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FEDERAL DEPOSIT INSURANCE CORPORATION

TESTIMONY OF

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CHAIRMAN
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WASHINGTON, D.C.

ON

THE FEDERAL DEPOSIT INSURANCE CORPORATION'S ADDITIONAL SUPERVISORY
RESPONSIBILITIES UNDER THE ADMINISTRATION'S PROPOSAL TO REFORM
THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION AND THE
SAVINGS AND LOAN INDUSTRY

BEFORE THE

EXAMINATION, AUDIT AND REVIEW TASK FORCE OF THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,
REGULATION AND INSURANCE
House COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
UNITED STATES HOUSE OF REPRESENTATIVES

2:00 P.M.
March 22, 1989.
Room 2222, Rayburn House Office Building

Good afternoon, Mr. Chairman and members of the Task Force. Thank you for the opportunity to testify today to discuss the Federal Deposit Insurance Corporation's ("FDIC") increased supervisory responsibilities under President Bush's proposal to reform the Federal Savings and Loan Insurance Corporation ("FSLIC") and the savings-and-loan ("S&L") industry ("President's Proposal").

We support the President's Proposal. As you know, our detailed views on the reform plan, including a few recommended changes, are contained in our written testimony of March 8, when we testified before the Financial Institutions Subcommittee.

Strong supervision is essential to an effective resolution of the problems in the S&L industry. Before the American taxpayers can be asked to shoulder a major portion of the cost of revitalizing that industry, they must be convinced that the government has taken the necessary steps to prevent a repeat of past mistakes. In this regard your efforts are a necessary and most welcome step in that process.

The FDIC brings over fifty years of supervisory expertise to its proposed new role as back-up supervisor of the S&L industry. We are confident that we can handle both the short-term and long-term supervisory responsibilities envisioned in the President's Proposal without undermining our bank supervision activities. We look forward to working with you to ensure that strong supervision is the foundation of the reform plan.

A full response to each question in your letter of invitation is provided in the attachment to this statement ("Attachment"). I now would like to highlight some of the major points made in our responses.

THE FDIC'S ROLE UNDER THE PRESIDENT'S PROPOSAL

The President's Proposal gives the FDIC two principal roles.

Short-Term Interagency Effort. First, the President requested that the FDIC lead a joint effort with the FSLIC, the Federal Home Loan Bank Board ("Bank Board"), the Federal Reserve and the Office of the Comptroller of the Currency ("OCC") to evaluate and oversee thrift institutions that are either currently insolvent under regulatory accounting principles or will become insolvent before the proposed legislation is enacted. Since that program was announced, the regulators, led by the FDIC, have assumed control of 166 S&Ls out of a projected total of approximately 232.

We anticipate that the major impact on our resources from this first role as managing agent of insolvent thrifts will last for perhaps three-to-four months, although we realize that this period could be longer. During the peak period approximately 1,200 to 2,000 interagency personnel from all the involved agencies will be needed. Considering that we are receiving substantial participation from the other federal regulatory agencies and state supervisory agencies, we anticipate at its peak that we will have to detail about 1,200 employees to this effort. Approximately 600 will come from our examination staff and about 600 will come from our liquidation staff.

After the peak period, we expect FDIC involvement to be reduced substantially to around 300 to 400. Since about half that number will come from our

liquidation staff, at most 200 bank examiners, or less than 10 percent of our supervisory workforce, will be involved until the new Resolution Trust Corporation ("RTC") comes into existence.

While this effort will press our resources in the short term, the task is clearly manageable. We already have taken some steps to help compensate for any disruption. For example, we have revised our examination priorities to ensure that, with the help of state supervisors, all banks most in need of close supervision will continue to receive it. Thus, we will not slip in our bank supervision responsibilities. We also have stepped-up our training activities to build our examination force as quickly as possible.

We believe we can handle this first phase of the additional S&L supervisory role because of its relatively short peak period, because the number of banks on our problem list has dropped from a high of 1,624 in 1987 to about 1,350 -- we expect 1989 to show significantly fewer bank failures than 1988 -- and because we are continuing to expand the examination force and improve productivity through automation and more streamlined examination processing procedures.

Long-Term S&L Back-up Role. The second major supervisory role envisioned for the FDIC under the President's Proposal essentially is to back up the Bank Board (to be renamed the Federal Home Loan Bank System ("FHLB System")) in its role of supervising both state and federally chartered S&Ls. The FHLB System will be the primary supervisor for solvent thrifts and its staff of approximately 1,800 examiners will continue to have primary responsibility for

supervising those institutions. It is important to emphasize that this back-up function will require significantly less resources than the primary supervisory function.

As the designated back-up supervisor, the FDIC would have authority, upon notification to the FHLB System, to examine all insured thrifts for insurance purposes. The FDIC also would be authorized to request that the FHLB System or state supervisory authority take any enforcement action applicable to any insured institution or its officers and directors. If the appropriate authority declines to take such enforcement action, the FDIC would be permitted to initiate that action independently.

The extent to which we will need additional staffing to carry out the FDIC's long-term role under the President's Proposal will depend in large part on the ability of the FHLB System examiners to carry out their responsibility as primary supervisor and the actual number of remaining S&Ls following removal of the insolvent institutions and the expected merger of several others. In this connection, the current caliber of that examination corps should not be underestimated.

We believe that the Bank Board has made significant strides recently in improving training, manuals and examination procedures. We expect that a significant part of S&L supervision will be under the FHLB System and that the FDIC will make maximum use of that work product. We are confident of our ability to assemble the personnel resources to meet our responsibilities in this long-term role.

The President's Proposal also places the thrift insurance fund under the FDIC and provides for a separate appropriated agency -- the RTC -- to handle thrift insolvencies. This segregates the responsibility for insolvent thrifts from that of the healthy thrifts. This division of responsibilities is important to discussions of FDIC staffing needs. Our role with the RTC is still being worked out, but it is not envisioned that it will include the use of any substantial number of our examination personnel.

As stated, the enactment of the President's Proposal will require the FDIC to increase staff further. Over the past several years we have worked hard to attract and retain qualified applicants in a planned effort to reinforce our examination staff. Since I became Chairman in 1985 we have increased our field examiner force from about 1,500 to 1,993. Because of turnover, which is not extraordinarily high at 12 percent per annum, we had to hire about 1,000 examiner trainees in order to reach our present staff level. In addition, after allowing for attrition, we have set a hiring goal of 507 new field examiners this year to meet the previously planned field staffing goal of 2,200 examiners by year-end 1989. Our goal for 1990 is another net increase of at least 150. This plan was made without regard to any additional duties included in the President's Proposal.

Including regional and Washington office support staff, the total personnel in our Division of Bank Supervision ("DBS") has increased from 1,800 at the end of 1984 to 2,565 year-end of 1988, and is projected to increase to about 2,800 by year-end 1989.

Given the amount of on-the-job training that is combined with classroom study, we generally have found it possible to assimilate about 400 trainees per year

in the ordinary course of business. A recent review of our training programs and procedures concluded that we could, if necessary, train a greater number of examiner trainees, using improved training techniques and equipment. The next few years will be more challenging than previous years, but we are confident that adjustments can be made to accommodate a greater number of trainees. With 500 new hires this year and at least the same number next year, the assimilation program will clearly expand.

We also have taken, or will take, a number of other steps to ensure adequate examination resources. To help stem examiner attrition and to properly reward performance, we intend to raise examiners salaries to more competitive levels after we receive the results of a commissioned study on private sector wage comparability. In the meantime, as necessary, other salary adjustments will be made to reward our staff. We believe we have already taken significant steps to provide an awards and benefits program which exceeds government norms. These include regional pay differentials and a 401(k) savings plan.

We also have implemented in July 1988 the cooperative Federal/State examination program, called SAFE. This program is consistent with the recommendation made in the Government House Operations Committee October 1988 report on fraud. It is designed to build on a long-standing tradition of Federal/State cooperation by explicitly stating the FDIC policy to communicate and coordinate regularly with the states and make maximum use of state examination resources. The SAFE Program provides additional flexibility and efficiencies in our bank examination work.

FDIC EXAMINATION PROGRAM

I now would like to turn to the FDIC's current examination program. We already have provided the Task Force with statistics on our examination frequency. Last July DBS issued a revised policy for examination priorities and frequency. A copy of that policy statement is attached. The policy established goals for onsite examination interval guidelines of every 24 months for 1- and 2-rated institutions and every 12 months for 3-, 4- and 5-rated institutions. The policy also states that intervals could be extended up to 48 months for 1- and 2-rated institutions and up to 24 months for 3-rated institutions. These extensions, however, apply only if state examinations meeting FDIC needs were performed in the interim and the ratings assigned are confirmed by our offsite monitoring system.

This revised policy was established as a goal that we anticipated reaching over a two-to-three-year period depending on available resources and circumstances within the industry. The prior examination policy permitted examination intervals of up to 60 months for 1- and 2-rated institutions with total assets of less than \$300 million and up to 24 months for 3-rated institutions provided certain conditions were met. The extended examination intervals were necessary at the time because of staffing shortages resulting from various hiring freezes imposed on the agency in the early 1980s and as part of an overall program to rely on state banking departments for examinations of satisfactory-rated banks so that the FDIC could concentrate more of its resources on problem institutions.

