within a bank. They are receiving increased attention today as a result of our nation's growth and the accelerated pace of change which has created new situations, new problems, and new challenges.

As our nation's population and wealth have grown and transportation--particularly automotive--has become more readily available, our cities have spread out into suburbia. The population shift from rural to urban centers and from cities into the suburbs has been accompanied by a corresponding shift in shopping and other service facilities. Banking has naturally followed--to serve the convenience and needs of business and of individuals. New banking offices--oftentimes departing from traditional designs--are a noticeable feature of these suburban areas.

By following their customers into suburbia, however, bank managers have come face to face with an old problem in a new guise--the problem of bank robberies and burglaries. From 1962 to 1966, the number of bank robberies and burglaries almost doubled. There was a slight decline in the number of these crimes last year, but the dollar amounts involved are continuing to rise.

The movement to the suburbs has increased the exposure of banking offices in these areas because their physical location makes effective protection more difficult. In addition, bank managers, bank marketing experts, and bank designers in expanding services have succeeded in attracting not only customers but also the criminally inclined to their attractive and accessible new quarters. Wide expanses of glass and open space without adequate protective devices and procedures offer a tempting target.

The responsibility for protecting a bank from external--as well as internal--crimes lies with bank management. Bank managers must develop procedures and programs and acquire whatever devices and equipment necessary to protect the bank, its employees, and its customers. From the standpoint of pure self-interest and efficient operation, moreover, the more effective the protection the lower the cost of insurance to an individual bank and the lower the basic cost of insurance to the banking industry as a whole.

Bank supervisors have always been concerned with the adequacy of protective measures taken by bank management. An external crime can impair the overall financial position and solvency of a bank--although the actual losses are generally fully covered by the blanket bonds. In addition, a good bank program of protection against external crimes is a measure of management's capabilities. With the recent increase in the numbers of banking offices in outlying urban areas, the need for added protection deserves renewed attention. From both your standpoint and ours as well as that of the banking public, therefore, this is obviously an area of common concern. I urge that your responsibilities for this aspect of your operations not be neglected.

Of quite a different nature are the complex of problems posed by the growing popularity of bank credit card plans. Their recent proliferation has stemmed from our increasingly affluent society, the aggressiveness of many banks in seeking business in the consumer credit field, and in part from computerization of bank operations, which has facilitated the mechanics of introducing such plans on the scale necessary for them to be profitable.

Bank credit cards and related plans have been hailed as the forerunner of a "checkless society". Unfortunately, they have also been used as a means for perpetrating fraud on banks. Although it is still debatable whether bank credit card plans are a first step toward a "checkless"--and even cashless--society, bank management must concern itself with some of the immediate problems raised by these plans. Does the failure to offer such facilities operate to the competitive disadvantage of the bank? Or does participation add only to overall costs? What are the implications of bank credit cards for the more conventional types of consumer lending services offered by the bank? Do they expand business or merely substitute one type of credit for another? What kind of operational controls should be instituted to determine the creditworthiness of cardholders, the extent to which the cards are used, and the loan limits, and what must be done to protect against abuses?

During this formative period for bank credit card plans, the bank supervisory agencies can help to assess the overall impact of this innovation on individual institutions, on the banking industry, and on the economy as a whole. Areas of vulnerability and potential difficulty can be pointed out. Such guidance will provide support to banks in these periods of transition and change--and thereby promote a strong and vigorous financial system.

As in other facets of banking, a changing environment is responsible for the current interest in the financial reports of banks and related accounting practices. The growing interest in the form of presentation of bank operating statements, for example, is attributable

in part to the widening market for bank shares in recent years. Up until the past decade or so, the investing public has been only mildly interested in bank stock ownership, except for the equities of a few very large institutions. But the situation has been changing. Now the base of bank ownership has broadened. A sharper distinction is being drawn between ownership represented by investment in shares and a continuing management group with recognized obligations to a diversity of interests--shareholders, customers, and the public generally.

Owing in part to greater investor interest in bank shares, the Congress enacted legislation three years ago providing for the disclosure of information pursuant to certain sections of the Securities Exchange Act of 1934. The statute applies only to banks with 500 or more stockholders and assets exceeding $1 million. Each of the three Federal regulatory agencies involved was authorized to implement the statute by its own regulations. Nevertheless, a degree of uniformity in accounting practices is slowly developing for banks subject to the requirements as well as others not covered by the statute. Modified accrual accounting is prescribed, although banks are not required to maintain their accounting systems in precisely the same form nor has there been any attempt to impose industry-wide standards of accounting practices.

