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REPORT BY THE

Comptroller General

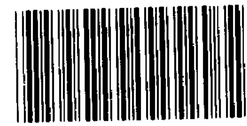
OF THE UNITED STATES

108985

Comparing Policies And Procedures Of The Three Federal Bank Regulatory Agencies

This report discusses a broad range of policies and procedures used by the Federal Deposit Insurance Corporation, Federal Reserve, and Comptroller of the Currency to regulate and supervise the Nation's banks. It highlights differences and similarities among the agencies without drawing any conclusions or recommending any changes.

This report is a followup to a 1977 GAO study of bank supervision and addresses specific interests of the Chairman, Senate Committee on Banking, Housing and Urban Affairs.



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MARCH 29, 1979

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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The Honorable William Proxmire
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate

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Dear Mr. Chairman:

This report compares selected policies and procedures of the three Federal bank regulatory agencies--the Federal Deposit Insurance Corporation, the Federal Reserve System, and the Office of the Comptroller of the Currency. The report is informational and makes no conclusions or recommendations.

Our review was made to followup on recommendations we made in our 1977 report entitled "Federal Supervision of State and National Banks" (OCG-77-1), and in response to interests indicated by the Senate Committee on Banking, Housing and Urban Affairs. The review was completed pursuant to the Federal Banking Agency Audit Act, 1978 (31 U.S. C. 67).

Since our prior study, the three agencies have initiated a number of actions affecting their regulation and supervision of banks. In some areas, there has been coordination in adopting common procedures. In other areas, the agencies still differ in the way they carry out their responsibilities. We have tried to highlight the similarities and differences in the agencies' approaches to Committee interest areas. It should be noted, however, that many of the areas discussed are quite complex and have been studied for years by experts in the financial field. Many of the subjects deserve separate indepth reviews before appropriate conclusions and recommendations can be reached. Using our new legislative authority, we intend in the future to give many of these matters the time and effort deserved.

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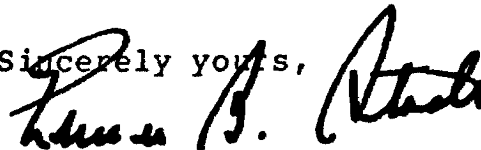
The three agencies have reviewed and commented on a draft of this report. To expedite processing, we obtained informal comments from the agencies' representatives, and to the extent possible, incorporated these into the final report. The agencies' written responses are presented in their entirety in the appendixes to the report.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until seven days from the date of the report. At that time we will send copies to the Senate Committee on Governmental Affairs, the House Committee on Banking, Finance and Urban Affairs, and the House Committee on Government Operations. Copies will be sent to the three Federal bank regulatory agencies as well.

Sincerely yours,



Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

COMPARING POLICIES AND PROCEDURES OF THE THREE FEDERAL BANK REGULATORY AGENCIES

D I G E S T

In most instances, each of the three Federal bank regulatory agencies--the Federal Deposit Insurance Corporation, the Federal Reserve System, and the Office of the Comptroller of the Currency--establishes its own procedures for carrying out its wide range of responsibilities. The degree of consistency in the approaches used by the agencies depends on many factors, including management's philosophy and pertinent Federal or State laws.

Although differences exist in the agencies' policies and procedures, there is also some uniformity and evidence of increased interagency cooperation in the last 2 years.

GAO discusses the following areas in this report:

(1) Bank regulation

--approving charters, membership, insurance, and mergers;

--permissible business activities

--single borrower lending limits; and

--conflict of interest

(2) Bank supervision

--frequency of commercial examinations,

--assessing capital adequacy,

--assessing the quality of a bank's assets,

--assessing shared national credits,

--evaluating country risk,

--reviewing standby letters of credit,

--communicating with the bank's board of directors,

--identifying banks needing special supervisory attention, and

--issuing cease and desist orders.

(3) Consumer compliance examinations.

(4) Travel policies.

/The two main areas of responsibility are regulation--the process of interpreting banking legislation and issuing rules--and supervision--the process of monitoring, examining and ensuring compliance with sound practices and laws./

REGULATION

The Comptroller of the Currency is responsible for chartering all national banks. The Federal Reserve grants membership to State-chartered banks. The Federal Deposit Insurance Corporation approves deposit insurance for State banks which are not members of the Federal Reserve System. All three agencies, as part of their regulatory role, act upon merger requests from the banks they regulate. When weighing applications, they consider the bank's financial history and condition, its capital structure, earnings prospects, management, and the needs of the community. The agencies' policies for evaluating these factors are flexible; therefore, it is difficult to assess, without extensive study, the degree of consistency among the agencies in approving applications.

In addition to agencies' chartering, membership, insurance, and merger application approval processes, Committee interests in the agencies' regulation of banks included permissible bank business activities, bank employee conduct, bank lending limits to a single borrower, and bank policy on disposition of credit life insurance sales commissions. The Comptroller of the Currency, as the chartering agency for national banks, has established some rules and regulations that apply to all national banks. While some Federal laws apply to State-chartered banks, GAO was told that each State generally establishes rules and regulations for State-chartered, Federally insured member and nonmember banks. The Federal Reserve and the Federal Deposit Insurance Corporation require State member and nonmember insured banks to comply with the various State rules and regulations and applicable Federal laws.

SUPERVISION

Bank examination is the agencies' primary supervisory tool for evaluating the condition of banks and their compliance with applicable laws, regulations, and rules. The agencies' policies for bank examination are influenced by the number and size of banks the agency supervises, the agency's concept of examination, and the agency's personnel resources.

In the areas of Committee interest that relate to the commercial examination process--frequency of examinations, capital adequacy, asset quality, country risk

assessments, shared national credits, standby letters of credit, and meetings with bank directors--the agencies have uniform systems in effect for two areas and there is similarity in a third. Uniform procedures have been developed for evaluating shared national credits and the country risk portion of foreign loans. The agencies have a common approach for treating banks' standby letters of credit.

The agencies' policies for the frequency of bank examination are conceptually similar, but are different in selection criteria, time frames, type of examination, and management discretion allowed. Also, agencies' policies on meeting with the bank's board of directors are different.

Two important and complex areas of the commercial examination process which we reviewed are the assessment of capital adequacy and asset quality. The agencies consider these important areas in evaluating a bank's overall condition. Only the Federal Reserve has numerical standards to assist their examiners in making consistent evaluations of capital adequacy and asset quality, and all three agencies depend heavily on examiner judgment.

Banks requiring special supervisory attention

The three agencies classify banks according to the magnitude of problems disclosed through their examination and monitoring processes. Banks with severe adverse conditions receive additional monitoring and supervision. The three agencies adopted a uniform interagency bank rating system in May 1978. The system is based on an evaluation of five critical dimensions of a bank's operations reflecting, in a comprehensive

fashion, an institution's financial condition, compliance with banking regulations and statutes, and overall operating soundness. The three agencies use the system to identify banks needing special supervisory attention. For the Federal Reserve and the Comptroller of the Currency, this includes identifying all problem banks. The Federal Deposit Insurance Corporation uses the system only to identify supervisory problem banks and is testing the system for use in identifying financial problem banks. It continues to use traditional methods for identifying financial problem banks until the testing is completed.

The agencies' policies on the use of formal administrative actions, such as cease and desist orders, are generally more formalized and aggressive than they were 2 years ago. The Comptroller and, more recently, the Federal Reserve require that an administrative action be considered for all supervisory concern and problem bank situations identified by the uniform bank rating system. The policies of the Federal Deposit Insurance Corporation state that whenever a nonmember insured bank is designated as a financial problem bank, a recommendation must be made with respect to formal administrative action. These policies do not apply to supervisory problem banks.

CONSUMER COMPLIANCE EXAMINATIONS

The agencies have identified consumer compliance as a separate examination area and are devoting more time and staff to examining this aspect of banks' operations. Each of the three agencies reviews similar bank documents and procedures during its examinations.

As an example of joint cooperation, the three agencies, in conjunction with the Federal Home Loan Bank Board, recently coordinated and issued joint regulations for implementing the Community Reinvestment Act.

They also established uniform examination procedures for reviewing the banks' compliance with the law and regulation. The act was written to encourage banks to help meet the credit needs of their communities, including low- and moderate-income neighborhoods, consistent with safe and sound operations of such banks.

TRAVEL POLICIES

There are differences in the agencies' travel policies. For example, the Federal Deposit Insurance Corporation and the Comptroller generally disallow first class air travel arrangements for all employees. The Federal Reserve generally disallows first-class air travel for most employees; however, 15 office and division directors are allowed to travel first class, but, GAO was told, are encouraged to use coach. The Federal Reserve and the Comptroller do not pay for the travel of spouses unless the employee is being permanently relocated. The Federal Deposit Insurance Corporation makes one exception to this in that it pays for the travel costs of spouses accompanying employees who attend periodic regional conferences.

AGENCY COMMENTS

The three agencies have reviewed and commented on a draft of this report. To expedite processing, GAO obtained informal comments from the agencies' representatives and, to the extent possible, incorporated these into the final report.

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II Letter dated February 21, 1979, from the Comptroller of the Currency, to the General Accounting Office 53

III Letter dated February 26, 1979, from the Director, Bank Supervision, Federal Deposit Insurance Corporation, to the General Accounting Office 69

ABBREVIATIONS

FDIC	Federal Deposit Insurance Corporation
FRS	Federal Reserve System
OCC	Office of the Comptroller of the Currency
SNC	Shared national credit
UIBRS	Uniform Interagency Bank Rating System

CHAPTER 1

INTRODUCTION

The three Federal bank regulatory agencies--the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve System (FRS), and the Office of the Comptroller of the Currency (OCC)--have a wide range of responsibilities for bank regulation (the process of interpreting banking legislation and issuing rules and regulations for the banks) and bank supervision (the process of monitoring, examining, and ensuring compliance with safe and sound banking practices and applicable laws). In most instances, each agency establishes its own procedures for carrying out its responsibilities. The degree of consistency in the approaches used by the agencies depends on many factors, including management's philosophy and pertinent Federal or State laws.

In 1977, we completed a study of the effectiveness of State and national bank supervision by the three regulatory agencies. In several instances, we pointed out that the agencies' procedures for regulating and supervising banks were different and recommended closer coordination among the agencies. Since the completion of our study, the three agencies have revised some of their policies and coordinated some existing and new procedures. However, there are still differences among the agencies, either generally or specifically, in how they carry out their regulatory and supervisory responsibilities. This report presents a comparison of selected agency policies and procedures, many of which were discussed in our 1977 report, and highlights similarities, differences, and coordination among the agencies for each area.

SCOPE OF REVIEW

Our evaluation was completed as a general followup to our 1977 study and addresses selected aspects of the three agencies' operations based primarily on specific interests shown by the Senate Committee on Banking, Housing and Urban Affairs. We reviewed applicable laws, regulations, procedures, and policies and talked with responsible agency officials to determine the agencies' policies,

the similarities and differences in these policies, and the degree of coordination among the agencies on these matters. We did not review State laws during our audit, so that references to State laws in this report are based on statements made by the agencies' representatives. We performed our evaluation at the Headquarters of FDIC, FRS, and OCC in Washington, D.C., between October and December 1978. The areas we reviewed represent only a portion of the multifaceted aspects of the three regulatory agencies and the comments on policy similarities, differences, and coordination do not necessarily reflect the agencies operations as a whole. Further, the general nature of the audit precludes us from making conclusions or recommendations on specific subjects or specifically to the agencies.

CHAPTER 2

BANK REGULATION

The three Federal bank regulatory agencies affect the structure and operation of commercial banks by granting national bank charters, FRS memberships, FDIC insurance, and by approving applications to establish bank holding companies, new branches, and other bank structural changes. Regulations governing permissible banking activities and the conduct of bank business are based on a combination of State and Federal laws.

APPROVING CHARTERS, MEMBERSHIP, INSURANCE, AND MERGERS

OCC considers applications for national bank charters; FRS considers applications for FRS membership by State-chartered banks; and FDIC considers applications for deposit insurance from State-chartered banks that are not members of FRS. Each of the agencies also has responsibility for approving merger applications for the banks it regulates. OCC must certify that the criteria for deposit insurance are met before it grants a national charter, and FRS certifies that a State bank meets the criteria for deposit insurance before it grants membership in the FRS. Although some differences exist in the management process and the factors considered by each agency when reviewing applications, the basic factors considered are essentially the same. These factors, as established by the Federal Deposit Insurance Act (12 U.S.C. 1816), are:

--The bank's financial history and condition.

--Its capital structure.

--Its future earnings prospects.

--The general character of its management.