There also was a belief at that time that onsite examinations of well rated banks might not be needed as often since our offsite monitoring had improved.

We now believe that more banks need to be examined more often, although not necessarily annually, in order to adequately assess the quality of management and the volume of risk assets.

We have made considerable progress reducing onsite examination intervals. In 1988, for example, we conducted 4,019 onsite safety and soundness examinations compared to only 3,653 in 1987. We have not yet fully complied with our ambitious objective, but we are only about eight months into a projected 2- to 3-year goal.

We would like to emphasize that, even when the FDIC has not conducted a full-scope examination within the prescribed period, we are informed of the bank's condition and are able to set examination priorities based on information received. Banks are subject to sophisticated quarterly offsite monitoring reviews in which any significant adverse or unusual trends are fully investigated by our analysts and examiners. Depending on the circumstances, the follow-up action required to answer an offsite monitoring question could result in an onsite visitation or examination.

The FDIC routinely exchanges supervisory information with the state banking departments including all examination reports, bank correspondence and enforcement actions. All this information is carefully reviewed and used by our field and office staff to monitor the condition of the bank. If a state examination meets our needs it can be used to extend the examination cycles for 1-, 2- or 3-rated institutions. However, even if the examination is not used to extend the examination intervals, the information in the report is used to help us set examination priorities.

Moreover, we have an extensive program of visitations to look at special situations and to keep apprised of a bank's condition. If a bank is in a holding company we also receive and review holding company examination reports from the Federal Reserve and we receive examination reports on other banks in the holding company system from both the Federal Reserve and the OCC. As insurer, we keep informed of the condition of National and State member banks by reviewing all OCC and Federal Reserve examination reports. We also are tied into their computer data bases so that we have access to the most current data.

Thus, the FDIC's examination program should not be judged merely by adherence to examination frequency schedules. While these guidelines are useful for internal monitoring purposes, today's environment demands that we emphasize identifying economic and industry risk and pinpointing individual banks that exhibit symptoms of higher than normal risk. Traditional methods of onsite examinations based on fixed examination cycles have given way to more continuous supervision.

Our examination staff is instructed to gather as much information as possible from as many sources as possible, analyze it thoroughly and establish examination priorities. Time intervals between examinations is only one component of this overall risk analysis. While onsite examinations remain an important part of the supervisory process, they are now being augmented by improving offsite monitoring systems, visitations and other anticipatory measures. Improvement in gathering and analyzing information from various sources has progressed to the point where even if resources were available to conduct annual onsite examination for all institutions, it would not be an efficient use of those resources.

Conclusion

We believe we can assemble the resources to do the short-range and long-range jobs assigned to us by the President's Proposal, while doing an even better job in our banking responsibilities. The FDIC stands ready to assist the Task Force in any way. I would be pleased to answer any questions you may have.

Attachments

ATTACHMENT

QUESTIONS AND ANSWERS

A. Data on Reallocation of Agency Examiners, FDIC Examiner Levels and Attrition, and Examination Frequency

1. Numbers of Agency Examiners Allocated:

(a) Please specify for the OCC, the FRB, the FHLBB, and the FDIC, the numbers of each agency's examiners now assigned or deployed to the FDIC's current insolvent thrift efforts. (b) When does the FDIC expect the peak period to end, and at that time, how will the numbers of examiners deployed to this effort be expected to change?

Response

a. As of March 16, 1989, 831 examiners were assigned or deployed to the FDIC's current insolvent thrift efforts. Of that total, 538 were from the FDIC, 97 were from the FRB, 144 were from the OCC and 52 were from the FHLBB. These totals do not include FDIC liquidation staff.

b. The FDIC anticipates that the peak period will be for a relatively short period of time, perhaps three-to-four months. After the peak period, agency personnel will be cut back to a minimum, with nominal participation by agencies other than the FDIC. It is estimated that the number of FDIC examiners being used will level off at around 200.

2. FDIC Examiner Levels, Attrition Rate, and Hiring:

a. Please set forth (in a table) FDIC examiner levels for year end 1986, 1987, and 1988, and as of February 28, 1989, indicating (a) for each point in time the total examiner levels, (b) the number of examiners which left the FDIC during the period covered, (c) the number which the FDIC hired during that period, and (d) the net increase in numbers of examiners at that point in time.

Response

FDIC Field Examiner Levels, Attrition Rate and Hiring

1987

<u>12-31-86</u> <u>Staff Level</u>	<u>Gains</u>	<u>Losses</u>	<u>12-31-87</u> <u>Staff Level</u>	<u>Net</u> <u>Gain</u>
1726	421	238	1909	183

1988

<u>12-31-87</u> <u>Staff Level</u>	<u>Gains</u>	<u>Losses</u>	<u>12-31-88</u> <u>Staff Level</u>	<u>Net</u> <u>Gain</u>
1909	362	288	1983	74

2-28-1989

<u>12-31-88</u> <u>Staff Level</u>	<u>Gains</u>	<u>Losses</u>	<u>Staff Level</u>	<u>Net</u> <u>Gain</u>
1983	57	47	1993	10

Gains and losses are shown as gross figures with transfers to regional offices and the Washington Office being shown as losses.

- b. (i) In 1988 what was the FDIC's attrition rate for (a) field examiners and (b) other staff within the Division of Bank Supervision (such as legal and supervisory staff)? (ii) What was the attrition rate for more experienced mid- to senior-level examiners? (The FDIC previously stated to the Commerce, Consumer, and Monetary Affairs ("CC&MA") Subcommittee that in 1987 attrition among experienced examiners totalled 1/3 of the total.)

Response

- a. In 1988, FDIC's attrition rate for field examiners was 14.5% if internal transfers to the regional offices and Washington Office are considered. Net of those types of transfers, the attrition rate was 12.0%.
- b. The Division of Bank Supervision's attrition rate for professional staff was 7.2% in 1988 and the clerical attrition rate was 22.9%, both computed net of internal transfers.

The attrition rate for more experienced examiners (Grades 12-15) was 6.10%, net of internal transfers. The 33% attrition rate noted in the question was the number of experienced examiners who left the FDIC as a percentage of total attrition. That percentage for 1988 was 21.2% of the 7.2%.

- c. The FDIC also advised the Government Operations subcommittee that it could not assimilate more than 350 new trainees per year, because it wanted to maintain a ratio of 1 trainee per 5 experienced examiners. Has either the maximum "assimilation" number or the ratio changed, or are they the same? If either has changed, please explain the reasons. (Could you also explain when a trainee is no longer a trainee but considered experienced, the amount of time required.)

Response

For 1989, we have set a hiring goal of 507 new field examiners. That target was designed to enable us to achieve the field staffing goal of 2,200 field examiners by year-end even after allowing for a 12% attrition rate.

The FDIC has no official policy of maintaining a ratio of one trainee per five experienced examiners. The larger-than-normal hiring goal for 1988 will make the assimilation process more challenging than in previous years; however, we are confident that the new employees can be trained and placed in our workforce without significant difficulty. In addition to the formalized classroom training for new examiners, trainees also receive individual on-the-job training under the guidance of more senior field examiners. The latter group is now of sufficient size and experience to train a greater number of new employees. We are constantly reviewing our training programs to improve efficiency and effectiveness.

After satisfactory performance as a bank examiner trainee for a one-year period, an employee is promoted to Assistant Bank Examiner, Grade 7. The employee is then eligible for promotion to a Grade 9 assistant examiner in one additional year and to Grade 11 examiner status at the end of another twelve months of satisfactory performance. Thus, it is possible to become a commissioned examiner at some point after three years of satisfactory service.

3. Examination Frequency:

(a) At present, what is the actual frequencies of examinations for (i) non-problem (i.e. healthy) institutions (rated 1 and 2) and (ii) problem institutions (rated 3-5)? (b) What is the FDIC policy or guideline on the preferred frequency of FDIC examinations for (i) non-problem institutions and (ii) problem institutions?

Response

a. Our latest analysis of FDIC examination frequencies was done for the period September 30, 1987 to September 30, 1988. For that period our intervals averaged 35 months for 1- and 2-rated institutions, 18 months for 3-rated institutions and 16 months for 4- and 5-rated institutions. Over that period the FDIC increased the number of onsite examinations from 3,188 in the prior year to 3,829 and significantly improved examination frequency intervals. For example, the number of 1- and 2-rated banks without a regular examination in three years reduced from 1,168 to 272; 3-rated banks with last examinations two years or older declined from 167 to 65 and 4- and 5-rated banks with last examinations two years or older dropped from 72 to 12.

It is important to note that between regular examinations the FDIC receives and reviews a variety of information from several sources which helps us monitor the condition of the bank. All banks are subject to quarterly offsite monitoring reviews where our examiners investigate adverse or unusual trends and perform onsite visitations when necessary. Importantly, we also receive additional information from interim state examinations and visitations. If the bank is part of a holding company, we receive

holding company examination reports from the Federal Reserve as well as examination reports from other Federal and state agencies on other banks in the holding company. In other words, even when the FDIC has not conducted an onsite examination for a longer than normal period, we are informed of the bank's condition and we are able to adjust examination priorities, based on the information received.

