Bank supervision and the public's right to know
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FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

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FDIC TO REMOVE "CONFIDENTIAL" LABEL FROM ANNUAL FINANCIAL REPORTS FILED BY NONMEMBER BANKS

Chairman Frank Wille announced in a recent speech before The Bankers Club of Chicago that the FDIC will hereafter make available upon request to any member of the public two important financial statements filed with the FDIC each year by State-chartered banks under its jurisdiction. The statements involved are the year-end "Consolidated Report of Condition" and the "Consolidated Report of Income" which are filed annually for each bank and its domestic subsidiaries, together with accompanying schedules, reconciliation statements and memoranda. At the present time, the income statement and the reverse side of the report of condition are maintained in a confidential status by the various bank agencies. Chairman Wille noted that most bank holding companies and all banks with more than $1 million in assets and 500 shareholders must now disclose much of this information, while national banks with less than 500 shareholders are currently required to send less detailed but nevertheless similar earnings information to their shareholders on an annual basis.

Chairman Wille stated that this reversal of past FDIC policy reflected the agency's judgment "that the advantages of making such information publicly available for each nonmember bank greatly outweigh the supposed risk of undermining public confidence in a few particular banks or undermining the effectiveness of FDIC supervision generally." The advantages cited by Chairman Wille included equal access by all shareholders and depositors to information which may now be limited to a select group of "insiders," greater competition in geographic areas of better-than-average profitability or greater-than-average

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demand for banking services, greater incentives for banks with a consistently poor performance to correct the problems which lie behind their inferior performance, an improved ability for nonmember banks to raise capital, the development of more uniform rules of bank accounting and reporting, the availability of more reliable and complete data for bank research efforts and legislative policy determinations, and greater consistency with the spirit of the Freedom of Information Act.

Chairman Wille further stated: "Somewhat in the same vein, the FDIC has become increasingly concerned about the substantive content of offering circulars used by nonmember banks for the public sale of their capital stock, capital notes and debentures -- if indeed offering circulars are used at all. These offerings, exempted from SEC registration requirements, are nevertheless subject to the general anti-fraud standards contained in the Federal securities laws and to the restraints imposed by common law. Because of the heavy statutory damages which a nonmember bank may sustain by an offering which misleads the public or omits to include material information concerning the bank's financial condition, the Corporation considers the use of such a deficient circular or the failure to provide any offering information at all to be an unsafe and unsound banking practice. We intend in the months ahead to improve and formalize our supervisory review of these offerings and to take appropriate action where this seems necessary."

Chairman Wille concluded by saying: "The disclosure today of meaningful financial information is as much a necessity for public confidence in the nation's banks as it is for public confidence in other businesses which vitally affect the economic interest of the American People."

The full text of Chairman Wille's speech is attached.

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(11-30-72)

BANK SUPERVISION AND THE PUBLIC'S RIGHT TO KNOW

One of the most persistent and perplexing problems which faces a public official concerned with the supervision of banks is the extent to which the public should be informed of a bank's financial condition and of any material developments that may affect an evaluation of its financial condition.

Historically, only the publication of a simplified balance sheet has been required while most earnings information has been kept confidential unless the bank itself volunteered the information -- and very few did. Since 1964, when the Federal securities laws were amended to impose reasonably full disclosure requirements on banks with more than 750 shareholders, a figure which dropped to 500 shareholders in 1966, a small but increasing number of the nation's banks have either become subject to these requirements or have volunteered such information to their shareholders. In addition, the Comptroller of the Currency now requires all national banks with less than 500 shareholders to disclose somewhat less detailed but nevertheless similar earnings information to shareholders on an annual basis, and more and more bank holding companies are subject to full SEC disclosure requirements. Only a few States, however, require the disclosure of earnings performance by the vast majority of the nation's 9,000 State-chartered banks, 8,000 of which fall within the nonmember category regularly examined and supervised by their State supervisors and by the FDIC. This state of affairs is increasingly indefensible and ill serves, in my judgement, the public, the supervisory agencies and the banking industry itself.

The confidential treatment of much of the information filed by individual banks with their supervisory agencies or developed independently by those agencies, as well as the publication requirement for a skeletonized balance sheet, have their roots in the nineteenth century when banks had to fight on their own to maintain depositor confidence. Obviously, if the disclosure of information developed in the course of a bank examination or some other supervisory effort were prohibited from being disclosed, one source of information that could be used to undermine public confidence in a shaky institution was placed off limits to its customers. Yet even the nineteenth century publication requirement for balance sheet data recognized that depositors and the public generally had good reason to know at least some facts concerning the financial condition of banks. Unlike other businesses, depositors rather than owners have always furnished the bulk of a bank's financial resources -- $12 today, for example, comes from depositors for every $1 supplied by the bank's owners. In addition, depositors have always used the balances in their accounts as money to settle business transactions and not merely for investment. Thus, by depositing their funds, they accorded their banks an important measure of their confidence, but little information over the years was supplied by banks to support this essential judgment. Banks in turn have always been custodians of the community's exchange facilities and their allocation of deposit funds invariably affects the communities they serve. Balancing off the need to maintain public confidence in banks and the interest of depositors and the public at large in knowing at least the basic facts about a bank's financial condition and investment policies led both to the general rule of confidentiality and the single exception, expressed in one State law after another, requiring publication of limited balance sheet data.