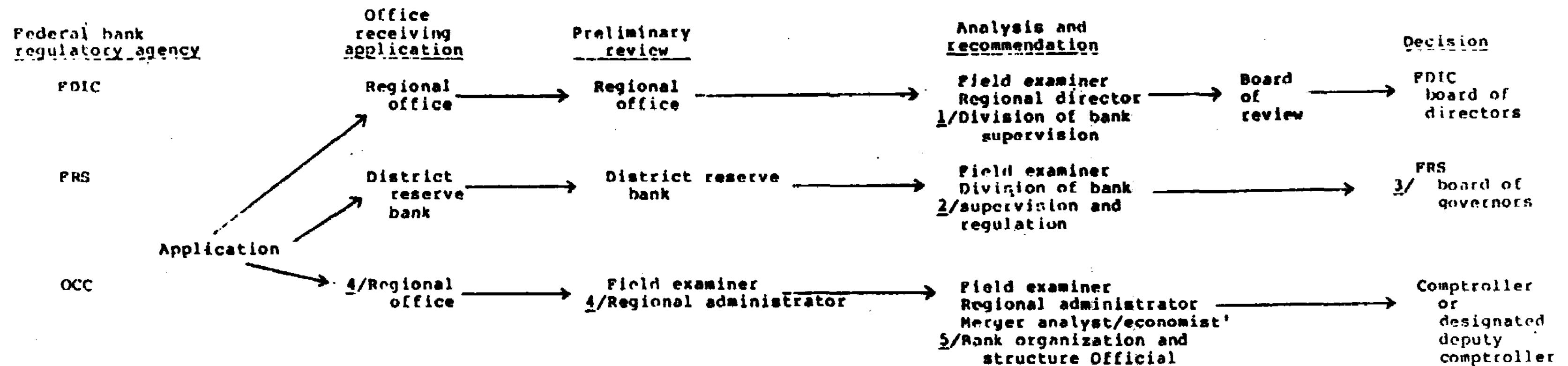
--Its convenience to and needs of the community it is to serve.

--The consistency of its corporate powers with the purpose of the act.

In the case of mergers, section 18 of the act requires that the agencies also consider whether such a merger would have anticompetitive or monopolistic effects. Agency policies provide little indication of exact criteria or specific weight given to any of the above factors, and judgment necessarily plays a large role. This makes it difficult to determine, without extensive study, how much consistency really exists among the agencies. The steps the three agencies normally follow to process a request for charter, membership, insurance, or merger are shown in the chart below. There can be exceptions, depending on the condition of a bank or bank holding company. Some areas where the agencies' policies or procedures differ are discussed following the chart.

Regulatory Agencies'

Review Processes For Charters, Memberships, Insurance And Mergers



1/At FDIC, the Division of Management Systems and Financial Statistics also has input in the decision making process on merger applications.

2/At FRS, Headquarters and the Regional Research Office may submit their own individual recommendation on merger and membership applications.

3/The district reserve bank is authorized to approve an application if certain conditions are met.

4/Merger applications go directly to OCC Headquarters where they receive a preliminary review.

5/For merger applications, the reviewing official is the Director, Bank Organization and Structure. For charter applications, the reviewing officials are the
(1)Director, Bank Organization and Structure, and
(2)Executive Assistant to the Senior Deputy Comptroller for Policy.

When considering an application for merger, the act requires the agencies to request reports on any competitive factors from the Attorney General's Office and the other two banking agencies. The agencies assign a classification of the effects on competition on the basis of an evaluation of these factors. The classifications used by the agencies differ as shown below:

FDIC	FRS	OCC
No significant effect	Not adverse	Beneficial effect
Adverse	Slightly adverse	No adverse effect
Substantially adverse	Adverse	Not substantially adverse
Monopoly	Substantially adverse	Substantially adverse
	Monopoly	

Since we did not review a sample of processed merger applications, we do not know whether these different classification categories adversely affected consistent and uniform consideration of the applications by the agencies.

FRS membership and merger process

The FRS process for considering applications for membership and merger differs from the process used by the other two agencies in that the Board allows individual Federal Reserve banks to approve membership and merger applications. The other two agencies retain sole approval authority at their headquarters--the Comptroller of the Currency at OCC and the Board of Directors at FDIC. Individual Federal Reserve banks cannot rule in all cases, but can approve applications within certain limitations. For mergers, some of these are:

--If the banks do not have offices in the same market, the bank to be acquired must have no more than $25 million in total deposits or control no more than 15 percent of total market deposits.

--If the banks compete in the same market, the resulting bank can control no more than 10 percent of total market deposits.

--Neither bank is the dominant organization in the State and the resulting bank can control no more than 15 percent of total State deposits.

Applications with circumstances exceeding these limitations must be forwarded to the Board for decision. In those cases where a Federal Reserve bank rules on an application for membership or merger, the application must be reviewed by the Division of Bank Supervision and Regulation at FRS headquarters before approval. Any application that the Federal Reserve bank cannot or does not want to rule on goes to the Reserve Board.

Minimum capital requirements

Minimum capital requirements for obtaining a national bank charter or FRS membership are spelled out in 12 U.S.C. 51 as follows:

Population	Minimum capital
Up to 6,000	$ 50,000
Greater than 6,000 but less than 50,000	$100,000
Greater than 50,000	$200,000 (with certain exceptions where State law permits capital of $100,000 or less)

As a general rule, however, OCC will not grant a charter and FRS will not approve a membership with capital of less than $1.0 to $1.5 million. FDIC does not have statutory capital limitations but, as a matter of policy, requires a minimum capital structure of $250,000.

Board of director approval and shareholder ratification--mergers

In all cases a majority of the board of directors of each participating bank must approve proposed national bank merger agreements. FDIC and FRS follow the State

requirements for shareholder's ratification of the merger, since the banks they regulate are subject to State law requirements. Generally, national banking law requires that shareholders controlling at least two-thirds of each bank's outstanding shares of stock ratify all merger transactions. If State law requires more than two-thirds approval, the State requirement must be met before approval is given.

PERMISSIBLE BUSINESS ACTIVITIES

State and Federal laws and the respective State and Federal chartering authorities generally determine the type of business activities in which commercial banks may engage. National banking law (12 U.S.C. 24) provides that national banks are formed for the purpose of carrying on the business of banking and sets forth their basic corporate powers. FRS and FDIC officials advised us that most States have similar provisions in the statutes which authorize the chartering of State banks. The question of what is "the business of banking" has been the subject of differences of opinion and controversy. For purposes of this report we have limited our discussion to those activities or services which can readily be distinguished from the traditional banking functions, such as loaning money and receiving deposits.

There are numerous Federal statutes that apply to the Federal regulation of banks. For example, statute prohibits banks from operating or participating in lotteries. This restriction applies to all banks supervised by FDIC, FRS, and OCC. Federal law also prohibits national and State member banks from keeping more than 10 percent of unimpaired capital and surplus in a nonmember bank. This restriction applies to all banks supervised by FRS and OCC. Other Federal statutes apply to only one of the agencies, such as 12 U.S.C. 92, which provides that national banks may act as insurance agents and real estate brokers if the bank is located and doing business in an area with a population of 5,000 or less.

As a chartering agency, OCC has issued interpretative rulings on the permissibility of various banking practices. For example, national banks may

--issue credit cards, either directly or through a subsidiary corporation;

--act as agent in warehousing and servicing of mortgages and other loans;

--assist its customers in preparing their tax returns, either gratuitously or for reasonable fees, but may not serve as an expert tax consultant;

--make charitable contributions;

--invest, with limitations, in community development projects;

--maintain and operate a postal substation;

--act as payroll issuer for customers;

--provide messenger service to customers;

--designate bonded agents to sell the bank's money orders at nonbanking outlets; and

--use data processing equipment and technology to perform authorized services for itself and others.

OCC recently requested national banks to divest themselves of travel agencies by May 1981.

For State-chartered banks which are supervised by FRS and FDIC, we were advised that the State chartering agency generally determines permissible banking activities. Because of the limited time available for completing our survey, we did not obtain information from State agencies regarding their policies on permissible activities. We were advised by FDIC and FRS that States generally allow and prohibit the same banking activities as those discussed for national banks. However, FRS said State member banks generally may not

--assist customers in preparing their tax returns or

--operate a postal substation.

COMMISSIONS FROM CREDIT LIFE INSURANCE SALES

Most banks offer credit life, health, and accident insurance (referred to as "credit life insurance") to borrowers at the time a loan is made. If the borrower

dies or is disabled before the loan is repaid, this insurance will pay off the loan. In this way, the insurance protects the interest of both the bank and the borrower.

Where credit life insurance is sold for a fee (rather than provided free as at some credit unions), the income derived by the bank can be substantial. In some cases, the income earned is paid to the bank and in other cases, is paid to the officers, directors, and controlling stockholders or their personally owned insurance agencies. The bank regulatory agencies' policies are different on how this income should be handled.

OCC

The Comptroller's Office has adopted a regulation (12 CFR part 2) which prohibits officers, directors, and significant stockholders of national banks from personally profiting on the sale of credit life insurance. The regulation declares that retention of this income by insiders is an "unsafe and unsound banking practice," as that term is used in the Financial Institutions Supervisory Act of 1966, 12 U.S.C. 1818(b). In general, the regulation places on the bank the responsibility to sell credit life insurance in such a way as to prevent insiders from benefiting. Where State laws prohibit banks from holding an insurance agent's license, the Comptroller's regulation requires that the bank must seek an alternative means of selling the insurance so that insiders do not personally profit.

FDIC

FDIC's present policy states that, while each case should be analyzed on its own merits and in accordance with laws and regulations of the State in which the bank is located, normally a bank must be reimbursed for the value of the bank space, equipment, and personnel used in the sale of credit life insurance. Also, the bank directors and shareholders have to be fully informed of the credit life insurance operations on the bank's premises, the funds received, and bank resources used. The bank's board determines how much income will be reimbursed to the bank. An FDIC committee has studied existing policies and is in the process of recommending revisions.

FRS

In September 1977, the FRS Division of Banking Supervision and Regulation completed a study on the credit life insurance commissions question. The study outlined in detail the controversy surrounding the subject, including a number of pros and cons. The study group recommended that the FRS Board formulate a stance in opposition to diverting the income from the bank, stating diversion of such revenue from the bank is deemed to be an unsafe and unsound banking practice. To date FRS has not issued a policy statement on the question, but does encourage the banks to at least recoup the costs associated with insurance operations (as in FDIC's existing policy).

SINGLE BORROWER LENDING LIMITS

Federal and State laws limit the amount of funds that a commercial bank can lend to a single borrower. The Federal law for OCC-regulated national banks prohibits a bank from lending more than 10 percent of its unimpaired capital and surplus to a single borrower. The State laws, with which FDIC and FRS require State member and nonmember insured banks to comply, provide various limitations. According to FRS, as of September 30, 1975, 14 States had a 10-percent limitation; 15, a 15-percent limitation; 16, a 20-percent limitation; and 4, a 25-percent limitation. One State, Vermont, based its limitation on total assets---1 percent of total assets or $60,000, whichever was greater. Additionally, certain Federal laws limit State and national member banks' lending for selected types of loans--for example, loans secured by stocks and bonds and loans to member bank affiliates.

The lending limitation to a single borrower may differ on the basis of definitions of a single borrower, unimpaired capital and surplus, and what constitutes a loan. For example, depending on whether such items like letters of credit, guarantees, acceptances, loan commitments, or overdrafts are defined as loans affects the determination of the lending limitation. According to the agencies' officials, for purposes of single borrower lending limitations, a loan does not generally occur until funds have been disbursed. Therefore, a commitment of funds without disbursement for both national and State banks generally would not constitute a loan. One exception is the standby letter of credit (discussed on p. 33) which is considered a loan.

With respect to what constitutes a single borrower, Federal law defines a single borrower on the basis of the entity involved. When assessing the lending limits to partnerships or associations, national banks should consider the obligations of the several members comprising the whole. In lending to corporations, a bank should consider the obligations of all subsidiaries which the corporation owns or in which it controls a majority interest. State laws vary on this matter, but a majority of the States have specific provisions for aggregating loans to partnerships and corporations. Federal statute (12 U.S.C. 84) is silent on the definition of a single borrower in terms of whether it includes only an individual or whether it also includes his/her family. OCC has issued interpretative rulings, and its examiners are guided by legal precedent. Generally, borrowers are considered a single entity on the basis of the use of the funds and/or the source of repayment. We do not know how this is defined by the various States.

OCC's interpretation of Federal statute on lending limitations cites unimpaired capital and surplus as a basis for determining the percentage limitations. Unimpaired surplus is defined as

--50 percent of reserve for possible loan losses,

--subordinated notes and debentures,

--surplus,

--undivided profits, and

--reserve for contingencies and other capital reserves (excluding accrued dividends on preferred stock).

According to FRS documents, State laws vary in that sometimes they cite only capital and surplus as a basis for determining the limitations and in other cases they include such items as capital notes and debentures, and undivided profits. We did not obtain from the States their definitions of unimpaired surplus.

CONFLICT OF INTEREST

The three agencies are responsible for assuring that their employees do not become involved in situations where the employee's private interests and personal activities conflict with the duties of his/her public employment responsibilities. In general, the three agencies advise their employees that they

- --should not accept anything of value that might compromise their positions;
- --should not engage in outside employment that might interfere with the performance of their official duties;
- --should not use their public office for personal gain;
- --should not have financial interest in, or deal in financial transactions that might conflict with their duties or responsibilities; and
- --should abide by general standards of conduct such as paying debts on time and not engaging in criminal, dishonest, or immoral conduct.

