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FEDERAL DEPOSIT INSURANCE CORPORATION

TESTIMONY OF

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WASHINGTON, D.C.

ON

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

BEFORE THE

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

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

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

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

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

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

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

THE FDIC'S ROLE UNDER THE PRESIDENT'S PROPOSAL

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

FDIC EXAMINATION PROGRAM

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

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

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

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

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

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

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

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

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

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

Conclusion

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

Attachments