- b. The FDIC policy for 1- and 2-rated institutions is to conduct an examination at least every 24 months. The examination interval can be extended up to 48 months when: (1) an interim state examination that meets FDIC needs has been performed, and (2) our offsite monitoring system confirms the rating. For 3-rated institutions the FDIC policy is to conduct an examination at least every 12 months. The examination interval for 3-rated banks can be extended up to 24 months when: (1) an interim state examination that meets FDIC needs has been performed, and (2) our offsite monitoring system confirms the rating. For 4- and 5-rated institutions the FDIC policy is to conduct its own examination at least every 12 months. A copy of our formal policy on examination frequencies is attached.

4. Projections on FDIC examiners needed to backup the Bank Board System:

If the Administration's proposal is enacted, with the FDIC becoming the deposit insurance agency for savings institutions, how many examiners does the FDIC project that it will require in a supporting role to the Home Loan Bank System (which will be the primary supervisor for these institutions)? Please describe any discussions with the Bank Board or with the Treasury Department on this.

Response

We believe the FHLB System, with 1,800 examiners, recently has made significant progress in improving its overall examination program. The number of additional FDIC examiners required will depend on our analysis of that program. Generally we intend to make full use of their work product and we intend, in most cases, to have our examiners accompany FHLB System examiners on their examinations to evaluate the examination program as well as provide information on the condition of solvent S&Ls. The number of independent FDIC examinations will be few. Our hiring projections will be based primarily on an analysis of the initial evaluations and on the number of S&Ls remaining once the insolvencies and the expected consolidations take place.

Without having done that analysis, our best estimate is that it will require 400 to 600 additional examiners to properly perform the back-up supervisory role envisioned by the President's Proposal. These numbers are preliminary estimates and could be higher or lower depending on the condition of the S&L industry and the level of confidence we develop in the FHLB System examination and supervision program.

We have had no formal discussions with the Bank Board or Treasury Department on this issue.

B. FDIC Examiner Compensation: Amounts, Deficiencies & Increases

1. Increases in Examiner Salaries: How much were examiner salaries increased in 1987, 1988, and 1989 (to present?)

Response

Examiner salaries increased in these years by the Government-wide annual salary adjustment and, in some locations, as warranted by the Corporation's regional pay differential program. The Government-wide salary adjustment for 1987 was 3%; for 1988 2%; and for 1989 4.1%. Regional pay differential rates are reviewed and adjusted annually as a percentage of base pay. The rates currently in effect for 31 locations nationwide range from a low of 0% to a high of nearly 20%--with the average covered employee receiving an 8% pay adjustment. In 1987, 27 locations were covered with a low of 1% to a high of nearly 19%. In 1988, 28 locations were covered with a low of 1% to a high of nearly 20%. In both years the average adjustment was 8%. In addition to the salary differential, the Corporation offers a benefit package which includes its own pre-tax or 401(k) savings plan separate from the Federal Thrift Savings Plan, free vision and dental care insurance, and privately sponsored health and life insurance programs. The FDIC also has established an Incentive Awards Program which recognizes and rewards employees whose performance or cost savings ideas contribute to the productivity and efficiency of the Corporation.

2. Examiner Salary Ranges:

Please provide data on the numbers of FDIC examiners in each of the following salary ranges at present (or, if present data is not readily

available, then the most recent data): (a) less than \$20,000, (b) \$20,000 to \$29,999, (c) \$30,000 to \$39,999, (d) \$40,000 to \$49,999, (e) \$50,000 to \$59,999, and (f) \$60,000 plus.

Response

<u>Base Salary Ranges*</u>	<u>Field Examiners</u>	<u>Regional & Wash. Prof. DBS Staff</u>
Less than 20,000	244	1
\$20,000 to 29,999	889**	2
\$30,000 to 39,999	190	20
\$40,000 to 49,999	443	26
\$50,000 to 59,999	212	209
\$60,000 plus	15	73

*Not including regional differentials

**This figure reflects the Corporation's aggressive recruitment of Bank Examiners (Trainee) over the last 4-1/2 years. Most of the individuals hired during that time are presently in the GG 7-11 salary range.

3. Past FDIC Surveys on Examiner Compensation:

Has the FDIC conducted or contracted for any past surveys on what salary increases were necessary to keep FDIC examiner salaries competitive with those in the private sector? If so, what did the surveys show? And how did the FDIC respond to them?

Response

The Corporation has not previously conducted any surveys to determine what, if any, salary increases were necessary to keep examiners salaries competitive with those in the private sector.

4. FDIC's Response to Pay Increase Recommendation and Need for FDIC Action:

- a. Who is conducting the study which the FDIC has commissioned? (Please provide a copy of the contract or project guidelines.) What is the status of the study and have any tentative conclusions been reached?

- b. Why was the report's recommendation for an immediate increase rejected outright (although there are FDIC funds for pay increases)?
- c. On March 9, 1989, the Secretary of Transportation announced an "experimental pay allowance" under a 5 year demonstration project, providing for a "retention allowance" of up to 20 percent of basic salaries for 2,100 air traffic controllers, inspectors and technicians at 11 facilities in "difficult-to-staff" locations. (The details of this project are set forth in the March 10th Federal Register.) Please explain why the FDIC has not considered and then implemented a similar demonstration, as a solution to the drastic shortfall it is encountered.

Response

- a. & b. The FDIC solicited competitive bids from outside consulting firms to review salary levels. A copy of the solicitation package is attached. Four bids were received by March 13, 1989. Those bids will be evaluated and a selection made by a committee being established by the Deputy to the Chairman. No immediate adjustment has been given because we believe we need more information as to amount and how to properly allocate any raises. We expect to grant at least some interim adjustments very soon. See also our response to Question 1, above.
- c. The Corporation has had a Regional Pay Differential program in place since December 23, 1984. The differential rates are reviewed and adjusted annually as a percentage of base pay. We will look at the D.O.T. program for any characteristics that may work for the FDIC.

C. Other Alternatives To Address Inadequate Numbers of FDIC Examiners

1. Use of Outside Organizations:

(a) Has the FDIC actively explored contracts with outside accounting firms, investigative firms, or other kinds of firms or consultants, to assist the FDIC in managing or closing insolvent thrift institutions, to take some pressure off its own examination resources, and, if not, why not? (b) if these alternatives have been explored, but rejected, what are the impediments making such alternatives not feasible?

Response

a. To date, the FDIC has not actively explored the use of outside firms or consultants to assist in its current thrift efforts. However, we intend to fully review the options in this area.

b. Not applicable.

2. Better Utilization of State Resources:

a. For how many states is the FDIC willing to accept a state banking agency examination in lieu of a FDIC examination, fully utilizing the State report? For how many States is the FDIC not willing to so accept?

Response

The FDIC accepts State banking department examinations, in lieu of an FDIC examination, from 32 states. We review all state examination reports, however, on an individual basis. In 6 other states, the FDIC accepts some of the examination reports and enters financial information from those reports into the FDIC data base.

Even in the 12 states where the FDIC is unwilling to accept examination reports, the state examinations are not ignored. The reports are reviewed for informational and follow-up purposes by Regional Office staff and field office supervisors and thus play a role in establishing priorities in scheduling FDIC examinations.

- b. (i) Since the Government Operation's Committee's October 1988 report, has the FDIC specially (a) conferred with each State banking department, (b) reappraised its use of State examination reports, and (c) given direction to FDIC regional directors to better utilize those reports done in a competent and thorough fashion by State regulators? (Please describe any such actions.) (ii) For each of these recommended actions not taken by the FDIC, specify why not? (iii) And is the FDIC now prepared to reconsider and take specific steps, including increased consultation, coordination, data sharing, joint-examinations, or other actions or the formulation of new regional agreements).

The FDIC has conferred specifically with all 50 State banking departments since October 1988. In addition, the FDIC has also conferred with banking authorities from Puerto Rico, Guam, American Samoa and The Federated States of Micronesia. The use of State bank examination reports is reappraised on a continual basis with a clear bias towards accepting and relying on as much information as possible without lowering FDIC standards for accurate information. During a recent management conference between Regional Directors and Division of Bank Supervision senior management the relationships and interactions with State authorities were fully discussed with the importance of getting as much cooperation and help from the states as possible being emphasized.

As mentioned above, examination reports from 32 states are fully accepted in lieu of FDIC examinations. In all states, coordination of scheduling takes place not only at the Regional Office level but also between FDIC field office supervisors and their state counterparts. Regional Directors are instructed by an active directive to consult, coordinate examination scheduling, share data, conduct joint and/or concurrent examinations and form formal or informal regional agreements to the fullest extent possible.

The FDIC takes active measures to maintain good relations with state authorities and improve the quality of state examination staffs. The FDIC makes its data base and early warning system available to the states, we provide examination forms for those states using the FDIC examination report, and we provide training for state examiners at the FDIC's training facility.