OCC examiners are prohibited by law from accepting loans or gratuities from the banks they examine, or from any person connected with such bank. OCC has, by administrative directive, extended this prohibition to all OCC employees having direct contact with banks. Under this directive, examiners and affected employees are prohibited from owning securities of a national bank and are required to disclose any relationships to employees of banks or relationships with any organizations having supply, consulting, or other contracts with OCC. This directive also applies to family members of the employee's household.

FRS examiners cannot borrow from State or national member banks or bank holding company bank or nonbank affiliates. They must disclose any relationships to employees of banks and may not examine banks employing relatives. FDIC examiners, regional counsels, and executive personnel cannot accept loans or gratuities from banks directly supervised by FDIC.

Each of the three agencies requires that its employees submit annual statements of their interests and any potential conflicting arrangements. FRS requires statements to be filed by headquarters' professional employees GS-13 and above in designated positions and by all examiners, assistant examiners, and certain others at the Federal Reserve Banks. FDIC keys the filing of annual statements to the employee's job. They require the following personnel to file statements: professional employees GS-13 and above, commissioned bank examiners GS-11 and above, assessment auditors GS-11 and above, certain procurement personnel GS-9 and above, and all attorneys. Any FDIC employee, regardless of grade, must disclose any interest which relates to or may conflict with job responsibilities. OCC requires statements to be filed by all bank examiners and by those professional employees listed in Appendix A to the Treasury Standards of Conduct.

The statements submitted to FDIC and OCC by their employees are assumed to be accurate and complete. If subsequently found otherwise, the penalties include, among other things, termination of employment. The FRS review process for headquarters' personnel is more aggressive in that its employees' financial interests are cross-checked against bank holding lists, bank subsidiaries, Dunn and Bradstreet, and other computer listings.

We issued three separate reports in 1977 on the financial disclosure systems in each of the three bank regulatory agencies. We reported that (1) the agencies had inadequate criteria for establishing who should file disclosure statements, (2) the statements themselves did not require sufficient information to guard against potential conflicts of interest, and (3) the procedures for processing and reviewing statements to determine employee conflicts of interest needed further development.

The agencies generally agreed with our conclusions and recommendations. A followup review in 1978 showed that the agencies had implemented most of our recommendations.

The agencies also have a supervisory responsibility for assuring the safety and soundness of banking institutions, including safeguards against certain bank employee conflict of interest situations. The agencies emphasize to their examiners the importance of identifying and discouraging favorable insider transactions by bank officers and directors.

In a booklet published on the duties and liabilities of directors of national banks, OCC states that directors and principal officers of national banks are responsible for maintaining a standard of conduct which avoids personal benefit not shared with other stockholders of the bank. The booklet cites various situations that directors and officers should avoid. The OCC examiners handbook also lists limitations. OCC requires bank directors and principal officers to maintain disclosure statements of their business interests and borrowing in their banks for examination purposes.

The examiners of all three agencies review the financial holdings and loans of all bank officers and directors and their interests and ask for a list of the officers' affiliations. Also, the examiners review insider transaction situations listed in the minutes of board meetings. FDIC regulations set specific requirements for nonmember insured banks to, among other things, maintain certain information on insider transactions to facilitate examiner identification and review. Banks supervised by FRS and OCC are directed by law to limit loans to bank officers, prohibit special interest rates on loans to insiders, and under certain circumstances prohibit interlocking directorates. Recent legislation sets statutory requirements and limitations in this area for all three agencies.

CHAPTER 3

BANK SUPERVISION

The bank examination is the agencies' primary tool for bank supervision. The Federal banking agencies conduct several different types of bank examinations. Separate examinations are made of banks' commercial departments, compliance with consumer protection laws and regulations, electronic data processing systems, trust departments, international branch operations, bank holding companies, affiliates, and subsidiaries. Most of the agencies' resources are devoted to examining commercial departments of banks, primarily to determine the soundness of the banks and their compliance with applicable laws and regulations.

With few exceptions, the agencies have authority for establishing their examination policies. This differs from their regulatory authority in which State and Federal laws often apply. Each agency establishes its own examination policies and procedures on the basis of what it perceives is necessary to assure bank soundness and compliance with applicable laws. Factors that influence these policies are the number and size of banks the agency supervises, the agency's concept of examination, and the agency's personnel resources. The agencies' examination procedures and policies differ in some areas and are common in others.

With regard to the Committee's areas of concern that relate to the examination process, we noted the following. The basic guidelines for rating capital adequacy and evaluating and rating asset quality are the same; however, there are some differences in the agencies' implementation of these guidelines. The agencies' policies differ in how frequently they examine banks; on when they meet with the banks' boards of directors; and under what circumstances they will consider issuing formal administrative actions, such as cease and desist orders. Through the Interagency Supervisory Committee, common policies have been developed for evaluating foreign loan country risk and shared national credits. Additionally, the agencies have consistent policies on the treatment of standby letters of credit.

FREQUENCY OF COMMERCIAL EXAMINATIONS

Each agency's policy is to examine problem banks more frequently and extensively than nonproblem banks. However, the specific guidelines used by each agency differ in selection criteria, time frames, type of examination, and management discretion allowed. For example, FDIC and OCC require that all banks be examined onsite within an 18-month period, while the FRS requires examinations of all banks within a 12-month time frame. OCC requires that problem banks be examined at least twice annually, while FDIC requires annual examination of problem banks. The FRS policy provides for flexibility, but generally requires an examination of problem banks every 6 months. Also, the frequency of examination by regulatory agencies for the State-chartered banks supervised by FDIC and FRS is increased by the State banking agencies' additional separate examinations.

FDIC

In January 1979, FDIC modified its policy on the frequency of its two types of commercial examinations--the full-scope examination and modified examination (curtailment in scope and report of examination). The policy provides a different frequency for examination depending on the extent to which the bank presents either supervisory or financial problems. Banks supervised by FDIC and classified as "Presenting Financial Risk" (problem banks) are to receive at least one full-scope examination by FDIC every 12 months. Additional examinations or visitations of such banks may be made if deemed necessary by the regional director.

Banks classified as "Presenting Supervisory Concern" are to receive at least one full-scope examination by FDIC every 18 months. Banks classified as "not presenting Financial Risk or Supervisory Concern" are to receive either a full-scope or modified examination by FDIC at least once in each 18-month period. We were told that modified examinations would be used as much as possible in these instances.

Banks supervised by FDIC are also subject to examination by State examiners. In several States, FDIC has arrangements for conducting examinations jointly with State examiners. In three States, FDIC and State examiners complete examinations on an alternating basis. The frequency

of State examinations differs from State to State and does not always coincide with FDIC's frequency policies. FDIC coordinates examination scheduling with State banking authorities.

FRS

The FRS policy on frequency of bank examinations provides that all State member banks will generally have a full-scope examination at least once annually. However, banks considered clearly free of unsatisfactory practices and historically demonstrating prudent management may receive a limited-scope or modified examination every other year in lieu of a full-scope examination. Banks demonstrating severe problems will be examined more than once a year as deemed necessary by the district Federal Reserve bank. FRS encourages its districts to examine problem banks every 6 months. FRS, we were told, performs examinations jointly with State examiners in more than half of the States where they examine banks. FRS examination cycles may differ or coincide with State examinations depending on the State, but efforts are made to coordinate examination planning.

OCC

Of the three bank regulatory agencies, only OCC has a statute which requires a particular examination frequency--at least three examinations of all national banks every 2 years. However, because of resource limitations, additional regulatory responsibility, and a change in examination approach, OCC has not conducted onsite examinations of all national banks this frequently. In the past, OCC has maintained this frequency as the goal for onsite examination of national banks, with regions informally setting their own priorities to attain this goal.

Beginning in 1979, OCC implemented a new national policy. The policy provides that all banks requiring special supervisory attention (see p. 37) and all banks of supervisory concern will be examined at least twice annually, including at least one full-scope examination for special supervisory attention banks; all other banks with assets of $100 million or more will be examined once annually as well; and all other national banks will be examined once every 18 months. The latter two categories may receive either a general (full-scope) or specialized (modified) examination on the basis of judgment of and resources available to the regional administrator.

Using this policy, each year OCC will examine those banks accounting for about 85 percent of all national bank assets.

ASSESSING CAPITAL ADEQUACY

A critical area of banking for regulators to judge is the adequacy of a bank's capital funds to absorb unforeseen losses and permit it to continue operations. The question of capital and how much is enough is a complex issue that has been discussed by experts for a number of years. The agencies would like to establish more formalized guidelines for assessing capital adequacy and continue to study the matter. Decisions reached on capital adequacy, according to one official, must be the proper ones because of the complexity of the issue and the potential impact.

Currently, there is no common definition among the agencies of what constitutes adequate capital or a common standard of how it should be measured. The three agencies, in broad terms, define capital as adequate if it is sufficient to (1) support the volume, type, and character of the business presently conducted; (2) provide for the possibilities of loss inherent therein; and (3) permit the bank to continue to meet the reasonable credit requirements of the area served. Capital should be sufficient to absorb shrinkage in asset value and other losses that may be incurred; and should be adequate to permit the bank to operate as a viable institution, capable of responsibly moving funds and providing related services while protecting against unanticipated adversity.

Given the lack of specificity on what constitutes adequate bank capital, it is understandable that the agencies' guidelines for analyzing and measuring a bank's capital position similarly lack specificity. The three agencies believe that many factors must be considered in assessing the adequacy of capital and that it is not feasible to employ a totally objective weighting system and reflect in a formula all the important factors which must be considered. The agencies believe that the measurement of some of the factors that must be considered is necessarily imprecise and requires an element of subjective judgment.

While all three agencies use ratios for the initial screening of a bank's capital position, FRS currently places more emphasis on a ratio in its decisionmaking process than does OCC or FDIC. FRS examiners are guided by ratio standards of capital in relation to a bank's risk assets; i.e., total assets less assets not subject

to some risk, such as cash and U.S. Government bonds. FRS examiners have the flexibility to deviate from the ratio standards if, in their judgment, other subjective factors justify a different rating.

It should be emphasized that even if the methods used by the agencies to analyze capital differ, it does not necessarily follow that the level of capital funds required by the different regulators for similar banks under their jurisdiction would necessarily differ.

Agency officials stated that they would like to establish more formalized guidelines for capital adequacy, but question the wisdom and capability of achieving such a goal. They said any standards would have to continue to allow the examiner flexibility to apply his judgment to the individual situation. An FDIC-initiated study, with input from FRS and OCC, is currently addressing the capital adequacy question.

The agencies have attempted to uniformly rate capital adequacy through the establishment of the Uniform Interagency Bank Rating System (UIBRS), which is a common system adopted by the three agencies to rate banks (see p. 35). Capital adequacy is one of five factors considered in the rating system. It is rated from 1 to 5 as follows:

--A 1 or 2 rating reflects adequate capital.

--A 3 rating reflects below-average capital adequacy.

--A 4 or 5 rating reflects inadequate capital.

All three agencies rate capital in accordance with this system. However, various factors are considered by the agencies, and individual examiner judgment plays a large role in assigning a rating. The current procedures used by the three agencies to assess capital and the basis for their capital ratings follow. As shown, existing guidance generally provides for subjective judgment in determining adequate capital.

<u>FDIC</u>

FDIC examination policies direct that "to evaluate capital adequacy, there are several important factors that must be weighed and judged":

1. Management--its ability, attentiveness, integrity, and record of management, together with the soundness of its policies.

2. Assets--the general character, quality, liquidity, and diversification of assets, giving special attention to assets adversely classified.

3. Earnings--the earnings capacity and the institution's dividend policy.

4. Deposit Trends--an upward deposit trend should be compensated with capital, the potential volatility of deposit structure adds another dimension of a different character to the analysis.

5. Fiduciary Business--the volume and nature of such business is significant in determining capital needs.

6. Local Characteristics--the general type of clientele, the stability and diversification of local industries or agriculture, and the competitive situation are important considerations.

FDIC advises that ratios, although usable as first approximations, are not conclusive and always must be integrated with all other pertinent factors.

FRS

In March 1978, in conjunction with the implementation of UIBRS, FRS issued new test guidelines to be used for assessing capital adequacy. Once the test phase is completed, the agency plans to fully implement guidelines to use for measuring capital. The principal ratio is the risk asset ratio, which the FRS instructions state is an objective measure of the amount of shrinkage that can be absorbed by a bank's capital structure. The risk asset ratio equals the gross capital funds divided by risk assets. Risk assets are defined as total assets plus reserve for possible loan losses, less cash funds due from banks and U.S. Government instruments.

Additionally, FRS states that the capital rating should generally equal or exceed the quality of assets rating. The quality of assets rating is to be considered because the risk asset ratio does not distinguish the degree of risk associated with differing asset structures; the quality of assets rating does.

The risk asset ratio was established to provide a basic consistency. However, FRS did not intend that a rating be issued solely on this basis. Rather, full consideration should be given to all the pivotal factors that determine the need for capital. FRS examiners must consider other pivotal factors as well, such as those listed for FDIC and OCC.

OCC

OCC instructions state that the following factors must be considered when evaluating capital, but emphasize that additional factors may be considered depending on the situation. Factors that must be considered are the

--quality of management,

--liquidity,

--asset quality,

--history of earnings and their retention,

--quality and character of ownership,

--deposit structure,

--quality of operating procedures, and

--capacity to meet present and future financial needs.