Neither the general rule nor the balance sheet exception has been much changed since the nineteenth century for most of the nation's banks, even though there have been significant developments since then which raise anew the proper relationship between disclosure and the maintenance of public confidence. We now have a Federal Reserve System which functions effectively as a central bank and thereby strengthens the entire banking system. We now have a system of Federal deposit insurance which has been singularly successful in maintaining depositor confidence in the safety of their money. We now have elaborate disclosure requirements for virtually all companies and banks whose securities are broadly traded. And we have an increasingly educated population whose sophistication in financial matters is well beyond the elemental grade. These changes in the banking environment, together with the experience of those banking agencies at both State and Federal levels which have enforced greater disclosure requirements than those followed elsewhere, have led the FDIC to reexamine the basic rule of confidentiality insofar as it relates to the reports of condition and the reports of income filed with the FDIC by each nonmember bank having less than 500 shareholders.

We have reached the conclusion that the itemization contained in both reports, including the detailed schedules of assets and deposit liabilities on the reverse side of the report of condition and the reconciliation statements for the capital accounts and for the reserves for bad debts on the reverse side of the report of income, should be available to anyone who seeks this information. That conclusion reflects our judgment that the advantages of making such information publicly available for each nonmember bank greatly outweigh the supposed risk of undermining public confidence in a few particular banks or of undermining the effectiveness of FDIC supervision generally.

In fact, after eight and one-half years in two positions of major supervisory responsibility, I have come to the conclusion that a greater degree of disclosure about the operations of individual banks can be a significant and positive incentive for the improvement of their operating performance, not least of all in the case of problem banks.

Let me elaborate at this point on some of the considerations which have led to this policy change at the FDIC.

With successive annual statements which existing and potential depositors and investors could compare in some detail, both groups would be able to make more informed decisions than they can today as to the banks in which they place their funds. At the present time, in nonmember banks with less than 500 shareholders, such an informed decision may be effectively limited to a select group of "insiders" consisting of top management, major shareholders, major creditors and perhaps some favored analysts to whom the bank's management feels free to disclose the necessary information. In far too many cases, minority shareholders and depositors (even those with deposit accounts above the $20,000 insurance limit) have little access to this information unless an enlightened management has already taken steps to disclose the same items of information voluntarily in a published annual statement. We believe elementary notions of fairness require that this information be equally available to any interested person who may seek it.

Such disclosure is also likely to encourage greater competition in geographic areas of better-than-average profitability or greater-than-average demand, while discouraging further investments in geographic areas of low profitability or low demand. Obviously, since these reports are filed on a bankwide basis, this result may be more readily apparent in unit banking States or in geographic areas where banks have only limited numbers of branches, but greater competition is also likely to occur in geographic areas where large banks with numerous branches have concentrated their offices. We subscribe to the view that the public at large generally benefits from an increase in competition. We also believe information as to profitability and demand will encourage a more efficient allocation of the limited capital available for the establishment of new bank facilities in all States, whether they permit _de novo_ branching or limit such expansion to the organization of new banks.

Such disclosure is also likely to have a beneficial influence on management policies and practices, particularly in banks with greater than average loan loss experience, greater than average expenses and lower than average yields on invested assets. While even the best run bank may have an occasional year in which its earnings performance falls short of its capabilities for one or more of these reasons, banks with more deep-seated problems will probably show a consistently below standard performance year after year without significant improvement. For such banks, the knowledge that their operating results will be disclosed should provide a meaningful incentive for correcting the problems which lie behind their inferior performance.

Greater disclosure of their earnings performance is likely to have a beneficial impact on the ability of nonmember banks to raise capital. One reason our larger banks and our larger industrial companies are able to attract capital investments from all over the United States and beyond is the detailed information which is required to be given to potential investors. If, as many economists believe, we face a general shortage of capital in the years ahead, the available funds are more likely than ever to flow to those organizations which maintain their investment credibility. When that credibility is lost through inadequate disclosure or exaggerated notions of confidentiality, capital values are likely to go down and the cost of financing up -- even when funds are available for investment. And capital adequacy in the years ahead will be just as much a concern for banks and bank supervisors as it is today.

Greater disclosure about the financial performance of nonmember banks should encourage the development of more uniform rules of accounting and reporting applicable to all categories of banks, because the ability to compare results will then become an increasingly important part of the judgment which can be exercised by large depositors and prospective shareholders. The accounting profession and the various supervisory agencies have made considerable progress toward more useful and more uniform accounting standards in recent years, but more can be done. Greater disclosure of the earnings statements of banks should encourage this development, and more uniform accounting standards in turn should encourage a better earnings performance for many banks.

The more general availability of operating data should also have considerable value to bank research efforts and to legislative policy determinations. At the present time we have frequent and quite legitimate requests from academic researchers and legislative committees for the detailed information as to individual banks which appears on the unpublished side of the report of condition and on the report of income.

