FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

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MAKING DECENTRALIZATION WORK

Remarks of

Frank Wille, Chairman
Federal Deposit Insurance Corporation

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of

The Conference of State Bank Supervisors

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As we await the Administration's recommendations to the Congress with respect to the Hunt Commission Report, it might be appropriate this morning to discuss one of the aspects of the regulatory framework for State-chartered banks which received little or no attention by the Commission in its Report. That Report dealt with only a few of the interrelationships affected by the division of authority between the Comptroller's Office, the Federal Reserve, the FDIC, the Federal Home Loan Bank Board and the National Credit Union Administration, and in some cases not even with the most important of these relationships. It ignored altogether the role in bank regulation played by the Justice Department and the SEC and the role increasingly sought to be played by the Federal Trade Commission. Its regulatory recommendations were severely limited, as a consequence, and those it made appear unlikely to win either the Administration's support or Congressional backing.

I regret, as you do, that more attention was not given by the Hunt Commission to the problems discussed in the prior report of your own Special Committee on Restructuring the Bank Regulatory System. This report detailed at least 20 areas in which the Federal Reserve and the FDIC had certain authority with respect to State-chartered banks, reviewed how that authority had been exercised, identified many disadvantages to State-chartered banks in the present structure, and made specific recommendations for a reallocation of power not merely between the FDIC and the Federal Reserve, but between each of them and the SEC, the FTC and the Justice Department, and between both agencies and State-chartering authorities.

Your report proceeded on the assumption that there were significant advantages to a decentralized system of banking and bank regulation, and that among these advantages were the dispersion of both economic and political decision-making, a greater capacity to respond to change and new ideas through innovation, adaptation and experimentation, and a means by which checks and balances against stifling and inflexible supervision could be mobilized. Not every observer or indeed every State bank supervisor would agree with every recommendation contained in the CSBS report -- most of which would require Congressional action in any event -- but most of us would share the Committee's obvious desire to increase regulatory efficiency, preserve the advantages of decentralization, provide greater consistency in regulatory decisions, and provide better banking in the public interest.

Each of us is familiar with the difficulties in achieving legislative changes which might significantly alter the powers of State-chartered institutions or the regulatory structure within which they operate. I suspect these difficulties are compounded at the Federal level, for a variety of reasons, when significant changes in existing law are requested of the Congress.

Moreover, when Congress has been prompted in recent years to enact new legislation affecting banks, it has tended to place increasing authority over State-chartered banks directly in the Federal Reserve as to member banks and directly to the FDIC with respect to nonmember banks, irrespective of State activity or regulation that might exist in the more active States in the same area. Even without a specific statutory mandate, the Congress frequently seems to expect direct action by both of these agencies with respect to State-chartered banks even though the authority of these banks is derived from State law and a State charter and even though there is a State agency with primary jurisdiction. I mention this, not to belabor what I believe to be the facts of Congressional life, but to indicate a natural difference between our response and your own to the problems which are inherent in a system which regulates State banks at both the State and Federal levels. Where you are rightly concerned with State interests and State policies, we at the FDIC and at the Federal Reserve must take our basic marching orders from Acts of Congress and our cues from the trend of policy at the Federal level. A decentralized banking system, in which Congress shows no disposition to end the overlap of Federal and State jurisdiction we have today, is likely to have as a result some points of irritation and some areas of legitimate disagreement between those who regulate at the State level and those who regulate at the Federal level. As I have said before, one of the essential jobs this Conference has, if Congress is to overcome its skepticism about State bank regulation, is to educate its members as to the initiatives, the regional variations and the effectiveness of State bank regulation in areas that are of concern to the Congress. We can, nonetheless, even within the present legal structure, seek to make decentralization work better than it does today. Three years ago, in my first address to this group as a Federal regulator, I stated that if we recognized each other's responsibilities and capabilities and if we proceeded with goodwill and persistence, we should be able to meet our mutual requirements and still leave room for the State-by-State variations which are the hallmark of a decentralized banking system.

During the past year, the FDIC has taken a number of steps to improve the workings of our decentralized banking system. In a cooperative venture with this Conference, we substantially increased the number of State examiners attending the FDIC Training Center from 5 in 1970 and 24 in 1971 to a full 100 last year. Your examiners are now attending each of our seven school programs on a regular basis, with their travel and subsistence costs shared by CSBS and FDIC on an equal basis. During the current year, with the active support of the CSBS Board of Directors, the number of State examiners attending these schools will increase again -- to 150: a plus for you and, we expect, the Federal deposit insurance fund.

