



NEWS RELEASE

FOR IMMEDIATE RELEASE

PR-44-79 (4-30-79)

Library

MAY 25 1979

FEDERAL DEPOSIT INSURANCE
CORPORATION

Address by

Irvine H. Sprague, Chairman

Federal Deposit Insurance Corporation

before the

Conference of State Bank Supervisors

① The Homestead
Hot Springs, Virginia

April 30, 1979 to ①

The first time I attended your State Supervisors annual convention was ten years ago. Today I was looking forward to renewing acquaintances I made in 1969, but I see only a few familiar faces. Only twelve of you were in office when I left the FDIC in February 1973. Those of you on the Honor Roll* whom I see here today are --

Harry Bloom - Colorado
Jack D. Dunn - Georgia
Tom D. McEldowney - Idaho
Jim E. Faris - Indiana
John B. Olin - Oregon
Bob Stewart - Texas
Dwight D. Bonham - Wyoming

Ten new State Supervisors have been appointed in 1979:

Beverly J. Lambert - Arkansas
Ignacio Borja - Guam
Roy Britton - Kansas
Michael J. Pint - Minnesota
Paul Amen - Nebraska
Ben McEnteer - Pennsylvania
Tany Hong - Hawaii
M. D. Borthick - Utah
Gerald T. Mulligan - Massachusetts
Thomas C. Mottern - Tennessee

While some turnover is unavoidable and perhaps even desirable to maintain a continual flow of new ideas into bank regulation at the State level, I am inclined to think that a somewhat greater degree of continuity at the State supervisory level would be in the public interest. However, I fully comprehend the attendant

* Other Commissioners with six years or more service who are not in attendance are:

Dick Francis - Michigan
Jimmy Means - Mississippi
Carl Cleveland - South Carolina
Walt Wintrode - South Dakota
Erich Mildenberg - Wisconsin

problems of reducing turnover at the top levels of bank regulation because similar difficulties exist at the Federal level.

When I left the FDIC six years ago, I was one of 13 regulators making up the governing bodies of the FDIC, the Office of the Comptroller of the Currency, the Federal Home Loan Bank Board and the Federal Reserve System. Today twelve of those thirteen are gone. I am the lone survivor, and I have been away from the business for six years.

For continuity, we must look to our staffs. The excellent staffs with which we are all blessed help to maintain relative constancy in our regulatory endeavors. Nevertheless, I believe we should make every reasonable effort to reduce the continual flux of our State and Federal supervisors. I, for one, made a commitment to the President to serve out my full six-year term as FDIC Chairman, and I would heartily recommend to those of you appointed for specific terms that you make similar commitments to your respective governors.

Another requisite to achieving excellence in the quality of bank supervision is closer cooperation between State and Federal regulators of financial institutions. At times in the past 15 years the banking system has come under great pressure; in the early 1970s the annual bank failure rate rose to its highest level since before World War II and at one time almost 400 banks were on the FDIC's problem list. To be sure, the number of failures

and problem banks were small by comparison to the number of insured banks. Nonetheless, bank regulators felt their responsibilities more keenly than at any time since the Great Depression. A significant culprit was economic conditions: the longest and worst peacetime inflation in American history and the most severe downturn in the post war period. Another significant contributing factor was the aggressiveness of bankers in liability management and in reaching out for exotic credits, failing to remember the lessons of the past.

The banking system is more sensitive to adversity than it once was and more resilient. But we still face problems, particularly if we have a severe economic downturn. That places regulation on its mettle. If the number of banks requiring close oversight and surveillance is larger, it means that even closer cooperation between primary and secondary supervisors is needed for increased effectiveness.

In that regard, holding company banking represents a particularly important area for supervisory coordination. Holding company banks now hold almost 3/4 of total bank assets in the United States and many have non-bank subsidiaries which cross product lines and State lines. The overlapping jurisdiction at the Federal level has been troublesome and the FDIC has recommended that the supervisor of the lead bank should supervise the holding company and its non-bank affiliates.

Two weeks ago, at an organizational meeting of the Federal Financial Institutions Examination Council, we sorted out priorities. I can tell you that this matter of bank holding company supervision is very, very high on the Council's list.