OCC states that capital ratios are useful in plotting trends and in comparing a bank with its peer group, but that there is no appropriate formula or ratio to measure the adequacy of some key issues in capital adequacy, such as quality of management.

ASSESSING THE QUALITY OF A BANK'S ASSETS

The appraisal of a bank's assets constitutes an important phase of a bank examination and consumes a large part of the time required to complete the entire examination. The quality of a bank's assets has a direct and indirect effect on many aspects of banking and bank supervision. It is an important element to be considered in assessing the overall soundness of a specific bank and the collective soundness of the banking system. It is considered when appraising the adequacy of the bank's loan reserve accounts and capital, and reflects on the quality of bank management and bank policy.

An indepth analysis of the procedures used by the banking agencies to examine and analyze the many facets of bank assets is beyond the scope of this survey. This report, however, does discuss some of the considerations involved in the agencies' assessment of asset quality and points out some of the differences in the approaches used by the three agencies. Following is a general discussion of two types of assets which are the principal assets that regulators must be concerned with in terms of assessing their current value.

Loans

The examiners do not evaluate the quality of all loans in a bank's portfolio. Generally, the examiners review all past due loans, all previously classified loans, and a sample of all other loans. None of the agencies project the total amount of banks' classified loans on the basis of evaluation of selected loans. At all three agencies there is a 100-percent review of all loans where the total amount to one individual or a single business entity exceeds a certain minimum level.

FDIC and FRS do not have agencywide guidelines on loan sampling selections. FDIC and FRS regional offices and the examiner-in-charge have responsibility for determining loan sample selection criteria including any dollar cutoff to be used. We were told that examiners normally consider the size of the bank, the bank's loan totals, the amount of classified loans found in the previous examination, and the quality of the bank's management in determining the sample. FRS examiners will generally include, in their samples, loans representing 1 to 2 percent of capital. The exact cutoff will vary, depending on the bank and examiner judgment.

The OCC approach to evaluating loans is a structured agencywide program based on the examiner's evaluation of a bank's internal controls, and internal and external audit. On the basis of these evaluations, a statistical table identifies the appropriate dollar cutoff for large loans and a sample size for all other loans to be selected by the examiner. The OCC approach was established to provide the agency with a higher confidence level for its asset quality assessment and an evaluation of the quality of the bank's lending process. In addition to the loans selected through its cutoff and sample, OCC reviews all bank-identified, past due and criticized loans; all nonaccruals; and insider transactions. The OCC examination approach includes both small and large loans.

The agencies use similar classifications to characterize loans that are considered to have varying degrees of credit risk. Criticized loans are divided into the following four categories with each category portraying an increasing degree of risk.

--Other loans especially mentioned.

--Substandard.

--Doubtful.

--Loss.

The three banking agencies' definitions of the above four categories of loan classification are essentially the same. The definitions are very broad and only intended to provide a general framework for classifying loans. Accurate classification of loans will largely depend on credit appraisal proficiency of the examiner and the exercise of sound judgment. Generally, other loans especially mentioned are considered as a potential risk, while the latter three categories represent an established risk.

While the preceding statement is true for most types of loans, the three agencies adopted a uniform policy on classification of delinquent consumer installment loans in November 1978. The policy, which is being held in abeyance pending public comment, provides that credit card loans, check credit, and/or overdraft credit will be treated the same as consumer installment loans.

Securities

Federal and State laws place limitations and restrictions on banks owning stocks and bonds. Generally, banks are prohibited from owning stocks, but there are a few exceptions.

One of the objectives of a bank examination is to determine the overall quality of the investment portfolio and how that quality relates to the soundness of the bank. It is not feasible, in this report, to cover all aspects of examining a bank's investment account. However, the following brief discussion will point out a few of the factors that are considered when determining the quality of securities.

The bank examiner, for all three agencies, generally reviews all of the bank's investment securities for quality, liquidity, and pricing information. The amount of additional securities analysis varies by agency. As in the case of loans, OCC reviews a sample of securities on the basis of the examiner's evaluation of internal controls and internal and external audit. FDIC and FRS examiners generally analyze all securities not issued or backed by the Federal Government. For securities selected for review, the examiners of all three agencies use basically the same analytical approach.

In evaluating the quality of the security, the examiner may use data published by rating services, such as Standard & Poor's Bond Guide or Moody's Bond Record. If the security is not listed in a rating service publication the examiner may attempt to obtain information from dealers in the security or may make his/her own analysis. When OCC examiners must make their own analyses, they may use information required by regulation to be in the bank's file. The OCC handbook contains a grading sheet to assist the examiner in determining the quality of the investment.

The examiner rates the bonds in one of three categories--investment quality, speculative, or defaulted--on the basis of their credit quality. Investment quality bonds are those included in the four highest investment grades by Standard & Poor or Moody, if the bonds are listed, and unrated securities of equivalent quality and soundness. Bonds with a lower ratirg are classified as speculative or defaulted issues.

For bonds classified as speculative or defaulted issues, the examiner must determine the market value of the security so that the asset can be classified. Market price of the security may be obtained from published quotations, dealers, or other sources. The examiner may test the prices by applying a formula in which the annual yield for the security is compared with yields afforded for similar type investments. Each agency classifies the value of market depreciation the same for these securities, but they differ on the remaining book value as shown in the chart below.

Agencies' Classification of Speculative and Defaulted Securities

	Speculative issues		Defaulted issues	
Agency	Market depreciation	Remaining book value	Market depreciation	Remaining book value
FDIC	Doubtful	Substandard	Loss	Substandard
FRS	Doubtful	Varies by district, may be substandard or not classified	Loss	Varies by district, may be substandard or not classified
OCC	Doubtful	Substandard	Loss	Doubtful

The three agencies are revising the policy for classifying defaulted municipal general obligation securities to allow the market for the securities to settle before making a classification. A uniform policy is expected in the near future.

Agencies' procedures for rating the quality of bank assets

As previously discussed, the three Federal bank regulatory agencies adopted UIBRS in May 1978 for rating the condition and soundness of the banks. One of the five critical dimensions of bank operations rated by UIBRS is asset quality.

The uniform rating system provides the agencies a common scale for rating asset quality on the basis of (1) the level, distribution, and degree of risk of classified assets, (2) the level and composition of nonaccrual and reduced rate assets, (3) the adequacy of valuation reserves, and (4) the demonstrated ability to administer and collect problem credits. The rating framework, which is set out in very general terms, is as follows:

Rating	Asset quality
1 and 2	Situations involving a minimal level of supervisory concern. Sound portfolios with the level and severity of classifications of a 2 rating generally exceeding those of a 1 rating.
3	Situations involving an appreciable degree of concern.
4 and 5	Represent increasingly more severe asset problems; rating 5 represents an imminent threat to bank viability.

Of the three agencies, only FRS has established a quantitative guideline to implement the UIBRS rating of asset quality. The FRS guidelines, which are still being tested, contain established ratio parameters for determining the rating to be assigned asset quality. Weights are ascribed to the three principal classifications of risk that examiners used to assign asset ratings. The weighted classifications are then compared to gross capital funds to determine the rating. The value of classified assets is determined by using weights of 20 percent for substandard loans, 50 percent for doubtful loans, and 100 percent for loss loans. Generally, if the total value of the weighted classified assets is less than 5 percent of gross capital funds, the bank's asset quality is rated 1; less than 15 percent, 2; less than 30, 3; less than 50, 4; and anything in excess of 50 percent, 5. Examiners have the flexibility to alter ratings based on other factors considered.

FDIC and OCC, like FRS, use UIBRS to compile ratings on the bank's asset quality. However, the two agencies have no established specific or numerical guides to assist the examiners in equating the volume of classified assets to a particular rating.

UNIFORM REVIEW OF SHARED NATIONAL CREDITS

The examiner's assessment of a bank's loan quality includes evaluating large loans that are shared by more than one bank. These loans, called shared national credits (SNC), are of an original amount of $20 million or more and (1) shared from inception by two or more banks under a formal lending agreement or (2) sold, in part, to one or more banks with the purchasing bank assuming its pro-rata share of the credit risk. SNCs can be shared by any combination of State and/or national banks.

Before 1975, each agency evaluated the portion of an SNC controlled by a bank it regulated during the course of the regular examination. This created problems with consistency because there were instances where portions of the same loan were rated differently during the examination of the participating banks.

In 1975, OCC began a program of conducting separate examinations of large shared credits once a year where the lead bank was a national bank or at the national bank with the largest share of the credit where the lead bank was a State bank. The purpose of the program was to provide a uniform treatment of the same loan among the participating banks. A three-person team of OCC examiners reviewed each SNC and voted on the quality of the loan. This single evaluation was incorporated into the regular examination reports of all participating national banks when the bank was subsequently examined, thereby eliminating multiple reviews of the same loan. The other two agencies continued to review their participating banks separately at each regular examination.

When we made a study of the Federal supervision of State and national banks in 1976, we found that the classification of risk assigned by the FRS and FDIC examiners, when the State-chartered participating banks were examined, often did not agree with the OCC-assigned rating on the basis of OCC's SNC examination at the lead bank.

In December 1976, FDIC changed its policy and advised its regional directors to begin using OCC's SNC classifications when examining a participating State nonmember bank. In 1977, the three regulatory agencies agreed to a uniform interagency approach for evaluating SNCs.

Examination process

Under the uniform system, a team of examiners evaluate SNCs on the basis of the same factors as any other loan: risk, collateral, borrower's character and financial position, and likelihood of repayment. No set formulas or specific standards determine quality, and each examiner's judgment is an important element in the evaluation process.

The teams are staffed with examiners from the three regulatory agencies. If a national bank is the lead bank, the team will consist of four members--three OCC members (one from the home region and two from other regions) and one FDIC member. If the lead bank is a State member bank, the examination team will consist of from three to six members, including examiners from the district Reserve bank, one FDIC team member, and, in some instances, participating State examiners. No State nonmember banks are the lead bank for an SNC.

Each team member has one vote in the overall process, and the majority votes determine the uniform rating. The team leader or examiner-in-charge reports the agreed-to rating--not classified, substandard, doubtful, loss, or especially mentioned; moderates the team discussion of the loan; conducts the rating process on each loan; and documents the justification for classified loans.

From approximately the beginning of May through the end of June each year, the examination teams are assembled and the SNCs examined. Each agency distributes a copy of the uniform classifications, a list of all reviewed loans and their status, and a list of its participating banks to its regional offices. In addition, the writeups of criticized loans are sent to each sharing bank under the organization's jurisdiction. The classifications assigned under the SNC review are incorporated into the regular examination of the participating banks when the bank is examined and prevails until the next uniform classification examination.

OCC and FDIC examination personnel are assigned by the national headquarters from a list of examiners obtained from each regional office. The responsible district Reserve bank assigns FRS personnel to its examination teams.

OCC jointly examines SNCs only at national banks which serve as the lead banks for five or more SNCs. National banks with four or less SNCs are examined by regional personnel. FRS does not have a similar limitation. Since FRS evaluation teams are from the district in which the bank is located, the costs of sending a team to evaluate one or two SNCs may not be as great as it would be for OCC, which assigns two of the three members from out of the region.

Reassessment of shared national credits

Lead banks are encouraged to inform the appropriate Reserve bank or the OCC Chief National Bank Examiner of any significant change affecting a shared credit, whether adverse or favorable, which occurs subsequent to the review of the loan by the SNC team. If a bank believes a reassessment is warranted, it is urged to furnish pertinent financial or related data demonstrating that a substantial change has taken place. FRS or OCC may initiate a request for reassessment if they obtain this information. The decision to conduct a reassessment is made by the district Reserve bank or the OCC headquarters in Washington. Reassessments are made, to the extent possible, at the district Reserve bank or OCC headquarters using information provided by the bank. If the magnitude and complexity of the change warrants a visit, a team, preferably the original review team, will visit the bank.

EVALUATING COUNTRY RISK

International lending, in addition to the traditional credit risk inherent in any extension of credit, involves country risk. This includes the risks of political or social upheaval, nationalization or expropriation, government repudiation of external debts, exchange controls, or foreign exchange shortfalls that might make it impossible for a country to meet external obligations on time. In November 1978, the three Federal bank regulatory agencies announced adoption of a joint approach for evaluating U.S. banks' country risk exposure in foreign markets. The approach was developed to encourage diversification of a bank's international lending. The first evaluations under the joint approach began in February 1979.

The procedures for evaluating country risk, which had been used before the adoption of the joint approach, differed at each of the three agencies. At FDIC the examiner-in-charge, when examining each State nonmember bank, was to consider all risk associated with the loans including country risk. Within FRS, two approaches were taken. The New York Federal Reserve Bank used an ad hoc committee of senior examiners to evaluate the country risks and assign a general classification to loans. All loans to those countries and their businesses received the classification, unless the borrower's ability to obtain the repayment currency was independent of the country's stability or the loans were made in the local currency. A loan in a local currency was judged according to the borrower's financial condition. At the other Federal Reserve banks, foreign loans were evaluated individually. This approach led to inconsistent classifications within FRS.

