

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C.

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 a.m. EDT
WEDNESDAY, MAY 21, 1980

STATEMENT OF
ELMER B. STAATS
COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

Mr. Chairman, we appreciate the opportunity to appear before your Committee today to describe our ^[GAO] progress toward meeting ^{its} our responsibilities under the Federal Banking Agency Audit Act of 1978. The act gives the General Accounting Office authority to conduct audits of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve System. The only areas we are not permitted to review are "deliberations, decisions, and actions on monetary policy matters." We have reached a workable agreement with the Federal Reserve as to what specific records and actions are covered by that exclusion.

010447



The act also contains a number of other significant provisions which are intended to preclude the unauthorized disclosure of confidential information about banks or to prevent our placing an unnecessary burden on commercial banks. According to the act, the General Accounting Office

--is not permitted to conduct onsite examinations of banks without the written consent of the appropriate Federal regulator.

--is not permitted to disclose the identities of open banks, bank holding companies or their customers in its reports or in any other fashion.

--must store its workpapers which identify open banks, bank holding companies, and bank customers on the agencies' premises.

Also, our auditors and analysts are subject to the same criminal penalties as bank examiners for the unauthorized disclosure of confidential bank information: a fine of not more than \$5,000, no longer than one year in jail, or both.

Shortly after the act was signed into law, we established a new group in our General Government Division. This group was assigned responsibility for audits and reviews of what we call "Federal Oversight of Financial Institutions." This encompasses the activities and programs of the

--Comptroller of the Currency,

--Farm Credit Administration,

- Federal Deposit Insurance Corporation,
- Federal Financial Institutions Examination Council,
- Federal Home Loan Bank Board,
- Federal Reserve System, and
- National Credit Union Administration.

During fiscal year 1979, we spent about 40 staff years on reviews of these agencies, including an audit of the 1977 and 1978 Federal Home Loan Bank Board financial statements. We plan to devote about 50 staff years to reviews of these agencies in fiscal year 1980.

REVIEWS COMPLETED

It was our intention when we began work in this area to concentrate on evaluating the regulatory and supervisory functions performed by the financial institution regulators. This approach was consistent with the needs of your Committee as well as those expressed to us by representatives of the Senate Committee on Governmental Affairs, the House Committee on Banking, Finance and Urban Affairs, and the House Committee on Government Operations. We also started a significant effort to evaluate the internal audit operations of each of the financial institution regulatory agencies. That effort will help improve internal auditing in those agencies and help

identify areas of agency management and operation which merit GAO review.

Since enactment of the Federal Banking Agency Audit Act, we have completed reviews and issued reports in the areas of bank regulation, bank holding company regulation, foreign involvement in the U.S. banking industry, and internal auditing. A complete list of the reports we have issued is appended to this statement. Let me summarize each report.

Bank Regulation

Although they regulate and supervise different sets of banks, the bank regulatory agencies perform similar functions. We examined and compared a wide range of regulatory policies and procedures used by the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve System. Our report highlights the similarities and differences among the agencies for the same functions.

The Federal Deposit Insurance Corporation, because it insures the vast majority of the Nation's 14,700 banks, focuses its attention on banks that are believed to pose a high degree of risk to its insurance fund. These banks are referred to as problem banks. We found that

--because of uncertain criteria, the identification of problem banks is largely a matter of subjective judgment, and

--the Corporation's regions used differing criteria for identifying banks requiring special supervisory attention.

As a result, there is no assurance that banks posing a similar degree of risk are being given the same supervisory attention. We recommended that the Corporation develop specific, objective criteria for the identification of problem and special supervisory attention banks.

The Corporation did not agree with our recommendation. This is an area which we will examine again in the future.

Bank Holding Company Regulation

In terms of banking assets controlled, bank holding companies represent the dominant form of bank ownership. The Federal Reserve System is responsible for regulating and supervising bank holding companies. Often, however, one of the other regulatory agencies is responsible for supervising the banks controlled by a holding company. In our first review of holding company regulation, we found that the lack of cooperation and coordination between the Federal Reserve and the subsidiary bank's regulator on holding company matters sometimes exacerbated problems or delayed corrective action. We recommended that the Federal Financial Institutions Examination Council establish a formal system to coordinate holding company and subsidiary bank supervision. Our recommendations were adopted by the Council.

During the same review, we noted that many of the bank holding companies which were required by law to sell their

impermissible nonbanking subsidiaries or their banks by December 31, 1980, were taking little action to comply with the law. We also found that the actions taken by the Federal Reserve System were not sufficient to ensure timely compliance. Our report to the Chairman of the Board of Governors of the Federal Reserve System recommended that the Board take specific steps intended to ensure holding company compliance by the legislative deadline.

The Board of Governors disagreed with our observation, and believed that its actions have been sufficient. However, the Board has taken steps recently to assure that all holding companies are in compliance with the law on December 31, 1980.

Foreign Involvement in U.S. Banking Industry

Foreign banks and other foreign investors became actively involved in the U.S. banking market in the 1970s. This activity raised concerns in the public and the Congress. We have issued three reports in response to these concerns.

