FDIC
Speeches

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FEDERAL DEPOSIT INSURANCE CORPORATION

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FDIC CHAIRMAN SEIDMAN PROPOSES NEW APPROACH TO COOPERATIVE STATE-FEDERAL EXAMINATION PROGRAM

Federal Deposit Insurance Corporation Chairman L. William Seidman today told the Conference of State Bank Supervisors that broader acceptance and use of state bank examinations would build upon existing cooperative programs while helping the FDIC achieve its goal of more frequent on-site examinations of institutions demonstrating deteriorating trends.

"Our goal is to conduct on-site examinations of all state nonmember banks rated 3, 4, and 5 at least annually, and 1 and 2 rated banks at least every two years. As it relates to 1, 2, and 3 rated banks, our proposal would envision treating many examinations conducted by state examiners as our own," Mr. Seidman said. "Where state examinations are accepted as our own, FDIC presence in these banks for full-scope examinations would be delayed."

Mr. Seidman estimated that reliance on state examinations could extend the period between full scope FDIC examinations up to two years for 1 and 2 rated banks, and an additional one year for 3 rated institutions. The specific arrangements would depend upon examination schedules developed jointly by each state and the appropriate FDIC examination personnel.

"This is an informal process not based on set rules. It emphasizes results," Mr. Seidman said. "The FDIC has general guidelines that will guide us as we talk with you--but we will be dealing with each state on the basis of its own situation."

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Bank examinations are one of several areas where program cooperation between the FDIC and the states can be improved. Another, Mr. Seidman said, is the planning for bank failures.

With respect to planning for bank failures, Mr. Seidman noted: "The new techniques the FDIC is using to market failing banks require more time prior to failure so prospective purchasers can adequately examine an institution--perhaps as much as three weeks for even the smallest bank. We all know the conditions today are difficult. There are fewer buyers, more banks to sell, and more problems in the banks. For the sake of your systems, we need more time."

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FDIC Speeches

New approach to cooperative state-federal bank examination program:

Remarks by

L. William Seidman

Chairman

Federal Deposit Insurance Corporation

Before

The Conference of State Bank Supervisors

Orlando, Florida

April 11, 1988

It's a pleasure to speak before the Conference of State Bank Supervisors at your 87th Annual Meeting.

I must say that I feel quite at home here in Orlando.

Our nation boasts three great amusement parks. Here in Orlando, we can visit Disney World and the Epcot Center.

California, of course, has Disneyland, where you can see the Matterhorn and ride the Monorail.

And just a few hundred miles to our north, we have Disneyland-on-the-Potomac. It boasts such famous attractions as the Fudge Factory, the Puzzle Palace, the Ollie and Fawn Shredding Party, the Hart-Rice Christmas Special, and the biggest show of them all -- the Budget Busters on the Hill.

The high tech surroundings provided by the Contemporary Hotel make an appropriate venue for your meeting's theme. It's very clear to me that state banks, and state banking agencies, are indeed on the "cutting edge" of the things that are happening in the industry.

In fact, my Swiss Army Knife may have fewer cutting edges than this group can boast of!

Your individual state banking agencies, as well as your state legislatures, have made remarkable progress toward helping the banks you regulate modernize so they can compete.

Our nation's "dual banking system" has allowed state chartered banks to provide leadership in banking. These are banks where new powers and services are tested and developed.

And the Conference of State Bank Supervisors, in cooperation with the FDIC, has played an essential role in increasing the competitiveness and stability of the state banking system.

Many state banks offer services to their customers that go far beyond traditional banking services.

To cite a few examples:

Banks in eleven states can now make equity investments. Twenty states allow banks to do some sort of securities underwriting; eight of these states even permit general securities underwriting. Thirty-five states allow banks to pursue either full-service or discount brokerage activities.

Twenty-three states allow banks some real estate development authority, and in 24 states banks can sell insurance.

States are opting for full-scale interstate banking. While others are choosing to approach interstate banking on a more regional basis.

All these changes and innovations can be good for banks competitively - but it is a challenge - a major challenge to regulators - to keep the system safe and sound.

State and Federal regulators need to develop NEW and IMPROVED ways to work together. And that is what I mostly want to talk to you about today.

The FDIC has reexamined our contribution to this cooperative effort and believe a renewed effort to meet today's challenge must be made by both state supervisors and the FDIC.

The FDIC is working to develop new FDIC procedures that recognize the role of the states and the increasing demands on the FDIC to protect your bank's insurance fund.

Machiavelli might have said about bank supervisors, "Hence it comes about that all armed regulators have been victorious, and all unarmed regulators have been destroyed."

We need to rearm with new tools to do our job and keep banks safe.