The Corporation has also delegated to its Regional Directors authority to approve most of the applications for de novo branches and facilities filed with the Corporation. Results since March 1, the effective date of that delegation, bear out our prior projections that more than two-thirds of all such applications are likely now to be decided at the Regional Office level -- with greater dispatch than heretofore and with more efficient utilization of FDIC resources. While some of you have expressed concern over the guidelines under which this authority may be exercised by our Regional Directors, the FDIC Board of Directors attempted to make it clear at the time that a failure to meet the guidelines for approval by our Regional Directors did not mean an automatic denial of other applications. What it does mean is that an application falling outside the guidelines will continue to be forwarded -- just as all applications were before March 1 -- to the Corporation's office in

Washington for closer review and ultimate disposition by the Director of our Division of Bank Supervision or by the FDIC Board of Directors. We certainly do not expect any material change in the 98 percent approval rate which has characterized the Corporation's handling of these applications in the past. We expect, however, to utilize our limited Washington office manpower only for those applications where further review appears warranted. If, as we gain experience with our own internal decision-making under delegated authority, it appears appropriate to revise the guidelines for our Regional Directors so that an even larger percentage of applications can be approved at the Regional Office level, I have no doubt that this will be done. Overall, I consider the Board's willingness to delegate action of this kind a significant step forward in the treatment of State-chartered banks. How well our delegation works may well depend on whether FDIC applications are filed at the same time as State applications, thereby giving our Regional Offices the lead time necessary to assure prompt action after the State approves. I can assure you that we are eager to process all de novo applications we receive from the 8,300 nonmember banks in this country with fairness and dispatch.

The Corporation has continued to encourage the use of joint examinations where State law lends itself to this procedure and where the State Supervisor agrees that joint examinations should be conducted. 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. At the present time, State nonmember banks in 10 States have all their examinations conducted jointly, while in 3 other States most of their examinations are on a joint basis.

Recently, in the State of New York, following up on a suggestion made by a blue-ribbon advisory committee, the State Banking Department and the FDIC agreed to conduct all examinations of mutual savings banks on a joint basis despite the fact that each agency had been using a different report of examination and had traditionally examined concurrently, i.e. independently but at the same time, with two full teams of examiners sent into a bank and two reports of examination transmitted to the bank's management upon the conclusion of the examination. In New York, it was necessary in order to institute a joint examination procedure for the State Banking Department and the FDIC to agree on a single report of examination both could use and this was accomplished with mutual respect for each other's requirements. The result was a report of examination in which the senior examiner for each agency has an opportunity to transmit to the bank his own evaluation of its condition but in which the schedules accompanying these evaluations are the same. In addition, where formerly two complete teams of examiners entered a bank together, only one team is necessary now and we agreed that it should be composed 50 percent of New York State examiners and 50 percent of FDIC examiners. The two agencies were further able to agree in advance on how differing loan classifications should be resolved (the more severe was to govern) and on how the mechanics of editing and typing the joint report should be handled (each agency would alternate these responsibilities with successive examinations), the report being transmitted to the bank in each instance by the State Banking Department.

If in your own State you feel such a change in examination procedures would be appropriate, I can assure you that we stand ready to explore the necessary arrangements with you. We recognize, however, that in some States the provisions of State law specify a greater frequency for State examinations than the FDIC follows. In 23 States, however, most examinations today are conducted on an independent basis which not only increases the number of disruptions faced each year by a bank's management and its customers, but also provides greater possibilities for substantial differences in supervisory evaluations of a bank's performance trends. In view of the enthusiasm expressed by bank officers and directors for joint examination procedures, it is possible that some of these 23 States may wish to change their current practice to joint examination procedures and the FDIC Board has accordingly instructed each of its Regional Directors to review with the State supervisors in his Region the State's current preferences as to the examination procedures to be followed by each agency.

The FDIC is now updating its Manual of Examination Policies, which serves as a manual of examining procedures for many State agencies as well. We will continue to issue revised chapters of this Manual until it reflects our current views with respect to the numerous items of examination and supervision which it covers. Needless to say, these revisions will be made available to State supervisors as they are made. The FDIC will also continue to make available to State supervisors upon request special statistical information beyond that contained in our various publications. We have, for example, supplied Summary of Deposit figures for specific counties or for individual bank offices when State supervisors have thought this would be helpful in some current State project or in the evaluation of State applications for de novo facilities. In the past, we have also supplied to State supervisors the most current data we had on branch location changes, on the operating ratios of national or State member banks, or loan data by individual counties within a State. Similar information will be supplied to any State supervisor who requests it for supervisory purposes.