OCC, as part of its evaluation process, used a committee for evaluating country risk. Each quarter, senior international examiners from headquarters and the Chicago, New York, and San Francisco offices met to evaluate the risk involved in and assign classifications to loans to certain countries. The loans classified included those for which the borrowers's ability to obtain the appropriate repayment currency was questionable. The committee classified these loans by using information from major banks' research departments and available Government sources. The classifications arrived at by the committee were then used throughout OCC for loans to these countries.

Our 1977 report pointed out the inconsistency in classifications of loans by FRS and OCC and recommended that the agencies develop and use a single approach to classify loans subject to country risk.

A new uniform procedure

In February 1979, the three bank regulatory agencies implemented a new uniform system for evaluating and reporting a bank's exposure to country risk. Unlike the old process, the country risk aspect of foreign lending is separately evaluated by a joint committee on an individual country basis and is reported in a separate section of the report of examination.

The committee, known as the Interagency Country Exposure Review Committee (three members from each bank regulatory agency), has four primary functions:

1. Review and judge economic conditions in countries where loans are made by U.S. banks.

2. Determine the level at which a bank's exposure to a country in relationship to the bank's capital should be commented on.

3. Determine when credits should be classified due to an interruption in payment or when the interruption is imminent.

4. Prepare commentaries on developments in foreign countries for use by examiners.

As now planned, the nine-member committee will review and summarize conditions in foreign countries three times a year, considering such factors as

--country debt service capability;

--country population and political and economic stability;

--country social and political conditions; and

--other factors, such as bank and other government funding sources, past performance, and economic trends.

Examiners are responsible for determining the value of a bank's loans by foreign country and for commenting on country exposure concentrations. Concentrations will be determined by relating the Committee's condition statements to the bank's foreign lending and its capital. The examiner will report concentrations as a separate item (not part of an overall loan rating) on the examination report.

The concentration of a bank's loans will not have an impact on the evaluation of an individual loan. The loan will be reviewed in accordance with traditional standards of credit analysis.

Examiners, as in the past, will also assess a bank management's ability to analyze and monitor country risk in its international lending. Examiners will include in their reports an evaluation of a bank's procedures for monitoring and controlling exposure to country risk, the bank's system for establishing lending limits, and the bank's method for analyzing country risk.

STANDBY LETTERS OF CREDIT

Unlike other forms of bank commitments, a standby letter of credit is usually payable by the bank against a simple statement of default or nonperformance on the part of the bank's customer. Because the risks assumed by the issuing bank are similar to those in making a direct loan, standby letters of credit are treated by all three regulatory agencies in a manner similar to that of a regular loan. The credit is assessed on the basis of the purpose of the credit, the collateral, and the borrower's capacity and repayment ability. Standby letters of credit are aggregated with all other credits in the overall analysis of asset quality.

COMMUNICATING WITH THE BANK'S BOARD OF DIRECTORS

The bank's board of directors is responsible for the management of a bank. The regulatory agencies have taken the position that the directors of a bank may delegate responsibility for day-to-day operations of a bank to officers and employees. However, they cannot delegate their responsibility for the consequences of unsound or imprudent policies and practices whether the situation involves lending, investing, protecting against internal fraud, or any other banking activity. The directorate is responsible to its depositors and shareholders for safeguarding their interests through the lawful, informed, efficient, and able administration of the institution. The agencies' bank examination process serves an important function by providing bank directors with an independent assessment of their performance.

The results of examinations are presented to the bank's board in written and verbal form. The procedure employed by each agency in transmitting the written results of bank examinations is similar. The criteria for verbally communicating the results to the board differ by agency.

At the conclusion of a bank examination, all three agencies provide the bank's board of directors with a written report of the examination. The report begins by summarizing the examiner's findings and conclusions, highlighting the bank deficiencies, and suggesting needed improvements. The body of the report discusses, in detail, the various aspects of the examination. Our review of a small number of examination reports showed that the reports of each agency generally cover the same matters--capital, loans, earnings, liabilities, etc.--but that OCC reports include more narrative comments and analyses than do FDIC and FRS reports. Examiners from all three agencies prepare a confidential addendum to the report presenting observations and notations of questionable matters. A recent FDIC instruction cautions examiners not to include unsubstantiated comments in the confidential section of the report. The confidential section of the report is not presented to bank management.

In addition to providing banks with written examination reports, each agency also meets with the banks' board of directors. FDIC examiners normally meet with the board of directors or an appropriate committee of the board at each full-scope examination or when any examination identifies a bank as being of supervisory concern. If a nonmember insured bank is designated a financial problem, the FDIC regional director or his designated representative will meet with the bank's board of directors. FRS meets with the bank's board of directors of all money center banks and all problem banks. Both FDIC and FRS may meet with the board of directors of any bank whenever they believe that a meeting is necessary. FRS believes that its examiners' time and the bank board's time is not well spent discussing routine examination matters. An FDIC official told us that FDIC, in the past, had a policy of meeting with the board of directors of every bank at each examination. We were told that, after some experience with this policy, it was discontinued at the request of the banking community.

It is OCC's policy to meet with the board of directors of every national bank at least once each calendar year. Normally, the meetings are to be convened in conjunction with a regular examination of the bank. The quality or size of the bank is not a consideration in OCC's policy. The objective of these meetings is to foster a working relationship with the group of officials directly responsible for the affairs of the banks. OCC believes a continuing dialogue with all directors, including those of banks without problems, is an important aspect of its supervisory function. Contrary to its policy, we were told that OCC has not met with the boards of all banks in the last year, primarily because examinations have not been performed as frequently as was planned under the policy (see p. 18). The policy on meeting with the board of directors is being changed to coincide with OCC's new frequency policy so that examiners will meet with the board of directors after every examination.

IDENTIFICATION OF BANKS NEEDING SPECIAL SUPERVISORY ATTENTION

Primarily through the commercial examination process, the agencies identify specific bank problems that need correction. These problems may be brought to the attention of bank management during the course of the examination, in the examination report itself, and/or through meetings with the bank's board of directors. The agencies' field offices have primary responsibility for bringing problems to the attention of bank management and for monitoring the actions taken by the banks to correct their problems.

When the problems are of major significance and magnitude, the agencies identify these banks as requiring special supervisory attention (problem banks) and provide additional monitoring and supervision at the agencies' headquarters and field offices. Our 1977 report pointed out that the agencies used different criteria to identify banks needing extra attention and, as a result, some banks were probably receiving more attention than they needed, and some less. We recommended that the three agencies develop uniform criteria for identifying problem banks.

In response to this recommendation, the three agencies, through the work of the Interagency Supervisory Committee adopted UIBRS. The system, adopted in May 1978, is being used by all three agencies to identify banks which need special supervisory attention--FRS and OCC for all supervisory concern and problem banks and FDIC

for supervisory problem banks. FDIC is still testing the new system for use in identifying financial problem banks and continues to follow procedures in effect prior to adoption of the uniform system until the testing is completed.

On the basis of the implementation of UIBRS, there is no assurance that banks with similar conditions will be rated similarly by each agency. The written document on the new jointly adopted rating system describes the factors to be considered in assigning ratings to banks. It also states that banks assigned a composite rating of 4 or 5 should receive close or constant supervisory attention. However, it does not include enough detail about the rating to be assigned to each factor or how the rating of each factor should have an impact on the composite rating for the bank to assure consistency in implementing the system.

In our opinion, the Director, Division of Banking Supervision and Regulation, FRS, placed UIBRS in proper perspective in a memorandum transmitting the system framework, together with implementing guidelines, to the offices in charge of examination at each Federal Reserve bank. He stated that

> "* * *This document [UIBRS] describes the general framework for a uniform approach to rating banks while according each agency latitude in setting performance guidelines for evaluating individual banks under their supervision. * * * The attached Implementing Guidelines have been drafted for use by the Reserve Banks in implementing UIBRS for rating state member banks. It should be noted, however, that while the general framework for rating banks has been accepted uniformly by the three agencies, the attached Implementing Guidelines are not necessarily identical to those that will be put into use by the Comptroller of the Currency and the FDIC in rating banks under their supervision."

The rating system is based on an evaluation of five critical factors of bank operations that are intended to reflect the bank's financial condition, compliance with banking laws and regulations, and overall operating soundness. The factors are:

--Adequacy of the bank's capital.

--Quality of the bank's assets.

--Ability of the bank's management and effectiveness of its administration.

--Quantity and quality of the bank's earnings.

--Capacity of the bank to meet the demand for payment of its obligations (liquidity).

Each factor is rated on a scale of 1 through 5 in descending order of performance quality. Each bank is accorded a summary or composite rating of the five performance dimensions. The composite rating is also based on a scale of 1 through 5 and the ratings are assigned in ascending order of supervisory concern. The lack of consistent implementation guidelines and the flexibility built into the system raise questions as to the true uniformity of the system and any policies resulting from it. For example, capital adequacy, as pointed out earlier in this report, depends on examiners' judgment for a rating, not on specific set guidelines followed by all three agencies. The composite rating, reflecting the overall condition of the bank, is based on individual ratings like the one for capital adequacy. But the system also allows the agencies to consider factors other than the five principal rating dimensions in assigning a composite rating.

The significance of uniform criteria for rating problem banks is shown below in that problem banks receive considerably more supervisory attention. A lack of consistent criteria for rating and identifying problem banks among the agencies raises questions about the consistent identification and additional monitoring of banks experiencing serious financial or supervisory difficulties.

<u>OCC</u>

OCC uses UIBRS to identify banks requiring special supervisory attention. Banks are classified according to the severity of their problems. Banks with a composite rating of 5 are classified as critical, 4-rated banks are classified serious, and 3-rated banks are classified close supervision. The first step of the identification process begins with the examiner who is required to submit a special projects memorandum in those cases where it becomes apparent that significant adverse changes in a bank have occurred to

indicate that additional supervisory attention may be necessary. Upon receipt of the report of examination and the examiner's special projects memorandum, the regional administrator evaluates these documents, assigns the composite rating, and submits this information to the Special Projects Division along with a summary of the problems and a statement of the suggested corrective action OCC should take with regard to the bank. Special Projects must concur with the rating and the suggested supervisory action. Special Projects, directly and indirectly, monitors the action taken to correct the problems.

FDIC

FDIC uses UIBRS to identify banks with supervisory problems. It is testing the use of UIBRS to identify financial problem banks but, pending the outcome of the testing phase, continues to use traditional methods for identifying financial problem banks. These methods include both objective parameters and subjective judgment. The process of identifying and monitoring financial problem banks is presented below.

When an examination of any insured bank reveals financial problems which are deemed by the regional director to warrant assignment of a formal problem designation (1) serious problem-potential payoff, (2) serious problem, or (3) other problems, the regional office must submit a memorandum citing the problem to FDIC headquarters. The memorandum should identify the nature of the problem, any corrective action taken or recommended, and a general statement outlining the history of the bank.

Regional directors' recommendations for problem designation are reviewed by FDIC's Problem Bank Section to establish concurrence or nonconcurrence with recommended designations and related corrective measures. Final authority for classification rests with FDIC headquarters.

Once a bank is designated as a serious problem-potential payoff bank or serious problem bank, the regional director must provide the Director of FDIC's Bank Supervision Division with quarterly updated analyses of the bank's status. An updated analysis of banks classified as other problems is to be provided semiannually. The Bank Supervision Division and its Problem Bank Section maintain updated files on all banks receiving problem designations. The regional office is responsible for the direct monitoring and supervision of problem-designated banks.

FRS

The FRS classification of problem banks is based on UIBRS. FRS officially adopted this as a basis for identification in January 1979. Composite 3 banks are identified as requiring more than normal supervision--banks which could become problem banks if not properly supervised. Banks rated composite 4 and 5 clearly warrant special supervisory attention. All 3-, 4-, and 5-rated banks are separately identified to FRS headquarters and monitored by the Financial Institutions Supervision section of the Division of Bank Supervision. Specific actions performed by the section include reviewing examination reports, tracking corrective actions, and maintaining contact with district bank managers on problem situations.

CEASE AND DESIST ORDERS

When the supervisory agencies identify problems at banks, they can take several actions to encourage or force banks to correct the problems. The principal statutory power provided to the regulators to force banks to correct adverse conditions is the authority to initiate cease and desist proceedings against the bank, under the Financial Institutions Supervisory Act of 1966 (12 U.S.C. 1818(b)).

A cease and desist order, as the name implies, directs the bank to cease the current practice and correct the condition. A cease and desist order can be issued when a bank

--has engaged or is engaging in unsafe or unsound practices;

--has violated or is violating a law, rule, regulation, written agreement with the agencies, or any condition imposed in writing by the agencies in connection with the granting of any application or other request; or

--is about to do either of the above.

Cease and desist orders have traditionally been used by supervisory agencies as a last resort, following the use of various less formal actions to correct banks' problems. The bank regulatory agencies were granted cease and desist authority in 1966, but made little use of the authority prior to the mid-seventies.

In our 1977 report, we concluded that (1) the three agencies could have used their formal enforcement powers, including cease and desist action, more than they did to correct problems and (2) written guidelines should be developed to assist agency officials in identifying the types and magnitude of problems that formal actions could appropriately correct. Since the study, the agencies have generally increased their use of cease and desist proceedings, and have developed written guidelines to assist their officials in deciding when the proceeding should be used. FRS and OCC guidelines are more specific as to when an administrative action should be taken.