The FDIC has traditionally worked with state supervisors in areas such as examinations and supervision, training, legal assistance, development of common paperwork, exchanges of information, and access to the FDIC's computer database. Even closer cooperation would be in the best interest of the states, the FDIC, and the banking industry. Here are our thoughts -- we welcome your reactions.

The FDIC proposes for your consideration a program we would like to label the Supervisors Annual Flexible Examination ("SAFE") program.

With regard to the FDIC examination program, we are attempting to position ourselves to conduct more frequent on-site examinations, particularly for banks that are having problems. I want to emphasis that this program will depend on the flexibility of the FDIC and the state examiners. We need to schedule examinations in a manner that is efficient, and most importantly, that will promote a safe and sound banking system.

This is an informal process not based on set rules. It emphasizes results. The FDIC has general guidelines that will guide us as we talk with you -- dealing with each state on the basis of its own situation.

Briefly, our goal is to conduct on-site examinations of all state nonmember banks rated 3, 4 and 5 at least annually, and 1 and 2 rated banks at least every two years. As it relates to 1, 2, and 3 rated banks, our program would envision treating many examinations conducted by state examiners as our own. These state exams would be placed on our examination-cycle data base, and would be counted as examinations by the FDIC for purpose of tracking adherence to our examination schedule guidelines. So, where state examinations are accepted as our own, FDIC presence in these banks for full-scope examinations would be delayed --

possibly for up to an additional 2 years for 1 and 2 rated banks, and an additional one year for 3 rated banks. In the case of 3 rated banks, our presence would depend on trends in the individual banks.

In the past we've had both informal meetings and structured programs. Now we seek the best of both.

Under this approach, we hope for a regular program -- but not a uniform program. success depends on your concurrence and support.

The FDIC will be asking each state commissioner for a meeting every year in order to develop cooperative examination schedules for the following year. Other meetings may be held as needed to determine our progress. At these meetings we would like to review our common problems, rejoice over our successes, mourn our failures, and plan our cooperative efforts. Each state's effort will depend on its desires, resources, and capabilities.

This approach will allow the FDIC to know, with greater certainty, how much of the examination burden your agencies will carry, and how much will be carried by the FDIC.

As we are all aware, there are a lot of banking problems in the banking industry these days, and even with the increasing number of examiners at the FDIC, there is still far more supervising that should be done than we alone can handle. So we welcome all the help the states can provide.

It is our hope that this approach will permit the FDIC and state agencies to work together more effectively and efficiently.

I also want to stress the value that comes when state and FDIC authorities can coordinate enforcement actions.

After all, as H . L. Mencken said, "Conscience is the inner voice that warns us somebody is looking." Together we can raise banker's consciences.

We consult with state authorities before issuing cease-and-desist orders, as well as in more informal actions. Aside from presenting a unified front, this caliber of cooperation results in improved communication, both among regulators, and between regulators and banks.

There are also a number of new examination tools available the FDIC would like to share with state banking agencies.

All of us can use all the tools we can develop because, to paraphrase Bismarck, people never distort the truth so much as after a hunt, during a war, and before an examination.

One of these new tools is our computer-based Automated Report of Examination (ARE) form, which will speed up examination preparation and processing.

There are still a few bugs to work out of this program, but a few states have already requested, and received, material related to it. We hope to make this program widely available to state banking agencies in the near future.

I note that 37 states now have access to FDIC's computer database, and more states have shown interest. That means nearly a dozen more states are participating in this program TODAY than just two years ago!

Our on-line terminals, and off-site monitory system called CAEL, give states access to Federal call report data, Summaries of Deposits, and bank structure information on all banks.

With regard to the new powers state banks are gaining, the FDIC wants to help keep state banks on "the cutting edge" by making sure that new powers and markets allow banks to prosper, but do not lead to new "safety and soundness" concerns.

We seek your advice on new FDIC policies designed to help us jointly provide the best supervision in the business.

The new FDIC real estate proposal is an example of an area for joint effort.

At present, we see only isolated instances in the state bank "laboratory" where commercial banks are having problems in the real estate investment area. Last year we dropped our proposed regulation in this area. We are now working to see what we can do to focus on problems associated with insider abuse in real estate-related transactions, which is the area we have seen the most problems.

Any FDIC real estate proposal that may go forward will rely on state law as to what banks can do -- with of course appropriate supervision of insider problems and diversification requirements by both the state and the FDIC.

Frankly, we would like to see state bank supervisors gain more authority, and better tools, and better financing.