Our first two reports focused on whether or not the Federal Government was in the position to identify and monitor the extent of foreign investment in the U.S. banking industry. We found that a comprehensive system to identify all foreign individuals and companies buying an interest in U.S. banks and savings and loan associations did not exist. However, current systems would be able to identify major investors. Any

more extensive monitoring would require a new data collection system.

The third report, the first from a major review of foreign banking in this country, presents an analysis of the extent of foreign involvement in the U.S. banking industry. When that report was issued, foreign banks, individuals and nonbank organizations controlled 8.4 percent of U.S. banking assets and 82 U.S. banks and 8 savings and loan associations.

Internal Auditing

We have issued three of the six anticipated reports on the agencies' use of internal auditing. These reports address the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the National Credit Union Administration. In each agency, we found that specific improvements in internal auditing were needed. For example, we recommended that the Comptroller of the Currency strengthen internal audit operations by:

- Renewing top management's commitment to internal audit.
- Improving audit program planning and implementation.
- Strengthening audit reporting and followup policies and procedures.

The Comptroller agreed with our recommendations and assured us that every effort will be made to achieve them.

WORK IN PROCESS

The areas emphasized by our past efforts--bank and holding company regulation, foreign bank activity and internal audit--carry over into our current work. For example, we will issue reports on internal auditing at the Federal Reserve System, Federal Home Loan Bank Board and Farm Credit Administration in upcoming months. In addition, we are conducting reviews in other important areas such as nonregulatory functions and operational efficiency.

Financial Institution Regulation

In the past we tended to concentrate on evaluating the Federal regulation of banks. We have now begun to broaden our reviews to include savings and loan and credit union regulation. Within this general category, our ongoing work addresses

- the manner in which the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, Federal Reserve System and National Credit Union Administration conduct onsite examinations of the institutions they supervise.
- how the five agencies examine compliance with consumer laws.
- the manner in which various Federal agencies are implementing provisions of the Right to Financial Privacy Act of 1978.

We are also conducting reviews which address whether different classes of banks are being supervised differently and whether past experience with problem or failed banks has changed supervisory philosophy or methodology.

Bank Holding Company Regulation

We are reviewing three aspects of holding company supervision which were only touched-on in our first reviews:

- the quality of Federal Reserve inspections of bank holding companies,
- the impact and supervision of nonbanking activities of banks and bank holding companies, and
- the efficiency and effectiveness of the processing of bank holding company applications.

Foreign Banking

We plan to issue the second report from our major review of foreign bank involvement in the U.S. banking and savings and loan industries in July. The report will address issues such as the current level of foreign activity, the ability of Federal agencies to regulate and supervise foreign banking in the United States, and the performance and condition of foreign-controlled U.S. banks.

Nonregulatory Functions

The agencies we have been discussing perform functions which we have viewed as being apart from financial institution regulation. The Federal Deposit Insurance Corporation, Federal

Home Loan Bank Board and National Credit Union Administration administer the various Federal deposit or share insurance programs and maintain the insurance funds. The Federal Reserve System is the Nation's central bank and serves as the Federal Government's fiscal agent. We believe these functions to be important and have started to conduct reviews in these areas.

We are reviewing the efficiency and effectiveness of the Federal Reserve's check clearing system. An important aspect of this effort is the impact of the requirement that the Federal Reserve begin charging for its services by October 1981 (section 107 of the Monetary Control Act of 1980). In response to a congressional request, we have also just started a review of the security afforded the transportation of currency and coin between Federal Reserve Banks and commercial banks.

Operational Efficiency

As I mentioned before, the bank regulatory agencies perform the same basic functions but with different sets of banks. We are analyzing the agencies' field structures, examination staffs, examination frequencies and travel policies to determine the feasibility of consolidating certain examination functions to save travel costs.

FUTURE WORK

Although we have attempted to plan our work on an 18- to 24-month cycle, we have found that the factors which shape

specific reviews--legislation, congressional interest, business and economic cycles--sometimes change so rapidly as to make even an 18-month plan obsolete. For example, since we became involved in the financial institutions regulation area in July 1978 three laws have been enacted which have seriously affected what we do:

- (1) The Financial Institutions Regulatory and Interest Rate Control Act of 1978,
- (2) The International Banking Act of 1978, and
- (3) The Depository Institutions Deregulation and Monetary Control Act of 1980.

These laws have already affected reviews that we are doing now. Part of our report on foreign banking in the United States will be devoted to the effects of the International Banking Act of 1978 and of titles VI and VII of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (the Change In Bank Control and Change In Savings and Loan Control Acts).

Each of these laws, especially the Depository Institutions Deregulation and Monetary Control Act of 1980, will affect what we do in the future. The Financial Institutions Regulatory and Interest Rate Control Act of 1978 (title X) created the Federal Financial Institutions Examination Council. We will want to evaluate how well the Council has accomplished its mission once

it has had time to operate. The requirement for Federal Reserve System pricing of and charging for its services, contained in the Depository Institutions Deregulation and Monetary Control Act of 1980, will no doubt increase our interest in the nonregulatory functions performed by the System.