As you know, the Federal Financial Institutions Examination Council was created by Title X of FIRICA (the Financial Institutions Regulatory and Interest Rate Control Act of 1978). It is made up of the five regulatory bodies, and its purpose is to explore areas of cooperation and consolidation by the agencies. In developing our procedures and establishing our priorities, we created five inter-agency staff task forces: A Task Force on Supervision (Paul Homan, OCC), a Task Force on Consumer Compliance (Harry Blaisdell, NCUA), a Task Force on Reports (Stan Sigel, FRS), a Task Force on Examiner Education (Jim Davis, FDIC), and a Task Force on Surveillance Systems (Bob Eisenbeis, FRS).

The law establishing the Council also gives special impetus to closer cooperation in Federal-State supervision by creating a State liaison committee to meet with the Council to encourage the application of uniform principles and standards. I have recommended in congressional testimony that the Council be given the best possible chance to succeed -- and we at the FDIC will do our part to attain this objective -- with special emphasis on Federal-State cooperative efforts.

The first members of the State liaison committee are:
Ms. Muriel Siebert, the Superintendent of Banks of the State of

New York; Mr. John B. Olin, the Superintendent of Banks of the State of Oregon; Mr. Walter C. Madsen, Superintendent of Banks of the State of Arizona; Mr. Timothy E. Griffin, the Commissioner of Savings and Loan Institutions for the State of Illinois; and Mr. Charles Filson, the Superintendent of the Credit Union Division for the State of Illinois. We will have our first session with your State liaison representatives May 3. We are unanimous in the opinion that these five State representatives will have a meaningful role in our deliberations.

I sense a genuine commitment on the part of all members, including myself, to make the Examination Council work. I know that our performance is going to be closely monitored by Congress and others. If the Council is perceived as ineffectual or as a dodge for genuine progress in supervisory cooperation, we will be confronted with a real push for legislation to accomplish some type of statutory consolidation of financial institution supervision. If it comes to that, I would take the position that such legislation should consolidate the regulation and supervision of all State banks within the FDIC. This would have the effect of separating monetary policy from supervision, except, of course, that the FDIC would continue to make available to the Federal Reserve all the information it needs for the effective conduct of monetary policy. Supervision and the conduct of monetary policy are two very important functions, and each is significant enough in its

own right to merit the full-time attention of the appropriate government agencies.

Regardless of the legislative situation, we all recognize that budget pressure is another significant force pushing the agencies toward cooperation.

Inflation and the opposition of taxpayers to wasteful government expenditures have made State and Federal authorities conservative in their expenditure authorizations. Banking agencies may be better insulated against austerity than other executive agencies because most are funded through fees and assessments paid by banks. But they are not immune. I understand that my home state of California, for one, is faced with severe cutbacks.

For my part, I have made it clear since I took office three months ago that we are going to run an extremely cost-conscious operation at the FDIC. I have asked our Controller, Jim Davis, and our Budget and Management Committee, which is chaired by my Deputy, Alan Miller, to take a very hard line on requests for expenditures. I intend to personally participate in our internal FDIC budget hearings this summer. New hiring, in particular, is going to be tightly controlled.

The dollar squeeze we all face means quite simply that we all must work together to achieve the greatest efficiency in bank supervision at the least cost.

As you know, the FDIC last year commissioned a study on the problem of overlap and conflict in the regulation of State banks. The object of the study is to make policy recommendations for making the State/Federal partnership work better. The report will be issued by the end of June and a considerable body of background research on the operation and structure of the supervisory system for State banks will also be made available. In broad terms, preliminary indications are that the study will show that the opportunities for constructive cooperation are great.

A good way to make our working partnership even more productive is for Federal and State supervisors to maximize cooperative examination arrangements. The FDIC has always tried to cooperate with State supervisors to the greatest extent possible in order to eliminate or minimize unneeded overlap. Depending on State law, manpower resources, and the preference of the State supervisor, the FDIC over the years has conducted examinations on a joint, concurrent, or independent basis and, in recent years, developed the divided examination program.

By joint examinations, I mean those examinations in which State and FDIC examiners comprise one examination team, where the work of the examination is assigned without regard to whether the examiner is employed by FDIC or by the State, and where the bank's management at the conclusion of the examination receives a single report of examination. A concurrent examination is

conducted in exactly the same manner as a joint examination, the only difference being that a separate examination report is prepared by the FDIC examiners and by the State examiners. An independent examination, of course, is self-explanatory.