3. Expanded Role of Independent Audits:

- a. Does the FDIC have statutory authority to order independent audits (with possible limited audits for very small institutions) for all state nonmember banks supervised by it? Does it have such authority to order independent audits for all FDIC-insured banks, irrespective of which agency is the primary regulator?
- b. If the FDIC does have such authority for state nonmember banks, is it prepared to revisit this issue to order independent audits for these banks? If not, why not, given the infrequency of FDIC examinations?
- c. If such authority (for both categories of banks) is missing, should the Congress confer on the FDIC such authority in the legislation under consideration?

Response

- a. The FDIC has the express authority to require insured State nonmember banks that are registered under the Securities Exchange Act of 1934 to have periodic independent audits. We also have authority, where necessary, to require external audits as a condition to granting federal deposit insurance. In addition, we have ad-hoc authority to include provisions requiring external audits in individual cease-and-desist orders.

There are no specific provisions in the Federal Deposit Insurance Act authorizing the FDIC to require insured State nonmember banks to employ independent auditors to conduct external audits. Thus, we have no express authority to require independent audits of non-registered State nonmember banks through a regulation of general applicability. However, we believe that we have implied authority to require external audits generally. Nevertheless, we have not chosen to invoke this authority, nor has it been tested; therefore, our authority in this area remains unclear at this time. Our authority to require external audits of all FDIC-insured banks, regardless of their primary Federal regulator, also is unclear.

- b. The FDIC continues to agree in principle with the desirability of independent audits for all insured banks, with perhaps some special allowance or exemption for very small banks. In keeping with this view, the FDIC Board of Directors approved the attached Statement of Policy Regarding Independent External Auditing

Programs of State Nonmember Banks on November 16, 1988. This policy strongly encourages all insured state nonmember banks under our supervision to adopt an annual independent external auditing program. Although it lacks the force of law, we are confident that over time the flexible application of the policy statement by our examiners and regional office staff will achieve positive results in terms of a much-expanded use of external audit programs by insured nonmember banks under our supervision.

Furthermore, the banking agencies have added an item to the Reports of Condition and Income that requires each bank to indicate in the March quarterly report the level of auditing work performed by independent external auditors during the prior year. This new item should enable us to see what changes result in external auditing programs of banks over the next several years. Thus, we would not be inclined to revisit the issue of requiring independent audits for banks until sufficient time has elapsed to assess the effectiveness of the new policy. We also continue to believe it would be unfair to have a regulation that did not apply equally to all categories of banks.

4. Other Alternatives: What other alternatives exist, in the FDIC's view, which could respond to the serious shortage of experienced FDIC examiners? Please describe them and indicate how the FDIC intends to utilize such alternatives, if such is feasible.

Response

As indicated previously, the FDIC hopes to attain a goal of 2,200 field examiners by year-end 1989. Further increases in subsequent

years can be expected. Our examination efficiency is consistently improving and our examination staff has increased dramatically -- from a low of 1,389 in 1984 to 1,993 at the present time. Increased efficiency, improved methodology -- including maximum use of automation -- and periodic review of priorities will be a continuous part of our program.

The FDIC is continually alert to alternatives for addressing our increasing workload. In the past we have initiated programs for hiring loan analysts and have contracted with CPA firms to assist in bank examinations, but with mixed results. The CPA program, for example, was dropped because of the high cost and insufficient number of available senior level CPAs to participate in the program. Further, the strict conflict-of-interest and confidentiality standards required for FDIC examiners and which had to be imposed on CPA personnel created an unacceptable burden. Also, bankers were concerned over CPA employees having access to their records when the same CPA firm may be providing consulting services to their competitors. These problems severely limited the attractiveness of the program.

While outside contractors remain an alternative that the FDIC will continue to explore as necessary, we have had better success handling workload increases by using expedited examination procedures such as visitations and targeted examinations and through better utilization of state banking department resources and expanding our own staff.

1. Creation of a wrongful discharge remedy:

- a. Does the FDIC have any information (including anecdotes) concerning bank employees or officers who provided information to the FDIC (or other agencies), including the frequency of such disclosures and also any discrimination which such officers/employees have suffered? (b) Are there any problems or concerns which need to be taken into account in considering this proposal?

Response

The proposed legislation would provide a cause of action for a person who has been wrongfully discharged by a financial institution for providing information about a possible violation of law to a regulatory agency or to the Department of Justice. We do not have any reliable means of quantifying the nature and extent of disclosures covered by this section nor of any recriminations that might have been suffered by those coming forward with the information. Bank supervisors in our regional offices report that, in their experience, situations of the kind contemplated in the proposed legislation are not numerous but have occurred often enough for them to recognize a need for the proposed legislation.

The following case is illustrative of many others: While copying bank records to be given to the bank's auditors, a bank employee noticed differences in the financial information being prepared by the chief executive officer. She made copies and provided them to the FDIC. She was immediately dismissed by the bank and later brought action against the bank for wrongful dismissal.

The information she provided the FDIC led to a full examination of the bank and an investigation into the activities of senior management. A temporary cease and desist order was issued; the executive was formally removed and ordered to pay a civil money penalty of \$250,000. The bank has since been merged with FDIC assistance. For taking a courageous step and informing the FDIC, the bank employee lost her job and had to pay legal expenses to get unemployment compensation because the bank contested her right to receive benefits. Because the bank has merged, the status of her claim is uncertain.

Notwithstanding the obvious protection afforded an employee who steps forward courageously to inform authorities of violations of law, the mere fact that the protection is available, if properly publicized to bank employees, should encourage them to volunteer information to regulators that might lead to earlier detection of violations and might actually deter bank insiders from attempting the violations in the first place.

2. Establishment of a reward or bounty provision:

- a. Does the FDIC have any information indicating that such a reward would bring forth information which could prevent unsafe and unsound practices or other violations in financial institutions?
(b) Are there any problems or concerns (including potential administrative difficulties), which need to be taken into account in considering this proposal? (c) What would be the source for the funds to pay the rewards? Does this need to be addressed in the legislation?

Response

We have no information on which we could conclude positively that a reward or bounty provision would elicit enough reliable information to improve the safety and soundness of financial institutions. We believe that some people who might not do so under present circumstances would be induced by the prospects of receiving a reward or bounty to bring forth information. As with any new provision, administrative problems are likely but should diminish over time. The payment of something of value to a potential witness in either a civil or criminal proceeding, however, might prove troublesome in that the person's motive for providing the information could be questioned.

We believe the funds used to pay the reward should come from the penalty that is collected and that the reward should be deducted from the penalty before the funds are paid to the U.S. Treasury.

Division of Bank Supervision

MEMORANDUM SYSTEM

Classification Number

6610(S)

Date July 29, 1988

Issuing Office DBS/PPD

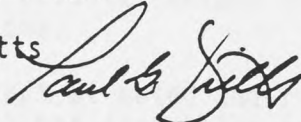
Contact

Robert Walsh, 6911

Notice Memorandum

TO: Regional Directors

FROM: Paul G. Fritts
Director



SUBJECT: Policy for Examination Priorities and Frequency

1. Purpose. To set forth DBS policies for examination priorities and frequency and to define those areas where Regional Director discretion is allowed.

2. Background. The FDIC examination program is designed to help maintain public confidence in the integrity of the banking system, monitor compliance with applicable laws and regulations, protect the insurance fund and establish a factual record to support recommendations for corrective actions. Examinations are the crux of the risk identification process. However, the process of identifying and controlling risk on both an individual bank and industrywide basis has become more difficult as additional powers are granted and banks expand into a wide range of new activities. The Division believes deregulation of the industry must be balanced with a more intense supervisory program. This memorandum revises current policy to require more frequent onsite examinations for all insured State nonmember banks while continuing to give priority to all insured institutions requiring special supervisory attention and to those institutions presenting the most risk to the insurance fund and the industry.

3. Examination Intervals -- Safety and Soundness Examinations. The standard safety and soundness examination intervals for insured State nonmember banks are set forth below. Subsection "a" details the criteria to be used for extending the examination intervals. The CAEL monitoring system should be used with information obtained from State examinations, visitations, offsite reviews and other sources to establish examination priorities especially for those institutions with extended intervals. Although this memorandum sets forth maximum intervals for examinations and certain visitations, Regional Directors are encouraged to perform additional examinations or visitations whenever necessary.

<u>Composite Rating</u>	<u>Maximum Interval (Months)</u>
1	24
2	24
3	12
4	12
5	12

a. Extended Intervals. Intervals for 1- and 2-rated institutions may be extended up to 48 months and intervals for 3-rated institutions may be extended up to 24 months when: (1) an interim State examination that meets FDIC needs has been performed, and (2) the "CAELDIFF" score of the CAEL monitoring system confirms the rating. There should be no more than 24 months between the State examination and an FDIC examination for 1- and 2-rated institutions, and no more than 12 months between the State examination and an FDIC examination for 3-rated institutions.

b. Offsite Reviews. Offsite reviews should be conducted in accordance with outstanding instructions.

c. Visitations. Except as noted under "Other Situations," the Regional Director (or designee) has discretion to conduct visitations as necessary to: (1) monitor compliance with a formal corrective order or an informal agreement; (2) comply with CAEL followup requirements and to investigate other adverse or unusual situations; (3) determine progress in correcting deficiencies noted at the previous examination; (4) act as an effective investigative and supervisory tool as deemed necessary; and (5) comply with frequency schedules described under "Other Situations" listed below. While a visitation is not a substitute for an examination, it may be expanded into an examination when deemed necessary.

d. Other Situations. In addition to the preceding instructions, examinations or visitations should be performed in the following situations:

(i) Newly chartered and insured institutions:

- ° Visitations should be conducted within the first three and six months of operation. An examination is to be conducted within the first 12 months of operation. Subsequent to the first examination and through the third year of operation, at least one visitation is to be performed in each 12-month period during which an examination is not conducted.
- ° State examinations that meet FDIC needs can be substituted for the required FDIC examinations or visitations outlined in this subsection subsequent to the initial visitations and examination.