OCC

OCC's policies and procedures for formal and informal administrative actions are set forth in a memorandum dated January 18, 1978, from the Comptroller of the Currency to all regional administrators. It is OCC's policy to take formal administrative action, either a cease and desist order or an agreement, on all banks rated 4 or 5 under UIBRS; however, formal action may be waived in appropriate circumstances. The policy statement does not define when the formal administrative action should be a cease and desist order or when it should be a written agreement, nor does it define under what circumstances formal action may be waived.

An OCC official told us that in the absence of serious insider abuse or a grossly deficient financial condition, OCC will proceed with formal enforcement action through use of a written agreement authorized by the cease and desist statute, 12 U.S.C. 1818(b). An agreement between a bank and the Comptroller can bind the bank to remedial action which may be unavailable through resort to other formal means, such as litigated cease and desist proceedings. Additionally, written agreements have the added benefit of being effective immediately upon execution by the parties, thus avoiding the delay and expense attendant to the contested cease and desist process. Written agreements between OCC and banks contain basically the same remedial provisions as are found in cease and desist orders issued by the agency. Violation of a written agreement is grounds, in and of itself, for the agency to issue a cease and desist order. In virtually every case where a written agreement is sought, OCC is prepared to initiate cease and desist proceedings if the involved bank refuses to enter into the agreement.

For all banks with an overall rating of 3 under UIBRS, the OCC policy is that formal administrative action is to be considered. If formal administrative action is considered inappropriate, a memorandum of understanding between the regional administrator and the bank is to be executed. The memorandum of understanding should be used in those cases where the regional administrator believes the problems have been adequately discussed with the bank management and board of directors and that the bank, in good faith, will move to eliminate the problems.

The memorandum of understanding is similar to the formal written agreement, but is considered by OCC to be less formal. A principal difference in the two documents is that the memorandum of understanding is between the regional administrator and the bank, while the written agreement is between the Comptroller of the Currency and the bank. Formal and informal administrative actions for banks with an overall rating of 1 or 2 is not precluded by the OCC policy. In 1978, OCC issued 98 administrative actions--24 memorandums of understanding, 50 written agreements, and 24 cease and desist orders. Also, two civil actions were issued in conjunction with investigations under the Securities and Exchange Act of 1934. This compared to 33 administrative actions taken in 1976 at the time of our last study, 7 of which were cease and desist orders.

FDIC

FDIC policies and procedures provide guidance on the types of activities warranting a cease and desist order, but do not spell out at what point the problem becomes significant enough to warrant such action. Their policies state that whenever a nonmember insured bank is designated as a financial problem bank, a recommendation must be made with respect to formal administrative action under section 8 of the FDIC Act. The agency does not have a policy of issuing formal administrative actions to banks with overall ratings of 3, 4, or 5.

FDIC has provided examiners with general guidelines on unsafe and unsound practices, such as:

--Management whose policies and practices are detrimental to the bank and jeopardize the safety of its deposits.

--Total adjusted capital and reserves which are inadequate in relationship to the kind and quality of the bank's assets.

--A serious lack of liquidity, especially in view of the bank's assets and deposit structure.

However, there is no explicit guidance on when these various characteristics become significant enough to warrant a cease and desist order. Essentially all banks have problems of some kind, so the question of magnitude becomes very important. The judgment of the examiner, the regional director and the managers at FDIC headquarters, therefore, play an important role in the process.

Since our 1977 report, FDIC has increased its use of cease and desist orders but attempts to use other mechanisms to cooperatively resolve bank problems before issuing a cease and desist order. FDIC-initiated cease and desist orders numbered 29 in 1976, 52 in 1977, and 37 in 1978.

FRS

In a policy statement issued January 8, 1979, FRS sets out the following guidelines for initiating administrative action. With few exceptions, a memorandum of understanding between the district Reserve bank and the rated bank is required for all composite 3 banks. The memorandum represents a good faith understanding between the bank's directorate and the Reserve bank and does not require the Reserve Board's approval. Composite 4 and 5 banks will be presumed to warrant formal supervisory action--a written agreement or a cease and desist order, for example--unless specific circumstances argue strongly to the contrary.

In 1978, FRS initiated 25 formal actions--13 against bank holding companies and 12 against banks. This compared to 29 formal actions--24 against bank holding companies and 5 against banks--in 1976 when we last reviewed FRS statistics.

CHAPTER 4

CONSUMER COMPLIANCE EXAMINATIONS

In addition to determining the financial condition of banks and acting to ensure their soundness, the three regulatory agencies are also responsible for assuring that banks are complying with laws to inform and protect the Nation's consumers.

Each banking agency must ensure that the banks it supervises comply with various consumer credit and civil rights laws, such as the Truth-In-Lending Act, the Equal Credit Opportunity Act, the Fair Housing Act, and the Community Reinvestment Act. To carry out this responsibility, the three agencies have established separate consumer compliance examination programs, coordinated with consumer affairs groups, and, in some instances, established uniform interagency examination procedures.

Because of the broad nature of the consumer compliance area, we selected several compliance examination areas and compared the agencies' policies and procedures. On the surface, it seems that the agencies are generally following the same procedures. However, a thorough review of the implementation of the various agencies' procedures is necessary before we can make any meaningful evaluation of the area. On the basis of our limited discussions, there are indications that the consumer area is receiving much more individual and coordinated attention than it has in the past.

TRUTH-IN-LENDING ACT

The Truth-In-Lending Act requires banks to disclose credit and leasing terms to consumers so they can more readily compare terms and avoid the uninformed use of credit and leasing. The agencies are responsible for determining if banks are complying with the law. For example, does the bank have adequate policies and procedures to implement the law and is it complying with these policies and procedures, are the required disclosures being made to customers, and are disclosed costs and annual percentage rates being computed accurately? Some of the specific procedures used by the examiners of the three agencies to make their determinations include:

--Obtaining and reviewing copies of disclosure statements and loan files for each type of credit offered.

--Performing specific verification procedures to ensure that disclosed costs are accurately calculated.

--Obtaining and reviewing copies of account agreements, periodic billing statements, and form letters used to handle billing error inquiries and/or consumer complaints.

--Reviewing with appropriate management (1) internal control exceptions, (2) deficiencies or discrepancies found in performing examination and verification procedures, and (3) violations of law in policy and practice.

All of the agencies have prescribed statistical sampling instructions for its examiners to use in selecting a sample size. Examiners are required to cite all violations and are given training and guidance in determining what constitutes a problem or at what point a problem becomes significant. Problem identification can differ with an individual examiner.

In December 1978, the three agencies, in conjunction with the Federal Home Loan Bank Board and the National Credit Union Administration, announced the adoption of uniform guidelines for enforcing of the Truth-in-Lending Act. Common guidelines for the Equal Credit Opportunity Act have been proposed and are now being coordinated among the agencies.

FAIR HOUSING ACT

The purpose of the Fair Housing Act, Title VIII of the Civil Rights Act of 1968, is to prohibit banks from denying a mortgage or home improvement loan to anyone for reasons of race, color, religion, sex, or national origin. This includes loans for the purpose of purchasing, constructing, improving, repairing, or maintaining a dwelling. Like the Equal Credit Opportunity Act, which is more comprehensive and prohibits discrimination with respect to all forms of credit, the Fair Housing Act prohibits discrimination in the fixing of the amount; interest rate; duration;

or other terms, such as application and collection procedures. Unlike the Equal Credit Opportunity Act, however, the Fair Housing Act does not cover discrimination on the basis of marital status or age. The bank regulatory agencies are responsible for examining bank compliance with the Fair Housing Act, but the Department of Housing and Urban Development has primary regulatory and enforcement responsibility.

The agencies' examiners determine if banks are complying with the law. For example, is the bank fairly administering application, collection, and enforcement procedures; is the bank's board of directors aware of and fulfilling their responsibilities under the law; and are decisions to reject applications for loans based on economic factors and uniformly applied?

The various examination procedures used by the three agencies include such things as:

--reviewing any past or pending fair housing complaints since the date of the last examination,

--verifying that the bank includes a statement of its nondiscriminatory practices in all advertising of real estate loans,

--reviewing home mortgage disclosure information for indications of discriminatory policies or practices,

--comparing the demographic distribution of the loan portfolio with the demographics of the bank's local community, and

--reviewing with management (1) the adequacy of written policy and internal controls, (2) deficiencies or discrepancies in loan application criteria, (3) deficiencies in personnel's knowledge of the act, (4) violations of law in policy and practices, and (5) suggestions for correction of policies and practices.

All of the steps are not followed by all three agencies.

For case sampling, FRS recommends judgmental sampling, FDIC advises examiners to randomly sample, and OCC instructs examiners to do both random and judgmental sampling depending on the situation. Judgmental sampling emphasizes the

review of files involving probable discrimination situations, as opposed to random sampling, which would give equal weight to all bank files. Examiners establish the sample size on the basis of individual bank circumstances and in conjunction with prescribed instructions. While there are provisions for reporting violations, the agencies provide little guidance on how the bank should be rated overall.

COMMUNITY REINVESTMENT ACT

In November 1978, the three bank regulatory agencies, in concert with the Federal Home Loan Bank Board, issued a joint regulation and uniform examination procedures to implement and examine compliance with the Community Reinvestment Act. The Act requires the four agencies, consistent with safe and sound operations, to encourage the institutions they regulate to help meet the credit needs of the institution's entire community, including low- and moderate-income neighborhoods.

The agencies worked jointly to establish uniform guidelines and examination procedures for the act. The examination procedures are aimed at determining compliance with the act and its implementing regulations and at assessing the institutions' records of providing local credit services. The procedures, which are the same for the four agencies, include reviewing the minutes of directors' meetings; analyzing public files; reviewing the community reinvestment statement adopted by the institution; and analyzing the institution's policies, procedures, and operating practices.

The provisions of the act apply uniformly to the agencies; however, some flexibility is allowed in administering the act due to the varying makeup of the financial institutions the agencies regulate. It is not clear at this time how many differences this will create among the agencies. When the joint procedures were adopted in November 1978, there were no individual agency supplemental instructions. The agencies are working together to evaluate the progress of the program.

CHAPTER 5

TRAVEL POLICIES

Employees of all three agencies travel in the performance of their duties. The amount of expenses and the type of authorized travel allowed differ by agency. Two specific areas of interest to the Senate Banking Committee are reimbursement for first class travel and travel costs of spouses accompanying agency officials on official business. A summary of other travel allowance policies is presented in chart form at the end of the section.

FIRST CLASS TRAVEL

FDIC and OCC policies generally disallow first class travel for all employees, and FRS headquarters policy specifically limits those employees below the division director level. Also, each FRS district has its own travel policies. FDIC and OCC travel policies state that all employees should normally use less than first-class travel when traveling on official business. Exceptions are made if space is not available in coach accommodations in time to carry out the purpose of the travel or if for reasons of health or physical condition, first class accommodations are warranted. OCC also submits a semiannual report to the Treasury Department on the use of first class travel. FRS travel policies state that employees are authorized to use only coach fares but are encouraged to use discount fares when feasible. The travel policies allow division directors and their equivalents to travel first class at their discretion, and staff members traveling with board members or division directors may be allowed first class travel if board business is to be discussed during the flight. FRS requests division directors to use coach accommodations when accompanied by staff members. In addition, we were told most division directors use coach when traveling alone.

TRAVEL OF EMPLOYEES' SPOUSES

The agencies' travel policies do not generally allow reimbursement for the travel of spouses except when the employee has a permanent change of duty station. However, an FDIC official told us that FDIC allows spouses to

travel with employees at agency expense for regional conferences held once every 18 months. The agency justifies this expense by citing improved personnel morale. An OCC official told us that OCC allowed spouses to travel to regional conferences in the past, but has since changed this policy. FRS has never allowed this type of expense. All three agencies' regulations allow travel expenses for an employee's spouse and dependents when an employee changes his or her duty station.

TRAVEL ALLOWANCES--A SUMMARY

The following chart shows a comparison of the travel allowances for FDIC, FRS, and OCC, indicating the differences and similarities in the allowances for the agencies. As can be seen for these eight areas, there are a number of differences among the agencies.