In 1978, 21 states conducted more than half of their examinations on a joint or concurrent basis and 29 conducted more than half on an independent basis. During 1978, 57 percent of FDIC's commercial bank examinations were done on an independent basis, 29 percent on a joint basis and 14 percent on a concurrent basis.

This indicates that most examinations still are conducted on an independent basis. Where independent examinations are conducted and both the FDIC and the State examine the same bank separately, you have greater possibilities for substantial differences in the criteria used for supervisory evaluations of a bank's performance trends. We recognize, of course, that in many states there are legal impediments to conducting joint or concurrent examinations.

As some of you may recall, on February 1, 1974, the FDIC in cooperation with CSBS and the states of Iowa, Washington and Georgia initiated a 13-month experimental program, subsequently extended, whereby the Corporation withdrew from examinations in a certain percentage of State nonmember banks in each of the three states. The Corporation agreed to rely heavily upon 1974

and 1975 examinations by the respective State supervisors for determination of the financial condition of the banks.

In 1976, the FDIC examined more than half of those banks in the participating states that it had not examined in the previous two years. The 1976 FDIC follow-up examinations had the additional purpose of providing an evaluation of the experiment as well as an assessment of the current condition of the banks.

The results of this review did not justify an expansion of the program. But the experiment provided us with the rationale for shifting our focus from complete withdrawal to a divided examination concept whereby examinations of a large portion of the nonproblem State chartered banks would be conducted by the State and the FDIC on an alternative year basis. The divided examination concept provides for the sharing of examination responsibilities, thereby reducing overlap and redundancy in the examination process.

The first formal agreement implementing the concept was executed early in 1977 with the State of Georgia. Similar arrangements with New Jersey and Missouri followed in early 1978.

Under a divided examination program, problem banks and other banks of supervisory concern ("pool") are examined by both supervisors at least once each year; the remaining banks ("other") are divided about equally and examinations alternated annually,

although either supervisor may examine a bank for which he is not primarily responsible that year. Either supervisor may at any time add banks to the "pool" group of banks and either can make progress visitations to "pool" banks after giving the other supervisor an opportunity to join. Either supervisor scheduling a board meeting of a "pool" bank, other than at the conclusion of an examination, would notify the other supervisor so that it might attend. Also, either supervisor is free at any time to cancel unilaterally a divided examination arrangement. Our experience at the FDIC is that the divided examination concept can provide a means, when all the necessary elements are present, of reducing overlap and redundancy in the bank examination process. Nevertheless, for a variety of reasons, adoption of a divided examination program may not be advantageous or possible for many states. Furthermore, divided examination programs are not lightly entered into. The Corporation must be assured through careful evaluation that the State involved has the resources and capabilities to implement a divided examination program. Of course, the Corporation reserves its right either to continue the program or to expand it with other states. While it is too early to fully evaluate the efficacy of the divided examination program, we stand ready to explore with each of you any method of examination which will increase efficiency and reduce costs in the examination of State nonmember banks without abdicating our statutory duties and responsibilities.

These initiatives in State-Federal cooperation coincided with FDIC's unilateral undertaking, begun in 1976, to revise and improve its procedures for examining and supervising banks. Our revised approach to the examination function is designed to deploy more effectively the resources needed to meet an increasing work load, to marshal efforts in the appropriate areas and to maintain technical competence in the face of increasing sophistication in operating and management systems of banks. The essential thrust of these changes is to concentrate the FDIC's efforts more on those banks in need of closer supervision while stretching out the frequency and reducing the scope of examination of those which do not exhibit such a need. Procedures were recently amended to provide even greater flexibility to the regions in conducting examinations of State nonmember banks and to encourage wider use of modified examinations where appropriate.

I have been talking about innovation. But one of the mainstays of our Federal-State cooperative effort has traditionally been training. I assure you that effort will continue. Last year 190 State examiners took courses at our training facility in Rosslyn, Virginia. As I mentioned, the Federal Financial Institutions Examination Council has established a Task Force on Examiner Education. Any improvements developed by the Task Force for the training of Federal examiners also can be shared with our State counterparts.