(ii) Institutions converting to insured nonmember status, including national, State member, thrift and industrial bank conversions:

- ° For national and State member banks converting to insured nonmember status, a visitation should be conducted within the first six months after the conversion. An examination is to be conducted within 24 months of the last examination prior to conversion if the institution was assigned a rating of 1 or 2 and the rating is confirmed by CAEL. An examination is to be conducted within 12 months of the last examination prior to conversion if a 3-, 4- or 5-rating was assigned or indicated by CAEL or to investigate other adverse or unusual situations.

- ° For thrift and industrial bank conversions, a visitation should be conducted within the first six months after the conversion. An examination is to be conducted within 24 months of the entrance examination if the institution was assigned a rating of 1 or 2. An examination is to be conducted within 12 months of the entrance examination if a 3, 4 or 5 rating was assigned.
- ° Thrift institutions and industrial banks that have not had an FDIC entrance examination prior to the conversion should have a visitation within three months after the conversion and an FDIC examination within 12 months after the conversion.

(iii) Institutions which have had a change of ownership control:

- ° If the Regional Director's knowledge of the new ownership reflects a satisfactory financial and management performance record, standard examination intervals apply. If new ownership is unknown, at least one visitation is to be conducted within the first three months after the change of ownership control and an examination is to be conducted within the first 12 months after the change. Subsequent to the first examination and through the third year from the change, at least one visitation is to be performed in each 12-month period during which an examination is not conducted.
- ° Subsequent to the initial visitation and the first examination, State examinations that meet FDIC needs can be substituted for the FDIC examinations or visitations required in this subparagraph.

(iv) Insured institutions that have received FDIC assistance or been involved in purchase and assumption or deposit transfer transactions:

- ° Acquiring institutions with total assets in excess of ten times the deposits acquired, which are rated composite 2 or better, and have an acceptable CAELDIFF score are exempt from the following requirements, including any reporting. Aside from the initial visitation, the requirements outlined in this paragraph are part of the ongoing supervisory process. Procedures directly related to compliance with assistance agreements will be described separately.
- ° If the institution is a State nonmember, a visitation is to be conducted within 30 days of the date of the transaction to determine how funds from the FDIC are being used and whether the bank is in accordance with the assistance agreement, if there is one. A second visitation is to be conducted within six months of the transaction. A third visitation should be conducted within the second 12-month period after the transaction.
- ° If the institution is a State nonmember, an examination is to be conducted within the first 12 months of the transaction. Thereafter, the standard examination frequency schedule applies.
- ° For national and State members, a cooperative program should be established with the other Federal supervisory agencies to ensure

that all institutions receiving FDIC funds are properly monitored. The primary Federal supervisor has responsibility for the oversight of the institution and should be requested to keep the FDIC Regional Director informed of important developments. The Regional Director has discretion to determine the extent of direct FDIC involvement in this process.

- ° The Regional Office is to submit to the Associate Director, Supervision, Enforcement and Surveillance Branch, a quarterly report that includes: (a) a listing of each assisted or assuming bank including State member and national banks; (b) a brief description of the bank's condition including the uniform bank rating; (c) the CAEL rating and CAELDIFF score; and (d) the Region's supervisory plan for each bank including the oversight performed by other Federal agencies. Banks should remain on the list for two years. Any deviation to the examination or visitation schedule outlined in this subsection should be explained in this quarterly report.

4. Coordination with State Authorities. Every effort should be made to coordinate examination and visitation schedules of all FDIC supervised institutions with State authorities to take advantage of State authority resources and to minimize duplication of effort and burden on the institutions. Toward the end of the year, the Regional Director (or designee) should meet with representatives from each State banking authority to determine relative examination responsibilities for the upcoming calendar year. This may be done in broad categories by rating, size and location of institution or it may be done by specific institution as deemed appropriate. Such agreements should remain informal, with enough flexibility to allow either party to alter schedules with minimal notice.

The agreement should strive to provide for a safety and soundness examination and, where appropriate, specialty area examinations of all insured State nonmember banks within intervals (including allowable extensions) not less frequent than those prescribed in this memorandum. While State law examination requirements should be considered in the negotiation process together with other appropriate factors, such statutory requirements should not be the determining factor in the final agreement.

5. Coordination with Other Federal Agencies of Bank Holding Company Inspections and Subsidiary Institution Examinations. Federal bank regulatory agencies have agreed to conduct coordinated bank holding company inspections and lead bank examinations for: (a) any bank holding company with consolidated assets in excess of \$10 billion; (b) any bank holding company or its subsidiary lead bank rated composite 4 or 5 under the bank holding company rating system or the uniform rating system for banks; and (c) any bank holding company or its subsidiary lead bank rated composite 3 whose financial condition appears to have worsened significantly since the last inspection or examination. In multibank holding companies without a designated lead bank, the largest bank in total assets generally should be considered the lead bank. However, when other banks in a holding company are similar in size or larger than the designated lead bank, the condition and general performance trends of those banks together with the lead bank should be an important factor in establishing examination

priorities. Whenever possible, examinations and inspections are also to be coordinated for all other bank holding companies.

Bank examinations for subsidiary banks within a multibank holding company should be coordinated with the parent inspection to the extent practicable and where resources will permit. Regional Directors (or designee) should meet at least annually with their counterparts from other Federal agencies in order to develop a coordinated schedule that will maximize the efficient use of examination resources and enhance the integration of bank and bank holding company examinations. The appropriate State bank regulator should be kept informed and encouraged to participate in the coordinated Federal efforts affecting State banks. Coordination of inspections and examinations should focus on the use of common financial statement dates where possible, and allow for joint discussions of examination findings with management. Absolute concurrency, common "as of" dates or simultaneous starting dates are not required.

Examinations of nonbank affiliates may be conducted at the discretion of the Regional Director, but independent examinations of holding companies supervised by the Federal Reserve may not be conducted without prior approval of the Washington Office.

6. Supervision of Interstate Banking Organizations and Chain Banks. In addition to the guidelines outlined in paragraph No. 5 above, a coordinated supervisory strategy for interstate banking organizations (both inter- or intraregional) should be developed. Regional Directors are responsible for designating a lead Region to design an appropriate supervisory strategy for those organizations and to ensure pertinent information is conveyed in a timely manner to other DBS Regions and to appropriate Federal and State regulators.

The supervisory strategy developed by the lead Region should combine traditional supervision of individual units with an appropriate top-down approach to assess risk and monitor and coordinate supervisory actions. For these organizations, the Regional Director has discretion to omit, delay or modify existing examination frequency policy if: (1) the financial condition of the holding company and lead bank is considered satisfactory; (2) the condition of the subsidiary units is believed to be satisfactory; (3) control over all insured banks in the organization is effectively centralized; and (4) management is favorably regarded. Refer to Regional Director Memorandums related to supervision of interstate banking organizations, Classification No. 6610, for further guidance in this area.

It is the policy of the Division to monitor and supervise banks that are part of a chain banking organization in a manner that fully considers the financial impact of the consolidated chain on the individual institutions within that chain. Regional Directors have been assigned responsibility for maintaining a record system for chain banking organizations and for developing an overall supervisory strategy for those organizations. This involves interregional planning sessions to: (1) evaluate examination priorities; (2) assign Regional responsibility; (3) develop examination strategies; and (4) coordinate the process with other supervisory authorities, as appropriate. Refer to Regional Director Memorandums related to chain banks under Classification No. 6800 for more specific guidance in this area.

7. Examinations of National Banks, State Member Banks and Federal Savings Banks. Regional Directors may use their discretion in planning examinations of State member, national and Federal savings banks. Examinations of State member banks where an FDIC presence is deemed appropriate will be subject to approval by the Director of DBS under existing guidelines. Examinations of Federal savings banks should be performed in accordance with the cooperative examination program that became effective in July 1984. Examinations of multinational national banks are to be decided on a case-by-case basis by the OCC's Senior Deputy Comptroller for Supervision and the FDIC's Director of the Division of Bank Supervision. Examinations of all other national banks, including large regional institutions are to be determined at the Regional Office level. Factors to be considered when establishing priorities for State member and national bank examinations include risk to the insurance fund; evidence of serious deterioration which may require corrective action; and whether financial assistance had been granted to the institution. Consideration should also be given to examining or participating in examinations of large well-rated institutions as an effective way to gain valuable experience in the large bank environment and in more specialized areas of banking.