Your Special Committee on Restructuring the Bank Regulatory System recommended much more dramatic steps to make our decentralized banking system work better than it does today. Its recommendations included a significant reallocation by Congressional action of the powers over State-chartered banks now lodged in the Federal Reserve and the FDIC. It stated further than even if all of these statutory recommendations were adopted, the area of bank examinations would continue to require close working relationships between State Banking Departments and the FDIC because of the mutual interest each would continue to have in the safety and soundness of the State-chartered segment of the nation's banking system. To delineate that relationship and to obtain optimum performance from all agencies, it recommended further that new procedures be instituted which would enable the FDIC, as a normal practice, to accept the examination reports of State Banking Departments in lieu of its own in those States which were fully capable of adequate supervision. The Special Committee proposed a specific method of certifying those States which were considered capable of adequate supervision and pointed out that similar procedures had been utilized in such varied areas of Federal-State relations as air pollution control, water and related land resources planning, voting rights, Medicare and labor relations. In its view, such a withdrawal of FDIC jursidiction would not only reduce duplication and conflicting judgments; it would also serve as an incentive to State legislatures to strengthen State Banking Departments and to restore to the chartering agencies in qualified States full authority to perform their functions. The Special Committee's discussion makes clear that it had in mind a much more extensive withdrawal of FDIC supervision in qualified States than its abstinence from routine examinations.

In reacting to this recommendation, I should make it clear at the outset that the Corporation has significant reservations as to the scope of the withdrawal suggested by your Special Committee and as to the specific certification procedure it recommended, particularly if -- as now seems likely -- Congress fails to enact the statutory changes also recommended by your Committee. There are, moreover, some very practical problems which must be faced in any system of regulation which contemplates the withdrawal of FDIC supervision -- even in a limited number of States. With respect solely to the examination process, for example, our Regional Directors estimate that at the present time FDIC supplies more than half the manpower needed in at least 20 States to complete the present schedule of examinations required of the State authority. Of the 30 States in which this is not the case, the most recent CSBS survey of State Banking Departments conducted two years ago indicated that only 20 had a total examination force numbering twenty or more examiners, that only 10 State supervisors thought they had an examination staff adequate to the requirements then imposed upon them and that only 14 thought their budgets were adequate to meet those requirements. Most of these 30 State agencies, moreover, are responsible for the supervision of

State-chartered savings and loan associations, credit unions and finance companies in addition to banks. Whether such States could now take on the full examination load for nonmember State banks will obviously vary from State to State. The same CSBS survey also revealed that only 10 of those 30 States had an examination force where 40 percent or more of the total number of examiners had even five years experience in bank examination work. The assessment income, moreover, of some State agencies depends in large part on man-hours presently supplied by FDIC. To the best of my knowledge, the budget implications to these States of FDIC withdrawal have never been adequately reviewed. In addition, the FDIC must be satisfied that it can still enforce the provisions of Federal law and regulation for which it has responsibility under Federal law. Your Special Committee no doubt recognized that these and other practical problems would have to be resolved before the risks to both the certified State and FDIC in FDIC withdrawal from supervision could be properly evaluated.

I believe, however, that there is merit and potentially great value to State-chartered banking in exploring further the concept of FDIC withdrawal from certain supervisory responsibilities in qualified States. At least initially, until greater flexibility is allowed by the Congress, that withdrawal may have to be limited to the periodic examination and evaluation of the condition of nonmember banks with no significant supervisory problems. And the extent of FDIC's withdrawal should depend on the experience we gain in a limited number of States on a trial basis. But it is clear that we cannot enter into the withdrawal process at all without a full, candid and cooperative exploration of the practical problems to which I have referred.

I suggest, therefore, that CSBS join FDIC in an intensive review of these practical problems to determine if a controlled experiment involving nonmember banks in two, three or four States can feasibly be undertaken for a limited period of time, such as one year, during which FDIC would withdraw from regular examinations (but not from special investigations) and following which the experience gained could be analyzed and assimilated before any further extension of the certification concept. We believe that if the States are carefully chosen for this experiment in federalism, the risks involved can be minimized, the standards for selection of qualified States can be refined, and the problems not foreseen at the beginning by either FDIC or CSBS can be exposed for further discussion and review before the withdrawal concept is extended to other States or to other supervisory functions.

We would enter into these discussions in good faith, sharing with you the hope that our decentralized banking system may be strengthened and not weakened by the limited reallocation of examination functions and responsibilities which is contemplated. I can assure you that FDIC, within the limits of the authority, the discretion and the obligations imposed on it by the Congress, will continue to seek additional ways to make our decentralized banking system work even better than it does today so that its many advantages may be more fully realized by all Americans.

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