Another area where the FDIC has attempted to streamline the Federal regulatory process and thereby minimize the dual regulatory burden on State banks is in the implementation of bank branching approval procedures. As you are all aware, the FDIC's Board of Directors has delegated authority to the 14 Regional Directors to approve applications to establish branches under certain circumstances. To insure uniformity throughout the various regions, certain minimum criteria were prescribed that an applicant would have to satisfy before the application could be approved by a Regional Director. The delegation of authority does not include the power of denial. Only the FDIC Board can deny an application for a branch office.

This delegation of branch approval authority has had its intended effect. Processing time for handling applications to establish a branch has been reduced as an increasing number of branch applications are processed through delegated authority. For example, in 1978, out of 892 applications to establish branches filed with the FDIC, 845 or approximately 95 percent were approved under delegated authority.

While these figures demonstrate that the vast majority of branch applications require no Board involvement, there are those who argue that the FDIC should accept the decision of the State authority with respect to branches and forego any independent review whatsoever. This argument apparently is premised on the

assumption that the FDIC could legitimately delegate to a State all decision-making authority regarding the approval or disapproval of branch applications and perhaps other types of applications as well. Our Legal Division reviewed the issues involved in such assertions and concluded that the statutory mandate of the FDIC, involving as it does the exercise of judgment and discretion, is not a function which may properly be delegated to any other agency or official, Federal or State. Just last week our Board denied a State-approved branch application with a finding that the institution had not yet met its obligations under the Community Reinvestment Act.

With 50 independent State supervisors, the FDIC's role in decision making brings to the entire application process a desirable degree of uniformity and continuity which might not otherwise exist.

The application process can be expedited when States permit banks to file applications concurrently with State authorities and the FDIC. We still would not act at the Federal level, of course, until the State authority has given its approval. But in the meantime, we would have the opportunity to begin our own processing so that we could be ready to act as soon as possible after the State approval. In controversial cases, a delayed filing with FDIC may be appropriate.

I believe that such a concurrent procedure would be a substantial improvement over the present system which prevents

the FDIC from even beginning its own processing until certain States have approved their banks' applications.

In any event, we want to foster improved cooperation in this area, and we actively encourage our regional offices to get involved in the application process with the State supervisor at the earliest possible time.

We are exploring the use of common application forms in processing branch and other applications by State nonmember banks. While recognizing the difficulty in framing common forms that would be acceptable and would meet the needs and statutory requirements of all 50 states and the FDIC, it would be worthwhile to reach as much commonality as possible. If forms can be agreed upon, the FDIC would be willing to bear the cost of printing such documents and of supplying them to the various State supervisors at no cost. I might add parenthetically that a recent survey conducted by the FDIC established that eight states use FDIC application forms to some extent.

In the same vein, most states already use FDIC Call Report forms, and FDIC and the Comptroller of the Currency have just entered into an agreement by which FDIC will handle joint processing and editing of certain banking reports both from our own banks and from the national banks supervised by the Comptroller.

Another cooperative effort -- State access to certain information in our FDIC data base -- has just been expanded.

The FDIC Board just last week authorized access for seven additional states -- Arizona, Michigan, Nebraska, New York, Ohio, Pennsylvania and Washington. They will join the three pilot states -- California, Indiana and Tennessee -- which are now connected with our computer data base.

At the close of March of this year, the FDIC issued new rules and regulations dealing with procedures to be followed by State nonmember insured banks in establishing remote service facilities, such as automated teller machines, cash dispensing machines, point-of-sale terminals, and other remote electronic facilities where deposits are received, checks are paid, or money is lent. The procedures are designed to be consistent with Federal appellate court decisions defining remote service facilities as branches, as well as to lessen administrative burdens for banks and the FDIC and to provide necessary information regarding remote service facilities. To expedite the application process, the FDIC has again delegated to the Director of the Division of Bank Supervision and Regional Directors authority to approve, but not disapprove, remote service facility applications.

The FDIC has traditionally pursued a policy of cooperation with State supervisors in our areas of mutual interest. We have worked together to find means to reduce the time in processing applications and to minimize overlap and redundancy in the supervision of State nonmember banks. We are always open to new