8. Entry of FDIC, State and Other Federal Agency Examinations onto the FDIC Database. The Regional Office is responsible for the timely entry of FDIC, State and other Federal agency examination data to the online database. FDIC examination data should be entered as soon as possible after the report is received in the Regional Office. Procedures should also be in place to ensure that State and other Federal agency reports are received within a reasonable time period and that the reports are reviewed and the database updated within 60 days of receipt. With regard to OCC examinations, the Regional Office should have access (either in hard copy or through the OCC's online SMS) to enough information to conduct a proper review. This is necessary to ensure that current examination data are available for offsite monitoring, bid list preparation and a variety of management reports. State examination reports dated after August 1, 1988, that are usable to extend examination intervals should be coded "A" on the examination system. Other State examinations, if useful for information purposes, should be entered and coded "B." Examinations coded "B" will not be used by CAEL. All reports from a given State need not be coded the same way; some can be coded "A" and some "B." Generally, those coded "A" should relate to the agreed upon examination schedule described in paragraph 4.

A Summary Analysis of Examination Report (Form 96) should be prepared for each OCC and Federal Reserve examination report which is reviewed. If all the information necessary to complete the form is not available from the examination report data, the database or discussion with the regulator, the information that is available should be entered. A type code of "N" and a scope of "X" should continue to be used for these examinations. When these codes are used the only items required are the CAMEL rating components and the composite rating together with the examiner-in-charge and date of examination. Additional items such as assets, deposits or classifications may be entered as available.

Since only ten examination events can be retained on the online database at one time, procedures should be established to ensure that the last full-scope or

most complete examination performed by the OCC and Federal Reserve is retained if it is still considered relevant. Other limited-scope examinations or events should be dropped from the database to permit entry of the most current examination.

9. Examination Intervals - Specialty Examinations. Specialty examinations generally should be conducted concurrently with safety and soundness examinations except when the size or arrangement of the department makes it impractical or inefficient to do so. However, when the safety and soundness rating is a 1, 2 or 3 and the specialty area is rated 4 or 5, a specialty examination is to be conducted within a 12-month interval. Conversely, if the safety and soundness rating is 3, 4 or 5, the specialty examination may be extended to the maximum interval if the specialty area is assigned a rating of 1, 2 or 3.

Only the Trust and Data Processing areas are eligible for extra extended examination intervals based on State examinations. The criteria for extending examination intervals in these areas are explained in the appropriate subsection below. Other areas must conform to the standard examination intervals listed below even when the safety and soundness examination has been extended.

<u>Specialty Composite Rating</u>	<u>Maximum Interval (Months)</u>
1	24
2	24
3	<u>24</u>
4	12
5	12

a. Bank Secrecy Act ("BSA") Compliance Examination. The FDIC is required by statute to review compliance with the Treasury Department's currency reporting regulations (31 CFR 103) and FDIC Section 326.8 at each examination of the bank. Accordingly, concurrent BSA reviews should be conducted with each safety and soundness or compliance examination (but not more than once per annum). Where a compliance examination is conducted concurrently with the safety and soundness examination, BSA reviews should be included in the compliance report. A separate BSA review should be prepared when no compliance examination is conducted with the safety and soundness examination. When the safety and soundness examination period has been extended, a BSA review should be done with any interim compliance examination.

b. Compliance. Examinations generally should be conducted concurrently with safety and soundness examinations in accordance with prescribed intervals. Additional examinations or visitations are encouraged as deemed necessary by the Regional Director.

c. Data Processing Facilities. Examinations of data processing facilities operated by an FDIC supervised institution or its subsidiary generally should be conducted concurrently with safety and soundness examinations, in accordance with prescribed intervals. In those cases where the size or arrangement of the data facility makes this inefficient or impracticable, separate examinations may be conducted. Regional Directors have discretion to extend examination intervals for 1-, 2- and 3-rated data processing facilities up to 48 months if there has been an interim State examination that meets FDIC needs since the last FDIC examination. There should be no more than 24 months between the State examination and an FDIC examination for 1-, 2- and 3-rated data facilities. Additional examinations or visitations are encouraged when considered necessary by the Regional Director.

Independent data processing facilities are subject to the same examination frequency policy as financial institutions. Regional Directors should coordinate with other responsible Federal agencies for joint or rotated examinations of data facilities operated independently or by a holding company, or its affiliate, which service both FDIC supervised institutions and other institutions. FDIC participation is encouraged for examinations of national and State member institution data facilities, or their affiliated organizations, which provide services for FDIC supervised institutions.

Examinations of data facilities subject to the Multiregional Data Processing Servicer (MDPS) program will be scheduled at the Washington Office level by the FFIEC's EDP Examination Task Force Subcommittee.

d. Government Securities Dealer and Broker Activity. The Department of Treasury has not issued regulations requiring specific examination frequencies for examinations of Government securities brokers and dealers. Nevertheless, for efficiency, when a bank is both a municipal securities dealer and a Government securities dealer or broker, the examinations of both departments should be conducted concurrently in accordance with prescribed intervals for specialty examinations. A bank which is a Government securities broker or dealer, but not a municipal securities dealer, also should be examined in accordance with prescribed intervals. These examinations generally should be performed concurrently with other types of examinations but may be conducted independently as appropriate. Additional examinations or visitations are encouraged when deemed necessary by the Regional Director.

e. Municipal Securities Dealer Activity. The Municipal Securities Rulemaking Board Rule G-16 requires that an examination of the municipal securities dealer activities of institutions which are registered with the SEC as municipal securities dealers is to be conducted at least once every 24 months. These examinations generally should be performed concurrently with other types of examinations but may be conducted independently as appropriate. Additional examinations or visitations are encouraged when deemed necessary by the Regional Director.

f. Transfer Agent. Examinations generally should be conducted concurrently with safety and soundness examinations or with independent trust examinations, as appropriate, in accordance with prescribed intervals. If an institution

is subject to the transfer agent registration requirements of Part 341 and also has a trust department, the transfer agent function should be examined at all trust department examinations. If the institution does not have a trust department but is subject to Part 341, the transfer agent examinations should be performed with the safety and soundness examination. Additional examinations or visitations are encouraged when deemed necessary by the Regional Director.

g. Trust. Examinations generally should be conducted concurrently with safety and soundness examinations in accordance with prescribed intervals. Separate examinations of larger departments may be conducted when deemed necessary by the Regional Director. Regional Directors have discretion to extend examination intervals for 1-, 2- and 3-rated trust departments up to 48 months if there has been a State examination that meets FDIC needs since the last FDIC examination. There should be no more than 24 months between the State examination and an FDIC examination for 1-, 2- and 3-rated trust departments.

10. Insured Branches of Foreign Banks. The same priorities and frequency of examinations including instructions regarding visitations and other situations described in this memorandum that are applicable to domestic FDIC supervised institutions are applicable to insured branches of foreign banks.

11. Responsibility and Action. Regional Directors should strive to provide for a safety and soundness examination and specialty area examinations of all State nonmember banks within the prescribed intervals (including allowable extensions). Consideration also should be given to the number of State member, national and Federal savings banks that may require FDIC examinations or participation by the FDIC. An estimate showing the number of safety and soundness as well as specialty area examinations by State for the coming year should be submitted to the Director of Division of Bank Supervision no later than January 31 of each year. This projection should be made after discussions and agreements have been made with State and Federal authorities regarding examination responsibilities for the next calendar year. A June 30 progress report should be submitted to the Director of the Division of Bank Supervision no later than July 31. Significant variances from projections or changes in future projections should be discussed in this report.

Full implementation of this examination program will depend on the personnel resources available as well as the general structure and condition of the industry. Because of differences in staffing and overall banking conditions in each Region, implementation periods will vary. However, Regional Directors should request authorization to hire sufficient staff and should develop necessary operating procedures to be in full compliance with this program within a reasonable time period.

When the examination frequency requirements outlined in this memorandum cannot be met because of personnel restrictions or other reasons, a description of the nature and cause of the situation, necessary corrective measures planned, implemented or needed and interim steps being taken to maintain an adequate supervision program should be included with the examination projections due on January 31. An updated discussion should be included with the June 30 progress report. A discussion addressing the general situation existing within the

region is acceptable in lieu of a notification for each institution for which examination requirements cannot be met. However, for a bank rated 4 or 5 which is not examined within 12 months, an explanatory memorandum to the files should be prepared.

12. Effective Date. This policy is effective immediately. Regional Director Memorandums: Priorities, Frequency and Scope of Examinations, May 14, 1985, Classification No. 6610, Transmittal No. 89, Supervision of Banks Having Received FDIC Assistance, March 29, 1988, Classification No. 6610, Transmittal No. 88-044, and Timely Updates to the Online "96" Database, June 13, 1986, Classification No. 6610, Transmittal No. 86-112, are hereby rescinded.