Comparison of Travel Allowances for OCC, FRS, and FDIC

	OCC	FRS	FDIC
Travel allowances:			
Normal duty travel:			
Advance	Maximum of $750 for travel within U.S.; up to $1,500 for travel to Alaska and overseas	Maximum not to exceed expected out-of-pocket reimbursables	Maximum $750 for travel within U.S.; from $600 to $1,000 for travel to Alaska and overseas
Lodging and subsistence	Lodging 1/ plus $16 per day subsistence	Lodging 2/ plus $16 per day subsistence	Lodging plus $20 per day subsistence
Commuting allowance (when lodging not obtained)	Transportation plus $8 subsistence (1-day travel, more than 10 hours, home after 6 p.m., cost of dinner is incurred)	Transportation and up to $16 per diem (travel must be 10 hours or more; or more than 6 hours beginning before 6 a.m. or terminating after 8 p.m.)	Transportation and up to $16 per diem not exceeding $35 (period is more than 10 hours or more than 6 hours beginning before 6 a.m. or terminating after 8 p.m.)
Car mileage allowance	$0.17 per mile	Same	Same
Change of duty station:			
Household goods weight allowance	11,000 lbs. with immediate family, 5,000 lbs. without	No weight limit 3/	Not exceeding 11,000 lbs. net weight (limit may be extended upon written application)
Reimbursement for sale and purchase of home	Actual expenses not to exceed 10 percent of actual sale price and 5 percent of purchase price	Actual ordinary expenses for the area 3/	Same as OCC
Lodging and subsistence employee and dependents	Employees same as normal duty travel; dependents allowed 1/2 per diem rate of employee	Employees same as normal duty travel; dependents allowed 3/4 per diem rate of employee 3/	Employees same as normal duty travel; dependents allowed 3/4 of per diem rate of employee
Miscellaneous expense allowance	$200; additional documented expenses up to 2 weeks salary, not to exceed that of a GS-13 employee	2 weeks salary not to exceed $750 3/	$400; additional documented expenses may be approved, no maximum stated

1/Standard lodging cost not to exceed $22 per day and in designated high cost area, lodging not to exceed $34 per day (unless otherwise approved). Subsistence is established on a sliding scale from $16 to $19 depending on lodging costs.

2/Members of the Board are allowed per diem in lieu of subsistence not to exceed $42 or $21 plus actual cost of room. Members of field examination staff allowed necessary transportation and per diem/subsistence of $35.

3/Relocation allowance for system transferees may not exceed $12,000 excluding income tax reimbursements.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

G. WILLIAM MILLER
CHAIRMAN

February 16, 1979

Mr. Allen E. Voss
Director
General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Voss:

We appreciate the opportunity to review the General Accounting Office's report entitled "A Comparison of Selected Policies and Procedures of the Three Federal Bank Regulatory Agencies." It is our understanding that the report was designed as a follow-up to certain recommendations contained in the GAO's 1977 study of Federal bank supervision, as well as to pursue specific areas of interest expressed by members of the Senate Committee on Banking, Housing and Urban Affairs. We also understand that, in order to expedite your effort, the scope of the report was limited to written policies and procedures and informal discussions with headquarters officials.

The information contained in the report confirms that numerous substantive steps have been taken by the Federal Reserve, together with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, to coordinate more closely their supervisory policies and thus ensure greater equity and efficiency in the Federal supervision of commercial banks. Action has been taken on all of the substantive recommendations made by the GAO in its initial report, and uniform agreements on a number of important supervisory policies have been worked out among the agencies. The following represent some of the more notable areas where uniform interagency positions have been adopted and/or are presently being considered:

1) a system for rating commercial banks and identifying those requiring more than normal supervision;

2) a system for evaluating large national credits held by more than on participating bank;

3) an approach for reviewing and commenting on the country risk element of commercial bank lending;

Mr. Allen E. Voss - 2 -

4) a set of regulations and examination procedures for ensuring compliance with the Community Reinvestment Act;

5) procedures for the implementation of the Financial Institutions Regulatory and Interest Rate Control Act of 1978;

6) procedures for the implementation of the supervisory aspects of the International Banking Act of 1978;

7) a proposal for a method of classifying consumer instalment loans, soon to be issued for public comment;

8) the supervisory treatment of investment securities held by banks, including defaulted municipal general obligation bonds;

9) interagency training, including that relating to the Community Reinvestment Act and to international banking and other specialized examination procedures;

10) systems for rating trust departments and electronic data processing service centers;

11) a common definition of what constitutes a concentration of credit warranting comment in the bank examination report; and

12) minimum standards for internal controls for foreign exchange operations.

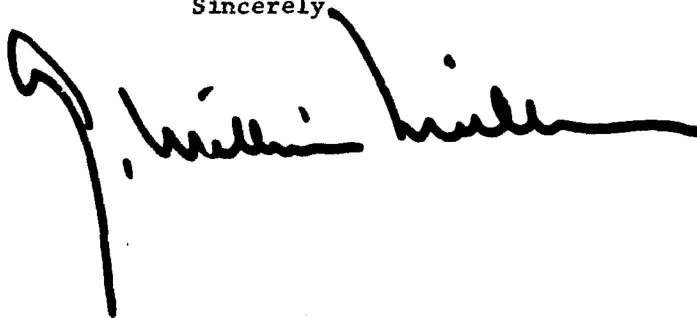
As this list clearly demonstrates, considerable voluntary efforts to achieve uniformity in appropriate areas have been made and continue to be made by all of the Federal regulatory agencies. Moreover, we believe that the Federal Financial Institutions Examination Council to be established next month in accordance with recent legislation will provide the vehicle for even greater coordination among the agencies.

Mr. Allen E. Voss - 3 -

With regard to the report's mention of agencies' travel policies, it should be noted that a recently issued change in Board policy calls for the use of less-than-first-class accommodations for all Board personnel.

On behalf of the Federal Reserve, I want to thank you for the opportunity to comment on the GAO report and for the professional manner in which your entire staff conducted itself during the study.

Sincerely,



Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

February 21, 1979

Mr. Allen R. Voss
Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

This is to inform you that we have reviewed your draft of a proposed report, "A Comparison of Selected Policies and Procedures of the Three Bank Regulatory Agencies."

We very much appreciated the splendid attitude and cooperation of the GAO staff in researching and preparing this report. Their receptivity to many of our comments and suggestions prior to the submission of the final draft contributed to a report which we believe is a generally complete and accurate summary of the various areas covered.

We do wish to incorporate, by reference and for the record, the enclosed OCC February 1979 response to GAO's 1977 report entitled "Federal Supervision of our Nation's Banks." This response contains OCC views on many of the same matters which are the subject of the report mentioned above.

One further comment is warranted. Page 50 of the draft report states "... there is no assurance that banks with similar conditions would be rated similarly by each agency even if all the agencies used the system for identifying problem banks." A further statement concludes that this is caused by the absence of firm and strict guidelines for considering the various factors that go into determining the composite rating, therefore, there is heavy subjectivity in arriving at that composite rating.

Although these statements are essentially correct, we do not believe they represent a significant weakness to the system. OCC's previous rating system indeed utilized strict guidelines tied primarily to

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asset quality. We abandoned that system when it became apparent to us that there was a clear need to recognize the many quantitative and qualitative factors, along with asset quality, that must be evaluated to establish an appropriate rating for a bank. We, therefore, rely primarily on the professional judgment of our examiners and administrators, rather than on a numerical formula, to weigh all the objective and subjective factors which must be taken into account in determining the final composite rating.

While this system necessarily involves more subjective judgment and results at times in differing opinions among the agencies as to what a proper rating might be, we feel it is far superior to the previous system in detecting problem situations. The differences in ratings among the agencies actually have served to focus on the reasons for divergent ratings, thus strengthening the system and evaluation process.

Should you have further questions on this matter, my staff and I are available to discuss them.

Very truly yours,

John G. Heimann
Comptroller of the Currency

Enclosure

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

February 21, 1979

Mr. Allen R. Voss
Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

An early request from the GAO group assigned to the Office of the Comptroller of the Currency was that we furnish a report on the status of implementing recommendations contained in the January 1977 GAO Study, "Federal Supervision of State and National Banks".

Enclosed you will find our response to this request. We feel that the OCC has made great strides in implementing GAO's recommendations, with a resulting improvement in our practices and procedures and interagency cooperation.

Should you have further questions on this matter, my staff and I are available to discuss them.

Very truly yours,

John G. Heimann
Comptroller of the Currency

Enclosure

Recommendation (2-21)

Accordingly, we recommend that the Comptroller of the Currency (1) develop more definitive criteria for evaluating charter applications and (2) thoroughly document the decision-making process, including an identification by reviewers of each factor as favorable or unfavorable.

Response

The OCC generally agrees with GAO and is now in the process of implementing a majority of this recommendation.

The courts have uniformly found the documentation of the charter application decision-making process adequate for judicial review purposes. However, as was indicated in a previous response, under present procedures (which were revised and publicly announced November 1976), we are continuously striving for more thorough documentation. Moreover, in a letter to the applicants, the OCC summarizes the reasons for an application's disapproval.

The OCC is now considering a proposal in which applicants would be informed of shortcomings in their application prior to a decision by the OCC. Thus, they would be able to correct problems which might otherwise lead to a negative decision. Such a procedure would require that applicants be informed that the ultimate decision on an application rests with the Comptroller or his designee. Staff review and recommendation would continue as a portion of the basis for the decision. Present procedures do allow for a conditional approval of an application which contains deficiencies in areas that can be controlled or corrected (e.g., capital deficiency, excessive investment in fixed assets, incompetent management).

GAO also recommends that the OCC develop more definitive standards in evaluating charter applications. The OCC agrees with that recommendation and has instituted a task force to review that and other matters. However, it should be noted that there are difficulties in developing such criteria (see OCC's response set forth in Appendix I, page I-5). The OCC is not aware of any state chartering authority which has specific standards or guidelines for the chartering of banks. Although it may be possible to develop such standards, experience suggests they might be so broad as to require chartering of unqualified applicants or so narrow as to exclude qualified applicants.

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Recommendation (4-7)

Therefore, we recommend that the Board of Directors, FDIC, the Board of Governors, FRS, and the Comptroller of the Currency establish scheduling policies and procedures which would avoid the setting of examination patterns.

Response

The OCC believes that each agency should have the flexibility to determine the utility of establishing scheduling policies and procedures. In our response dated January 14, 1977, we stated: "Historically, the OCC has viewed surprise as an important element of an examination. However, a primary feature of our new examination approach entails the pre-examination analysis wherein the examiner will determine the adequacy of internal control and audit activity. The OCC feels that the best deterrent for fraud is not periodic unannounced visits by examiners but rather the existence of sound bank policy, procedure, internal control and audit activity on a continuing basis. The element of surprise is necessary only in those cases where such factors are suspect."

The revised examination approach employed by the OCC encompasses a review of the present as well as the past operation of a bank. The OCC has, therefore, deemphasized the surprise element in examinations except where there are reservations about management integrity or when there are plans to perform procedures of an auditing nature. The OCC has recently revised its examination priorities to achieve the most efficient use of our limited resources.

Legislative attempts to obtain flexibility in scheduling of examinations continue. If that flexibility is forthcoming, examination scheduling will probably take the form outlined in Recommendation 4-8. The first part of that program would be a general comprehensive examination covering every area of banking activity. That examination would include an in-depth analysis of each bank's system of operations with the intent of strengthening the system to prevent unforeseen situations.

A strong system of operation will protect the bank against fraud and thus reduce the need for surprise examinations. Subsequent examinations in a cycle are specialized, with scope and timing dictated by the results of the general examination. Should the general examination reveal that a bank's system of operation is weak, the next specialized examination may be on a surprise basis and include the examiners performing certain auditing functions. With the timing and scope of specialized examinations determined on an individual bank basis, the probability of establishing examination patterns is greatly reduced. Further, periodic review of each bank's system of operations between examinations offsets the risks of a pattern of examinations.

- 3 -

Recommendation (4-8)

We recommend that the Board of Directors, FDIC and the Board of Governors, FRS adopt flexible policies for examination frequency which would allow them to concentrate their efforts on banks with significant problems.

We recommend that the Congress amend the National Bank Act to allow the Comptroller of the Currency to examine national banks at his/her discretion.

Response

The OCC concurs with the GAO recommendation. OCC housekeeping legislation, included as part of the FIRA package in the last Congress, would have amended 12 USC 481 to allow the OCC to examine every national bank as often as it deemed necessary. This portion of the legislation failed to reach a floor vote. Further attempts will be made this Spring to amend the code.

If the appropriate legislation is enacted, it is proposed that the OCC would complete one on-site examination per year of all banks rated 1 and 2 with assets greater than $100 million, two on-site examinations per year of all banks rated 3, 4 and 5, and one on-site examination per 18 month period of banks rated 1 and 2 with assets less than $100 million. Practically, because of staffing limitations externally imposed, this is the present examination cycle.

Recommendation (4-29)

We recommend that the Board of Governors, FRS and the Comptroller of the Currency develop and use a single approach to the classification of loans subject to country risk.

Response

The OCC agrees with GAO and the recommendation has been implemented.

Since July 1974, a committee of OCC examiners from the major United States financial centers and from the Washington headquarters has met quarterly to evaluate credits by national banks to foreign public sector borrowers and, when necessary, determine risk criticisms. The committee's decisions are applied uniformly to all national banks. Examiners for the Federal Reserve Bank of New York have employed a similar technique for member banks in the Second Federal Reserve District. The remaining Federal Reserve Districts do not have a formal approach to country risk evaluation.

The Interagency Supervisory Committee has formed a Task Force for International Supervisory Matters. After several months of discussion and planning that task force formulated a proposal for an Interagency Country Exposure Review Committee. The proposed committee has been approved by the Interagency Supervisory Committee and will begin functioning in early 1979. This committee, composed of three representatives from each of the three federal bank regulatory agencies, will meet at least semi-annually to evaluate credits by United States commercial banks to foreign public sector borrowers and, when necessary, to determine risk criticisms. The committee will also determine procedures for evaluating levels of concentration of country exposure within the banks and, where necessary, will define comments on such concentrations. The committee's actions/decisions will be applied uniformly to all national, state member, and state non-member banks.