Finally, making available to the public individual bank data which is currently required to be filed by each nonmember bank with the FDIC seems to be more consistent with the thrust of the Freedom of Information Act passed in 1966 than keeping these reports confidential. That Act creates a heavy presumption in favor of disclosure, and we can no longer justify exercising the discretion which the banking agencies have over the report of condition and the report of income.

We believe that very few of the banks that might oppose making this operating information available to the public are seriously concerned about a deposit run or a bank failure. We ourselves do not believe that the disclosure of this additional information will materially increase the chances of either event happening, even in the case of a serious problem bank.

In the first place, the trend of developments in such a bank is likely to be more important than its financial condition at a particular year end, and successive statements will be necessary to assess that trend. The bank's management, in such a case, has every incentive as I have previously noted, to improve their operating performance from one set of reports to the next.

Secondly, the facts of a particular bank's operating performance would replace what today is passed around by way of rumor or the educated "guess" solely because such information has traditionally been kept confidential.

Thirdly, we take considerable comfort from actual experience in the most analogous cases we can find -- those where a bank has suffered considerable adverse publicity because of an embezzlement, a fraud or a misapplication of funds. In most such cases, the bank in question survives, perhaps because depositors are aware of deposit insurance or because the media is usually able to report that the bank is likely to recover the loss from a bonding or insurance company. Our tentative conclusion, looking at deposit behavior both before and after such adverse publicity in a recent year, indicated a limited decline in IPC demand deposits ranging from 4 percent to 17 percent -- and 63 percent of the banks sampled regained that deposit loss within twelve months. In reacting to these figures, it should be further stated that part of the decline in IPC demand deposits may have been due to a general decline in such deposits throughout the banking system in the year under review (1970) rather than to the adverse publicity. Moreover, a substantial portion of the decline for many of the banks was offset by an increase in IPC time and savings deposits. We also believe that the events which might have triggered the loss in IPC demand deposits in these cases were probably far more newsworthy and much more widely disseminated than any story is likely to be which is written about an annual report of condition or an annual report of income.

Fourthly, we have the benefit of several years of experience with the consequences of reasonably full disclosure by banks with more than 500 shareholders, by national banks with less than 500 shareholders, by bank holding companies, and by State-chartered banks in such States as Connecticut, New Hampshire and New York where quite detailed information about operating income and expenses, assets and liabilities and the reconciliation of capital and reserve accounts is required either to be published or to be sent to shareholders. We are aware of no case in which the publication of information of this kind has led to a run on a bank or its failure.

The objections to disclosure are more likely to be couched in terms of an unwarranted invasion of the privacy of closely held banks. But in view of the importance to every bank of its depositors' funds (as distinct from the capital funds contributed by its owners), we find this particular argument not at all persuasive. Even in small, closely held banks, the public benefits of greater disclosure and comparability appear to us to outweigh the possible embarrassment which might be caused in a few instances by the publication of data concerning such items as salaries and wages, pensions and other employee benefits, interest expense on deposits, occupancy expense, loan losses or dividends.

The FDIC would obviously encourage nonmember banks themselves to distribute this information to shareholders and others who may seek it, and we would also encourage State supervisors, who are the primary regulators of nonmember banks, to require such dissemination in the absence of voluntary disclosure. What the FDIC alone can do, insofar as nonmember banks with less than 500 shareholders are concerned, is to remove the confidential treatment now accorded to annual reports of condition and annual reports of income which nonmember banks are required each year to file with the Corporation. This would have the effect of making available to those who affirmatively seek it from the FDIC the additional information which I have been describing, but would not, for example, require nonmember banks to publish such information or to send it to shareholders in advance of an annual meeting.

Although limited in its impact and by no means as desirable in our judgment as the distribution of these same reports in full to shareholders, depositors and other interested persons by the banks themselves, we believe it in the public interest to take the limited step we can. The FDIC's staff, accordingly, is presently at work on an appropriate means of implementing this policy decision.

Somewhat in the same vein, the FDIC has become increasingly concerned about the substantive content of offering circulars used by nonmember banks for the public sale of their capital stock, capital notes and debentures -- if indeed offering circulars are used at all. These offerings, exempted from SEC registration requirements, are nevertheless subject to the general anti-fraud standards contained in the Federal securities laws and to the restraints imposed by common law. Because of the heavy statutory damages which a nonmember bank may sustain by an offering which misleads the public or omits to include material information concerning the bank's financial condition, the Corporation considers the use of such a deficient circular or the failure to provide any offering information at all to be an unsafe and unsound banking practice. We intend in the months ahead to improve and formalize our supervisory review of these offerings and to take appropriate action where this seems necessary.

In both cases, we are seeking to maintain, not diminish, public confidence in the nation's banking system, but with a clear recognition that the requirements for public confidence have changed over the years. The disclosure today of meaningful financial information is as much a necessity for public confidence in the nation's banks as it is for public confidence in other businesses which vitally affect the economic interests of the American people.

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