SOLICITATION

FEDERAL DEPOSIT INSURANCE CORPORATION

Solicitation Number: 89002900CD

Date Issued: February 2, 1989

SUBMISSION OF OFFERS

PROPOSALS ARE DUE IN THE OFFICE DESIGNATED BELOW BY 5:15 P.M. EASTERN STANDARD TIME ON MONDAY FEBRUARY 27, 1989

Proposals may be mailed to this address:

Federal Deposit Insurance Corporation
Contracts and Acquisitions Unit, Room F-104
550 17th Street, N.W.
Washington, D.C. 20429
Attn: Campbell DeMallie, Jr.

Proposals may be hand carried to this address:

Federal Deposit Insurance Corporation
Contracts and Acquisitions Unit, Room F-104
1776 F Street, N.W.
Washington, D.C. 20006
Attn: Campbell DeMallie, Jr.

For information call Campbell DeMallie, Jr. on (202) 898-3664 (No collect calls)

See Article I, Statement of Work, in the Contract Special Provisions for a description of the goods and services to be provided under any contract resulting from this solicitation.

OFFER

The firm named below offers and agrees to furnish any or all items upon which prices are offered, at the price offered herein or in papers attached hereto, delivered at the designated points, within the time or times specified herein or in papers attached hereto. Prices are subject to the following prompt payment discount:

None _____ % _____ calendar days (check one box)

Name of Offeror Firm: _____

Address: _____ Signature: _____

Name of Signer: _____

Title of Signer: _____

Telephone Number: () _____ FAX Number (if any): () _____

REQUEST FOR PROPOSALSTABLE OF CONTENTS

1. Signature Page
 2. Contents Page
 3. Part I - Solicitation Instructions and Conditions
 4. Part II - Evaluation Criteria
 5. Part III - Contract Special Provisions
 - Article I - Statement of Work
 - Article II - Consideration
 - Article III - Progress Reports
 - Article IV - Billing Instructions
 - Article V - FDIC Contract Representatives
 - Article VI - Advertising and Publicity
 - Article VII - Confidentiality of Information
 - Article VIII - Conflict of Interest
 - Article IX - Inspection and Acceptance
 - Article X - Option for Phase II
 - Article XI - FDIC General Provisions
 - Article XII - Order of Precedence
- Appendices: "B" - FDIC General Provisions
"C" - Representations and Certifications

Part I - Solicitation Instructions and Conditions

1. It is anticipated that this solicitation will result in a Firm Fixed Price contract with a period of performance of about four (4) months. The anticipated period of performance of Phase I is two (2) months.
2. Any proposal submitted under this solicitation must be signed with an original signature by an official authorized to submit offers and contractually bind the organization submitting the proposal.
3. The proposal shall stipulate that it is predicated upon all the terms and conditions of this Request for Proposals and shall acknowledge any amendments thereto.
4. Envelopes containing responses to this Request for Proposals should be marked with the Solicitation Number - 89002900CD. Also, please reference the solicitation number in your cover letter.
5. Each offeror shall furnish the information required on various pages of this solicitation. The offeror shall print or type his name on any sheets on which he enters any information or makes any changes.
6. Addresses for submission of proposals:
 - (a) Proposals may be mailed to the following address:

Federal Deposit Insurance Corporation
Contracts and Acquisitions Unit, Suite F-100
550 17th Street, N.W.
Washington, D.C. 20429
Attn: Campbell DeMallie, Jr.
 - (b) Proposals may be hand carried to the following address:

Federal Deposit Insurance Corporation
Contracts and Acquisitions Unit, Suite F-100
1776 F Street, N.W.
Washington, D.C. 20006
Attn: Campbell DeMallie, Jr.
7. Proposals received after the due date and time on page 1 may be rejected for that reason.
8. Modifications of otherwise acceptable proposals submitted after the RFP due date may be considered by the FDIC at any time prior to award. Modifications must be in writing and signed by an official empowered to bind the offeror.
9. Because of the time required by the FDIC to adequately evaluate proposals, offerors are requested to specify a proposal acceptance period of not less than sixty (60) days.

CONTINUATION SHEET

Ref. No.
89002900CDPage | Of
4 | 11

10. Prior to proposal submission offerors shall examine the Contract Social Provisions and note all conditions and limitations which may influence execution or completion of the work required. Any discrepancies noted should be identified in writing to the FDIC Contracting Officer for resolution prior to submission of proposals. Any substantive information given to a prospective offeror will be furnished to all prospective offerors as an amendment to the solicitation.
11. If the FDIC, at any time prior to the due date for receipt of proposals, amends or changes any part of the RFP, then the issuing office will transmit an appropriate notification to all prospective offerors, and each offeror shall acknowledge in writing the receipt of any such amendment unless otherwise provided for in the particular amendment.
12. Award of Contract
- (a) The contract will be awarded to the responsible offeror whose offer conforming to this solicitation will be most advantageous to the FDIC, price and other factors considered.
 - (b) The FDIC reserves the right to reject any or all offers and to waive informalities and minor irregularities in offers received.
 - (c) A written award or acceptance of offer mailed or otherwise furnished to the successful offeror within the time for acceptance specified in the offer shall be deemed to result in a binding contract without further action by either party.
 - (d) The FDIC may accept, within the time specified therein, any offer, whether or not there are negotiations subsequent to its receipt, unless the offer is withdrawn by written notice received by the FDIC prior to award. If subsequent negotiations are conducted, they shall not constitute a rejection or counteroffer on the part of the FDIC.
 - (e) The FDIC reserves the right to accept other than the lowest offer and to reject any or all offers.
 - (f) The FDIC may award a contract, based on initial offers received, without discussion of such offers. Accordingly, initial offers should be submitted on the most favorable terms that the offeror can submit to the FDIC.

Part II - Evaluation CriteriaA. General

The technical portion of the proposal will be the most important single consideration in the award of the contract and should, therefore, be as complete and specific as possible. The evaluation will be based on the technical and administrative capabilities of the prospective contractors in relation to the needs of the FDIC.

B. Technical Evaluation Factors

Proposals submitted in response to this RFP shall be evaluated in accordance with the following factors with a maximum total score of 100 points:

1. Approach - Offerors should demonstrate an understanding of the work to be performed by providing a thorough description of their approach to the project.....40 points
2. Personnel - Experience and other qualifications of the people who will perform the project. Offerors should describe in detail what each person will contribute to the project and what experience each person has in the resolution of problems similar to those of the FDIC.....30 points
3. Experience - Technical competence of the firm, as evidenced by the recommendations of references and other sources of information, of successful performance on similar work with respect to such factors as control of costs, quality of work and ability to meet schedules.....30 points

C. Price Evaluation

Price will be a significant factor along with the technical evaluation of an offeror's proposal and will not be disregarded in the negotiation and award of a contract under this solicitation. A separate price analysis will be performed on each pricing proposal received. The contract will be awarded to the responsible offeror whose proposal conforming to the solicitation will be the most advantageous to the FDIC, price and other factors considered.

Part III - CONTRACT SPECIAL PROVISIONSArticle I - Statement of Work

I. BACKGROUND

The Federal Deposit Insurance Corporation (FDIC) was created by the Banking Act of 1933 to protect depositors in the nation's banks, to help maintain confidence in the banking system, and to promote safe and sound banking practices. The FDIC implements these programs through a program of federal deposit insurance for about fourteen thousand (14,000) commercial banks and savings banks, and regulation and supervision, in cooperation with the states, of about eight thousand (8,000) state-chartered banks that are not members of the Federal Reserve System. The other six thousand (6,000) or so commercial banks are covered by FDIC deposit insurance but are regulated and supervised by the Board of Governors of the Federal Reserve System or by the Comptroller of the Currency.

The FDIC has about eight thousand (8,000) employees. Of this number about four thousand (4,000) are temporary liquidation employees. Many temporary liquidation employees are former employees of failed banks whom the FDIC has hired to assist in the liquidation their old employer and other failed banks. They work for the FDIC for an average of two (2) years. The number and location of liquidation offices varies. They are established to support bank liquidation or "bailout" activities and are discontinued when no longer needed. There is currently one consolidated office in Puerto Rico. The others are in the contiguous United States. About two thousand (2,000) FDIC employees are bank examiners. They are hired directly out of college and are trained by the FDIC. Most temporary liquidation employees and bank examiners work in small rural communities. Geographic pay differentials are currently addressed through local differences in the CPI. The other two thousand (2,000) FDIC employees have a wide variety of jobs. Most of these employees work in the FDIC's headquarters in Washington, D.C. or in one of the FDIC's regional offices. FDIC Regional Offices are located in Atlanta, Boston, Chicago, Dallas, Kansas City, Memphis, New York, and San Francisco.

The Federal Deposit Insurance Corporation (FDIC) has the legal authority to develop and use its own pay structure. From its founding in 1933 the FDIC has generally voluntarily subscribed to the U.S. Office of Personnel Management (U.S. OPM) regulations in the areas of pay and classification of positions. Although position descriptions and job evaluation criteria exist, many of the FDIC's jobs have functional responsibilities unique to the FDIC. As a result it has been difficult to measure comparable positions and salary structures against external points of reference.

The FDIC is subjected by law to the U.S. OPM regulations in the critical areas of hiring and promotion practices. The fact that the FDIC is subject to the U.S. OPM regulations has significant impact on how the FDIC's Personnel Office responds to management's needs in these areas.