We like to be helpful in finding ways for more state banking agencies to achieve a stable funding source through examination fees. Our experience tell us that a stable source of funding would enable you to pay more competitive salaries, and to maintain even more effective banking departments. Your help in keeping the FDIC independent was, and is, invaluable in Congress -- we'd like to lend our support for a comparable arrangement at the state level.

We would also like to see more states granted all the powers included in Section 8 of the FDI Act so that we can both act to limit abuse in the banking industry. These include cease-and-desist authority, the power to remove bank officers, and the ability to assess civil money penalties. Rulemaking authority is necessary to put due-process procedures in place. Some states still lack investigative powers, subpoena powers, and the authority to examine bank holding companies.

An especially important area where more cooperation is needed is in the bank failure area. The FDIC continues to pass on as many -- if not all -- assets of a failed bank to an assuming bank.

But this procedure requires more time for prospective purchasers to examine the situation -- perhaps as much as three weeks for even the smallest bank. Conditions today are difficult when we try to sell a bank - there are fewer buyers, more banks to sell, and more problems in the banks. For the sake of your systems, we can use more time.

In the discussions between our regional directors and the state supervisors we need to figure out how the FDIC can be provided more time between our starting preparation for closing a bank and the actual closing date.

Only the cooperation of the chartering authorities can make this new process work. We also need your help in working with the management of failing banks to encourage them to be more cooperative with this "shopping process."

More time means we can handle closings with less disruption and better service to bank customers, and particularly with a better chance for your good banks to make an advantageous purchase of failed institutions.

We at the FDIC look forward to working to make our new sales effort work to your state's advantage.

Another major area for a renew effort is education. We have a new training center well under development -- it will be one of the best in the country.

The FDIC has traditionally supported state training needs. In fact 832 state examiners participated in FDIC or FFIEC programs last year. And we provide this education at bargain rates, subsidizing about 40 percent of the tuition and related costs!

Your education foundation has plans to increase the amount of basic training performed by the states.

Resources are scarce, and to avoid duplicative efforts our programs need to be coordinated -- and soon. We need to sit down and determine what policy will best serve the needs of all the states. We need to conclude what makes sense for the FDIC to do, and what makes sense for the states to do on their own. Of course, the FDIC will be supportive of your plans in this area that maintain excellence in training.

And it should be kept in mind that the quality of training state examiners receive will play a large part in determining the level of responsibility each state can handle in the examination process.

A joint task force should be established to make these important decisions -- and it should be established <u>now</u>!

Coordinated educational efforts will put all of us in a better position to keep the banking system safe and sound. As it has been said, experience alone is a good school. But the fees are just too high.

Finally. I'd like to take just a moment to give you a brief update on the strength of the FDIC, and our ability to handle the problems you have been hearing about in the banking industry.

It is safe to say that the FDIC has just come through perhaps the most challenging year in its history.

But even after handling a record number of bank failures, I'm pleased to say we ended up just in the black with about a 50 million dollar increase in net worth.

The roughly 3.3 billion dollars the FDIC received from premiums and interest last year was needed to handle the cost of last years failures and assistance transactions, plus operating costs.

And that includes the almost one billion dollar assistance package for First City of Houston. Even though it won't be completed until later this year, our reserves for possible losses on the deal were carried on 1987's books.

Some have complained of certain of our policies for handling the Texas problems. But as its been said, "To escape criticism -- do nothing, say nothing, be nothing." That's just a price we cannot afford to pay.

Our inventory of managed assets from failed banks at year end was about 11 billion dollars, exclusive of loss reserves. It stands at about the same level it did a year ago, DESPITE the fact that the number of failed banks in 1987 was one-third higher than the year before.

This enabled us to keep our cash-type reserves high, which after accounting for our assistance to First Republic in Dallas, stands at over 15 billion dollars. That represents almost 85 percent of our net worth of over 18 billion dollars.

So, it is clear that while we have handled a lot of problems lately, the FDIC fund remains healthy. We are prepared to deal with any banking problems we can foresee in 1988.

Anyway, as my friend Henry Kissinger used to say: "There cannot be a crisis next week -- my schedule is already full!"

In closing, the next decade will be an important one for banks. And one of the things that will make or break the future of banking will be if state banking agencies and Federal regulators like the FDIC can improve their record of teamwork.

On the subject of teamwork, I'm reminded of a story told about one of the greatest teams in the history of show business -- Bob Hope and Bing Crosby.

An interviewer once asked Hope to give the secret of their success.

Hope answered; "There's nothing I wouldn't do for Bing. And there's nothing Bing wouldn't do for me. We go through life doing nothing for each other."

But the fact of the matter is they did do a lot for each other -- together they achieved more than either could have achieved by themselves.

Let's make that the story of teamwork between the FDIC and state bank supervisors!

Thank you.