Although we cannot definitely state what specific reviews will be undertaken in the next year or so, we can outline major areas of interest and the basic objectives we have established for each.

Effective Regulation of Financial Institution Practices

We are concerned with issues involving the Government's efforts to influence or control financial institutions' practices through regulations, monitoring, examination and enforcement. Whether we focus on institutions or their holding companies, the main issue is whether the Government is actually assuring institution and industry soundness through effective regulation of individual financial institution practices. Our objectives in this area are to

- improve the regulatory procedures employed by the agencies,
- improve the effectiveness of regulation, and
- reduce the adverse impact of regulations on the Government, the public and the regulated.

Possible work in this area would include

- a review of the Federal supervision of savings and loan associations,
- a review of the Federal supervision of credit unions,
- a review of agency consumer complaint resolution processes, and
- a review of the effectiveness of supervision of overseas branches of U.S. banks.

Effective Regulation of Financial Institution Structure

The Government, through its regulatory agencies, reviews and acts on applications for new financial institutions, changes in ownership (mergers, holding companies), or changes in institution structures (branches, acquisitions of subsidiaries). Because of the regulators' powers to control entry into the industry and to affect or control the position of an institution within a particular market or within the industry as a whole regulators can profoundly influence, if not control, competition and industry soundness. It is important, then, that decisions and actions taken with regard to structural changes

- are made in accordance with sound criteria applied consistently from case to case;
- are made to serve the public interest;
- lead to sound, competitive institutions;
- do not restrain competition or dangerously concentrate resources and power;

- are free of personal interest, favoritism and fraud,
and
- are done within a reasonable period of time, at the
least possible cost to the applicant and the
Government.

Our objectives in this area are to

- improve the economy, efficiency, timeliness and
consistency of the structural change applications
review and decisionmaking processes,
- further the public interest in the consideration
of structural changes, and
- further institution and industry soundness through
structural changes.

Possible future work in this area would include

- a review of the approval/rejection process for
proposed new financial institution branches,
- a review of the approval/rejection process for
financial institution mergers,
- a review of the chartering of financial
institutions.

Effective Fulfillment of Nonregulatory Responsibilities

The regulatory agencies have program responsibilities which, though not regulatory per se, are directly linked to or certainly supportive of their financial institution regulation responsibilities. These include deposit or share insurance, central bank services, fiscal agency, and the Farm Credit

securities program. Each nonregulatory responsibility is important to the continued efficient and effective operation of the Nation's money system. Also, the functions performed to meet these responsibilities result in significant agency expenditures and represent major Government liabilities or commitments. Our objective in this area is to improve the economy, efficiency and effectiveness of the agencies' non-regulatory program operations.

Possible assignments under this area would include a review of the management and liquidation of failed institution assets and a review of the adequacy of Federal deposit and share insurance funds.

This concludes my statement. I would be pleased to answer any questions you may have.

REPORTS ISSUED BY
GENERAL ACCOUNTING OFFICE
FEDERAL OVERSIGHT OF FINANCIAL INSTITUTIONS

<u>Title</u>	<u>Date</u>	<u>Report Number</u>
Information Obtained by the Department of the Treasury About Foreign Portfolio Investment in the United States	9/20/78	GGD-78-114
Certificate of Deposit Maturity Notification	10/20/78	GGD-79-11 GGD-79-12
Banks Having Problems Need Better Identification and Disclosure	1/24/79	FOD-79-1
Comparing Policies and Procedures of the Three Federal Bank Regulatory Agencies	3/29/79	GGD-79-27
Analysis of Automatic Savings-to-Checking Transfer Services and Negotiable-Orders-of-Withdrawal Plans	4/ 2/79	GGD-79-36
Federal Systems Not Designed to Collect Data On All Foreign Investments In U.S. Depository Institutions	6/19/79	GGD-79-42
Examination of Financial Statements of the Federal Home Loan Bank Board and Related Agencies for the Years Ended December 31, 1978 and 1977	6/21/79	GGD-79-72
Considerable Increase In Foreign Banking in the United States Since 1972	8/ 1/79	GGD-79-75
Converting Savings and Loan Associations from Mutual to Stock Ownership - A National Policy Needed	10/ 1/79	GGD-79-78

APPENDIX

APPENDIX

<u>Title</u>	<u>Date</u>	<u>Report Number</u>
The Office of the Comptroller of the Currency's Internal Auditing Needs Strengthening	11/ 9/79	GGD-80-8
Internal Auditing Needs More Support in the National Credit Union Administration	1/ 4/80	GGD-80-31
Federal Supervision of Bank Holding Companies Needs Better, More Formalized Coordination	2/12/80	GGD-80-20
Opportunities to Further Strengthen Internal Auditing in the Federal Deposit Insurance Corporation	3/ 4/80	GGD-80-46
The Federal Reserve Should Assure Compliance With the 1970 Bank Holding Company Act Amendments	3/12/80	GGD-80-21