The FDIC is interested in exploring the advantages and disadvantages of developing a compensation system that is more directly tied to prevailing local pay rates in areas of the country where the FDIC has an employment presence. The FDIC is thus interested in obtaining the services of a contractor with capability and experience in reviewing compensation systems.

(continued)

Article I - (Continued)

II. SCOPE AND STRUCTURE OF THE PROJECT

The Contractor shall review the present salary structure of the FDIC's seventy-five (75) occupations and develop a specific and practical salary program to ensure comparability with the competitive markets. The Contractor shall perform the study in two separately priced phases. The FDIC will evaluate the results of the first phase and decide whether or not to continue with the second phase. It is expected that the FDIC will decide whether or not to continue with the second phase within two (2) months after delivery of the Contractor's final report for Phase I. In accordance with Article X of this contract the FDIC has an option to order the Contractor to perform Phase II for six (6) months after delivery of the Contractor's final report for Phase I.

Both phases of the project entail the review of the present structure, selection of benchmark jobs to be used as a basis for comparison with jobs in the local and national markets, a salary survey of the market, analysis of the data, construction of a new salary structure, the grouping of jobs, and the process to maintain the structure. In addition, Phase II of the project requires the development of new salary administration procedures. This includes describing how salaries would be determined for new entrants, how movement would occur within and between grades or structures, rules for promotion, and how increased experience should be factored into salary determinations. The Contractor shall develop competitive marketplace data for a representative sample of benchmark positions using published data if available supplemented by a marketplace survey of selected positions. In particular, the Contractor shall identify available published survey sources; identify benchmark positions that can be matched with published survey data; develop comparisons between current pay rates and competitive marketplace pay rates for the selected benchmark positions; and estimate the cost associated with bringing current pay rates in line with the competitive marketplace. The Contractor should provide the FDIC with recommended principles and guidelines which can be used to initially set individual employee salaries using the new structure. Also the firm will identify merit pay programs that have been shown to be effective in environments such as the FDIC's. The Contractor should provide extensive communication support throughout the project as well as periodic written status reports and presentations to managerial and employee groups.

III. PHASE I

The Contractor shall explore the feasibility of developing a market-based pay system for the FDIC. To do this the Contractor shall develop the data needed for the FDIC to make an intelligent decision whether or not to proceed with the design and implementation of a market-based pay system. The end product of the Phase I shall be a report containing the Contractor's analysis and findings including a recommendation for whether or not to proceed with the development of a new compensation system. The report shall include a discussion of the important administrative issues that would need to be addressed in moving from the current pay system to a market-based system.

(continued)

Article I - (Continued)

These administrative issues include the following:

1. How is competitive pay data gathered and maintained over time?
2. To what extent would the compensation system be administered centrally versus locally?
3. What will be the basis for determining the amount of the budget available for pay increases in a given year?

IV. PHASE II

The contract will give the FDIC a firm (priced) option to direct the Contractor to perform Phase II which consists of the actual design of a new salary structure, development of policies and procedures for maintaining the pay system, a plan to integrate the existing internal evaluation system with the market-based external pay system, and development of the necessary communication materials, training and support in order to effectively implement the new compensation system.

Article II - Consideration

The FDIC will pay the Contractor the firm fixed price of \$ _____* for performance of Phase I in accordance with this contract. The FDIC has a firm option to acquire from the Contractor the goods and services described as Phase II of this contract for a firm fixed price of \$ _____*.

*To be included in the contract document.

Article III - Progress Reports

The Contractor shall provide progress reports, either verbal or in writing, at the frequency and discretion of the FDIC Project Manager.

Article IV - Billing Instructions

The invoice for the fee shall include (1) the contract number and (2) a short description of the work for which payment is sought. Invoices shall be submitted in original and two (2) copies to:

Federal Deposit Insurance Corporation
Financial Operations Unit/Accounts Payable Group
550 17th Street, N.W.
Washington, D.C. 20429

Article V - FDIC Contract Representatives

1. Project Manager - The "Project Manager" is the chief and only participant to whom the Contractor should look for technical guidance in presenting the work. He or she provides coordination between the Contractor and FDIC committees, division heads, the Chairman of the Board of Directors of FDIC and is responsible for all FDIC technical decisions and directives relating to the project on behalf of the FDIC.

_____ * _____ is hereby designated as the FDIC Project Manager.

2. Contracting Officer - The term "Contracting Officer" means the person executing this contract on behalf of the FDIC and any other FDIC employee appointed by the FDIC to succeed him as Contracting Officer of this contract. There will be only one Contracting Officer at a time but the Contracting Officer may appoint authorized representatives who have limited or temporary authority to represent the FDIC in his stead.

_____ * _____ is the Contracting Officer for this contract. His telephone number is (202) 898- _____ * _____.

*To be included in the contract document.

Article VI - Advertising and Publicity

Neither the Contractor nor its subcontractors, if any, shall issue or sponsor any advertising or publicity that says or implies, either directly or indirectly, that the FDIC endorses, recommends or prefers the Contractor's services. This does not, however, preclude the Contractor from using the FDIC as a confidential reference in seeking other business.

Article VII - Confidentiality of Information

- A. To the extent that work under this contract requires that the Contractor be given access to confidential financial information belonging to the FDIC, the Contractor shall, after receipt thereof, treat such information as confidential and agrees not to appropriate such information to its own use or to disclose such information to third parties unless specifically authorized to do so by the Contracting Officer in writing. The foregoing restrictions shall not apply to:

1. Information which, at the time of receipt by the Contractor, is in the public domain;
2. Information that is published after receipt thereof by the Contractor or that otherwise becomes part of the public domain not through any action by the Contractor;

(continued)

Article VII - (Continued)

3. Information that the Contractor can demonstrate was in its possession at the time of receipt thereof and was not acquired directly or indirectly from the FDIC or other entities related to the overall scope of this engagement; or
 4. Information that the Contractor can demonstrate was received by it from a third party who did not require the Contractor to hold it in confidence nor was bound by the FDIC to hold it in confidence.
- B. The Contractor agrees to hold all information obtained in performance of this contract in confidence, and to disclose it neither to anyone outside the FDIC nor to any Contractor employee not involved in performance of this contract. Furthermore, the Contractor agrees not to use any such confidential information for any purpose other than performance of this contract.
- C. Notwithstanding Paragraphs A and B of this Article VII, in the event that the Contractor is requested or required (by oral questions, interrogatories, requests for information or documents, subpoena, Civil Investigative Demand or other process) to disclose (i) any confidential information or (ii) any information relating to the Contractor's opinion, judgment or recommendations in connection with such transaction concerning the FDIC, its affiliates or subsidiaries as developed from confidential information, it is agreed that the Contractor will provide the FDIC with prompt notice of any such request or requirement so that the FDIC may seek an appropriate protective order or waive the Contractor's compliance with the provisions of this agreement. If, failing the entry of a protective order or the receipt of a waiver hereunder, Contractor is, in the opinion of the Contractor's counsel, compelled to disclose confidential information, Contractor may disclose that portion of the confidential information which the Contractor's counsel advises Contractor that Contractor is compelled to disclose. In any event, the Contractor will not oppose action by the FDIC to obtain an appropriate protective order or other reliable assurance that confidential treatment will be accorded the confidential information.

Article VIII - Conflicts of Interest

- A. The Contractor shall notify the Contracting Officer immediately whenever the work under this contract conflicts with or appears to conflict with the Contractor's obligation to another company or organization. This obligation shall continue for one (1) year after the required date for completion of work under this contract. The Contractor shall furnish sufficient details to permit evaluation of the situation. The Contractor shall not proceed with the performance of the work in question until written notification to do so is given by the Contracting Officer.

(continued)

Article VIII - (Continued)

- B. The Contractor agrees that if after award it discovers an organizational conflict of interest with respect to this contract, then it shall make an immediate and full disclosure in writing to the Contracting Officer which shall include a description of the action that the Contractor has taken or proposes to take to avoid or mitigate such conflict. The FDIC may, however, terminate this contract for convenience if it deems such termination to be in the best interest of the FDIC.
- C. If the Contractor was aware of an organizational conflict of interest prior to the award of this contract and did not disclose the conflict to the Contracting Officer, then the FDIC may terminate this contract for default.

Article IX - Inspection and Acceptance

Inspection and acceptance shall be accomplished by the Project Manager.

Article X - Option for Phase II

The FDIC has a hard (priced) option to obtain from the Contractor the goods and services described in the Statement of Work (Article I) as Phase II. The FDIC may exercise this option within six (6) months after delivery of the Contractor's final report for Phase I.

Article XI - FDIC General Provisions

Appendix B entitled FDIC General Provisions is hereby incorporated into and made a part of this contract.

Article XII - Order of Precedence

Any inconsistency in this contract, unless otherwise provided herein, shall be resolved by giving precedence in the following order: (1) Special Provisions; (2) Statement of Work; (3) Terms and Conditions of the Solicitation, if any; (4) FDIC General Provisions; and (5) Other provisions of the contract, when attached or incorporated by reference.