Uniformity in bank accounting practices and reporting facilitates the comparison of operations from bank to bank and assists investors in their choice of alternative investment opportunities in the bank share market. But even more significant is the influence of the reporting requirements on the upgrading of bank accounting and reporting standards.

The regulations contribute indirectly to the development of minimum standards of acceptability in bank accounting to better inform bank managers, depositors, and investors, as well as the general public.

The lack of complete uniformity in bank accounting and reporting practices between banks is not a fatal weakness in itself, either for banking or for bank supervision. If a bank is not confined in the straitjacket of a uniform system of accounts, management is free to develop a set of records which best serves its purposes. Thus the larger banks can apply the principles of accrual accounting to their operations where appropriate, while most of the small banks can continue to maintain their accounts largely on a cash basis. If bank management conforms to reasonable standards, the accounting records should provide information to interested persons that is generally comparable with information concerning other like units in the banking system.

What we are striving for is a generally higher standard of bank accounting and reporting. By prescribing standards that permit a desirable degree of flexibility for the individual institution, we hope to achieve our goal with a minimum of interference in the detailed day-to-day operations of banks. The movement toward greater uniformity in the disclosure of bank information and the availability of better information thus reflects the response of the supervisory agencies and the banking industry to the realities and requirements of a modern financial system.

A related issue concerns accounting practices and procedures with respect to specific types of transactions. Instead of becoming involved

in the intricacies of accounting practices, however, I would like to elaborate on the circumstances which have been responsible for the revival of interest in certain bank reporting practices. Agitation for changes in the methods of showing securities transactions in a bank's operating statements, for example, has occurred several times in the past 30 years--whenever there has been a sharp run-up in security yields. Such was the case in 1936-37 and again in 1951-52 after the Treasury-Federal Reserve accord. The issue was revived again--in possibly even greater intensity--in 1966. During these periods, it is obvious that a bank's investment performance would present a better picture if securities losses did not have to be taken all in the year in which they were sustained. On the other hand, if a profit were involved, its deferral over a number of years could provide a tax advantage to the bank. These practices, by taking advantage of the vagaries of the market in the short-run, tend to present a distorted picture to depositors and shareholders of a bank's financial position for the immediate benefit of the individual bank. In such a situation, the interest of investors would be equally well--if not better--served by supplements to the conventional balance sheets and income statements rather than the substitution of new accounting practices that subordinate or ignore the interests of the depositors and the general public.

From the standpoint of the bank supervisory authorities and bank management, the impact of changes in the price structure for securities on the overall liquidity of a bank is more important than its effect on

the form in which the bank's accounts are presented. Once the sharp fluctuations in rates of return on securities moderate, the pressure to alter bank accounting practices will lessen because little immediate advantage can be derived then by an individual bank. Those bank accounting practices which have stood the test of bad times as well as good should not be lightly abandoned. Bank managers must guard against being diverted by transitory short-run phenomena at the sacrifice of sound long-term growth and the basic strength of their institutions.

Bank accounting practices and standards are pertinent also to another aspect of banking still in its infancy--the development of management information systems. Management information systems have become feasible only in the past several years as increased computer capabilities became available to handle the mass of data involved. But a management information system is more than just a data bank. Ideally, it can be a highly sophisticated and useful tool for bank management, providing guidelines for policy and analytical models to assist in bank decision-making. As our problems become larger in magnitude and more complex, the need for such managerial information systems also grows.

Many of you here are--or will undoubtedly be--involved in some stage of the development of a management information system for your own bank. Not only must the quality of the input be high but the systems design must be relevant to the problems to be solved. Internal controls must be instituted to ensure that such a system makes a real contribution to the bank. Initially, the decision must be made whether the management information system concept is even feasible for your bank and whether the

substantial costs involved will be justified by the results. Thorough advance preparation and a good understanding of what a management information system can and cannot do are essential in order to maximize its effectiveness.

The Corporation is investigating the feasibility of a management information system to assist us in carrying out more effectively our supervisory responsibilities and, at the same time, to provide additional support to banks. To a significant extent, the Corporation and bank management are interested in the same information relating to bank operations and in the development of additional useful--and more timely--information. This is not an easy task. The Corporation is currently in the process of drawing up the specifications for such a system. We are contacting many banks for their ideas. It will be some time before any concrete results will be available. We will keep banks informed of our progress.

I have touched lightly on a number of diverse topics which, however, share a common feature. That is, the need for bank supervisors and bank management to remain responsive to the changes that are occurring in banking and in the economy as a whole. Old problems constantly require rethinking, new approaches, and new solutions. New situations in turn require new answers. These are but a few of the challenges that we face today--but they are challenges that promise an exciting future.