Recommendation (4-30)

We recommend that the Board of Governors, FRS, and the Comptroller of the Currency implement procedures whereby major foreign branches and subsidiaries, including subsidiaries of Edge Act corporations, are examined periodically and whenever adequate information about their activities is not available at the home office.

Also, we recommend that the Board of Governors, FRS, and the Comptroller of the Currency exchange each others' examiners' to cut expenses when conducting examinations in foreign countries.

Response

The OCC agrees with both recommendations.

Adequate information about the activities of foreign branches and subsidiaries of national banks is usually available at, or can be provided to, each bank's head office. However, in order to further substantiate the condition of the overseas activities of national banks, the OCC has been conducting on-site examinations of their overseas branches since 1968. With the exception of "secrecy" countries, all major, and many lesser, overseas branch locations are visited regularly. Examination sites are chosen on the basis of their relative importance to the condition of the total bank and their accessibility to OCC examiners. Information on activities in "secrecy" countries is obtained from the bank and further substantiated by the bank's independent internal, and sometimes external, auditors. Direct negotiations have also taken place with representatives of the bank supervisory departments in "secrecy" countries in an attempt to obtain direct access to information and conducting of on-site examinations in those locations.

For several of the major national banks operating extensive and diversified overseas operations, examiners must visit key overseas locations to conduct examinations of those banks' overseas activities. Such visits are part of our normal examination policies and procedures. Those examinations of decentralized management locations encompass a review of all branches, subsidiaries and affiliates of each bank within the specific geographic responsibility of the overseas center.

We agree that the exchange of examiners for overseas examinations between the OCC and the Federal Reserve System would be beneficial both because of the potential cost-savings and because of the exchange of ideas and procedures that would occur between examiners from both agencies. In the past, there have been a limited number of joint examinations of overseas affiliates of national banks in which the two agencies participated. The International Examinations Division of the OCC is currently working with the Division of Banking Supervision and Regulation of the Federal Reserve System to coordinate examinations involving foreign affiliates of national banks. All such examinations in London during 1979 will involve some coordinated efforts. Although the OCC is willing

to expand that exchange, some legal barriers remain.

Federal Reserve examiners are authorized to conduct examinations of overseas branches and affiliates of National banks, since all National banks are member banks. Presently, however, National Bank Examiners are not legally authorized to examine overseas branches or affiliates of state member banks. However, a section of the Financial Institutions Regulatory Act not considered during the last session of Congress proposed to amend 12 USC 481 to include: "The Comptroller of the Currency, upon the request of the Board of Governors of the Federal Reserve System, is authorized to assign examiners appointed under this section to examine foreign operations of state member banks." We assume this item will be considered during this session of Congress.

Recommendations (7-25 & 26)

We recommend that the Comptroller of the Currency invite the FDIC and the FRS to jointly review and evaluate its new examination approach. Further, we recommend that in the event of a favorable assessment of the new process, the Board of Directors, FDIC and the Board of Governors, FRS revise their examination processes to incorporate the features of the OCC's new examination approach.

Additionally, we recommend that the Board of Directors, FDIC, the Board of Governors, FRS, and the Comptroller of the Currency jointly staff a group to analyze shared national credits at state and national lead banks under Federal supervision and that the three agencies use the uniform classification of these loans when they examine the participating banks.

We also recommend that the Board of Directors, FDIC, the Board of Governors, FRS, and the Comptroller of the Currency work together in refining their monitoring systems and their approach to consumer credit compliance examinations.

Response

The OCC agrees with all three recommendations. Substantial progress has been made toward implementing each recommendation.

The OCC response dated January 14, 1977, explained that our Office had made a presentation to the FDIC and the FRS in November 1976 and that the Acting Comptroller had recommended to the Interagency Coordinating Committee that a permanent staff group be formed for the purpose of reviewing and analyzing the OCC's approach to examination. The FDIC and the FRB have adopted the OCC's EDP examination procedures.

Through the Interagency Supervisory Committee (ISC), several facts of the OCC's revised examination process have been adopted by the FRS and the FDIC. We believe the Federal Financial Institutions Examination Council will make additional progress toward establishing uniform examination standards and guidelines. At a recent ISC-EDP subcommittee meeting, a proposal was made to issue an interagency examination procedures manual which would be followed by the OCC, FDIC, FRB, FHLBB, and NCUA. Those agencies issued implementation guidelines for interagency EDP examination scheduling and report distribution on May 31, 1978.

With respect to shared national credits, the FDIC and the FRS have joined the OCC in conducting a joing annual review of shared national credits at state and national lead banks.

While considerable progress has been made toward the integration of a uniform early warning system, this task will be one of the top priority objectives of the Federal Financial Institutions Examination Council. The OCC has previously informed GAO of several meetings among the agencies at which the National Bank Surveillance System was explained and technical

information was offered.

In our January 1977 response to comments concerning consumer credit compliance examinations, we explained that we were actively engaged in implementing revised examination procedures in that area and were working closely with the FRS, FDIC, NCUA and the Department of Housing and Urban Development in refining the process.

Since then the OCC has worked with the FDIC and FRS in refining monitoring systems and the approach to consumer credit compliance examinations. The three agencies have participated in eight regional consumer compliance workshops sponsored by ABA. On January 12, 1977, the OCC invited the FDIC and FRS to participate in meetings designed to provide a regular exchange of information about monitoring systems. Since February 1977, the three agencies have met approximately monthly to gain familiarity with each other's systems, to discuss possible modification of each system and to discuss inclusion of additional data items in the Reports of Condition and Income. In the area of consumer credit compliance examinations, the OCC submitted its handbook for Consumer Examinations to FDIC and FRS for comment prior to publication. The three agencies have worked together in the development and implementation of joint schools on consumer law and examination. In October 1977, a joint notice of proposed statement of enforcement policy for truth-in-lending was published in the Federal Register. The three agencies issued identical Guidelines for Corrective Action for Regulation Z and provided identical information to their respective banks regarding the Fair Debt Collection Practices Act. Also, an issuance of idential guidelines for Regulation B has been proposed.

Recommendation (8-20)

We recommend that the Board of Directors, FDIC, the Board of Governors, FRS, and the Comptroller of the Currency establish more aggressive policies for using formal actions. Written criteria should be developed to identify the types and magnitude of problems that formal actions appropriately could correct.

Response

The OCC agrees with this recommendation and has implemented its own policies and procedures for administrative actions. Examining Circular No. 160 dated August 12, 1977, established written criteria for formal action on all banks with composite ratings of "4" or "5". On January 18, 1978, the Comptroller, in a memorandum to all Regional Administrators, further defined and clarified the enforcement policy previously stated in that examining circular. In addition to announcing the policy, the memorandum contains procedures to be followed by examiners, regional offices, and Washington personnel in considering and taking formal action.

The OCC policy is tied to the uniform rating system utilized by the three bank regulatory agencies. Under the policy, all banks rated "4" or "5" are to be subject to formal action. Banks rated "3" must be considered for formal action and, if no formal action is taken, a "Memorandum of Understanding" is expected. Further, if a Memorandum of Understanding is not considered necessary for a bank rated "3", the regional office involved must outline the reasons such action is considered inappropriate and must propose alternative supervisory action, seeking the concurrence of the Special Projects Division. Some actions continue to be taken on banks rated "1" and "2".

Recommendation (8-47)

We recommend that the Board of Directors, FDIC, the Board of Governors, FRS, and the Comptroller of the Currency develop uniform criteria for identifying problem banks.

Response

A uniform rating system for commercial banks was implemented in May 1978. Additionally, uniform ratings systems for trust departments and data processing operations were adopted in September and November of 1978 respectively.

Recommendation (10-6)

We recommend that where feasible the Comptroller of the Currency; Board of Directors, FDIC; and Board of Governors, FRS; combine their examiner schools and standardize their curricula.

Response

The OCC agrees with this recommendation and has made significant progress toward achieving this objective.

An interagency training coordination subcommittee was established under the ISC to determine areas in which examiner schools and standardized curricula would be practical. The first area identified was consumer affairs. A one-week consumer affairs school was held by the agencies in June 1977, for management level personnel. The school emphasized consumer laws from a policy rather than examination procedures viewpoint.

A management level trust program was held the week of December 12, 1977. The purpose of that school was to provide participants with the opportunity and information to develop their own ideas concerning examination practices and procedures consistent with current developments in the trust business.

In addition, representatives of the FRB, FDIC, NCUA and state banking commission attended the OCC's Bank Fraud Training Program in September 1978.

The subcommittee is also conducting an analysis of each agency's training programs to identify other areas suitable for joint training such as EDP and International. In addition, enrollment in existing agency programs has been made available to the other financial agencies.

Representatives of the FRB/FDIC/OCC are evaluating properties suitable for use as a joint training center. Choices presently include building new space; purchasing an existing facility, leasing commercial space; or using college or university space. The subcommittee also is looking into joint training in connection with the Community Reinvestment Act.

Joint training involving OCC, FDIC, FRB, FHLBB, and NCUA is one of the responsibilities assigned to the Federal Financial Institutions Examination Council. After it is established on March 10, 1979, it will assume many of the projects listed above.

Recommendation (10-10)

We recommend that the Board of Governors, FRS (1) establish a full-time training office to operate its examiner training program and (2) carry out the revision of examiner school curricula which it has recognized as needed for sometime.

We also recommend that the Comptroller of the Currency, Board of Directors, FDIC, and the Board of Governors, FRS, increase their training in EDP, law and accouting as desired by their examiners.

Response

The OCC agrees with these recommendations. As indicated in Recommendation 10-6, uniform training will be the responsibility of the Federal Financial Institutions Examination Council.

The OCC has developed a one-week Electronic Data Processing school for examining personnel. The school introduced participants to EDP, internal countrols, and audit procedures.

Instruction in law and accounting has been developed for first-year examiners to include: overview of banking laws, regulations and interpretive rulings, generally accepted accounting principles, and financial reporting. As each area of instruction is developed for future programs, applicable laws and accounting principles will be included. In addition, OCC now trains staff attorneys in all levels of bank examiner continuing education curricula.

A specialized program for consumer affairs laws has been implemented. The purpose of this school is to train assistant national bank examiners in consumer lending and related laws. Examiners responsible for consumer affairs examinations must complete this program.

A specialized Securities Exchange Commission review was held in January 1978 for all National Trust Examiners. The review included laws regulating trading in investments.

A continuing program has been implemented to provide specialized training in handling and investigating bank fraud cases. The program is aimed at providing a well-trained group of national bank examiners to handle such cases. However, it has been attended by various supervisory staff and personnel from other federal and state agencies.

Recommendation (11-8)

We recommend that either (1) of the Board of Directors, FDIC; the Board of Governors, FRS; and the Comptroller of the Currency jointly establish a more effective mechanism for the three agencies to combine their forces in undertaking significant new initiatives to improve the bank supervisory process or in attacking and resolving common problems or (2) the Congress enact legislation to establish a mechanism for more effective coordination.

Response

The OCC agrees with this recommendation and notes that it supported the newly passed legislation mandating the Federal Financial Institutions Examination Council which will implement GAO's recommendations through a more formal structure.

This matter was addressed fully in testimony by Comptroller Heimann on September 16, 1977, before the Committee on Banking, Housing and Urban Affairs, United States Senate. The Interagency Supervisory Committee, a subcommittee of the Interagency Coordinating Committee, was established in February 1977. Substantive progress has already been made in several areas commented on in the GAO study.

Through the ISC, interagency agreements on the following matters have been reached and implemented: 1) a uniform bank rating system, 2) uniform consumer examination training, 3) a shared national credit program 4) a uniform, interagency approach to evaluation and risk criticisms to foreign public sector credits, 5) a uniform approach to concentrations of credit, 6) a uniform approach to non-accrual laons, 7) a uniform trust department rating system, 8) revision of the 1938 accord on classification of investment securities, 9) a uniform policy on upstreaming deferred tax liability, 10) a uniform policy on diversion of income through management fees, 11) joint or rotated examinations of data processing centers, 12) uniform interagency rating system of data processing centers, 13) uniform approach to classification of delinquent instalment loans, 14) minimum EFT guidelines, 15) CRA examination procedures, 16) uniform recordkeeping and confirmation requirements for securities transactions, 17) improper/illegal payments examination procedures, and 18) trust department annual report. Areas presently being studied include: 1) training program coordination, 2) uniform disclosure policies on administrative actions and examination reports, 3) bank sales of bank holding company commercial paper, 4) remote disbursement/zero balance accounts, 5) capital adequacy, 6) interagency EDP manual, 7) SBA loans, 8) establishment of standards for documentation, accounting and auditing of foreign exchange operations and, 9) supervision of foreign bank holding companies.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

February 26, 1979

Mr. Allen R. Voss, Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

Members of my staff have met and discussed with members of your staff the recent draft of a proposed GAO report entitled: "A Comparison of Selected Policies and Procedures of the Three Bank Regulatory Agencies." Members of my staff discussed our differences with portions of the initial draft of the report and agreed with your staff representatives informally to certain changes. We trust that all of our suggested changes will be incorporated in the final report. We appreciate the opportunity to review and discuss the draft report with members of your staff.

Sincerely,

John J. Early
Director

(23100)

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