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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

The Federal Structure For Examining Financial Institutions Can Be Improved

Responsibility for Federal supervision of approximately 14,300 commercial banks scattered throughout the United States is divided among three Federal bank regulatory agencies. Each agency maintains its own onsite examining capability rather than sharing or consolidating services. This situation has resulted in

--high examination costs,

--morale problems and high turnover, and

--difficulties in managing workloads.

This report discusses some alternatives to the present organizational structure and recommends that the Federal Financial Institutions Examination Council undertake additional study and planning of these alternatives. The Council's ongoing projects to develop uniform examination principles, standards, and reports and to conduct common examiner training courses should result in more consistent examinations as well as make sharing or consolidating the examination forces more feasible.

UNITED STATES GENERAL ACCOUNTING OFFICE

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To the President of the Senate and the
Speaker of the House of Representatives

This report focuses on alternative field structures for conducting examinations of financial institutions. We undertook this review because of the extensive debate and controversy over the current Federal structure for regulating financial institutions and whether or not that structure should be changed. While the Congress took a giant step to improve coordination among the Federal regulators by establishing the Federal Financial Institutions Examination Council, we wanted to determine whether additional restructuring would overcome certain basic weaknesses inherent in the present Federal regulatory structure.

Copies of this report are being sent to the Chairman, Board of Directors of the Federal Deposit Insurance Corporation; the Chairman, Federal Home Loan Bank Board; the Chairman, Board of Governors of the Federal Reserve System; the Administrator, National Credit Union Administration; the Comptroller of the Currency; and the Chairman, Federal Financial Institutions Examination Council. In addition copies are being sent to the Secretary of the Treasury and the Director, Office of Management and Budget.

Milton J. Socolar

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

THE FEDERAL STRUCTURE FOR EXAMINING FINANCIAL INSTITUTIONS CAN BE IMPROVED

D I G E S T

Three Federal agencies--the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve System (FRS), and the Office of the Comptroller of the Currency (OCC)--carry out their responsibility of supervising approximately 14,300 commercial banks primarily by means of periodic onsite examinations of the banks' activities. (See p. 1.)

Two other Federal agencies--the Federal Home Loan Bank Board (FHLBB) and the National Credit Union Administration (NCUA)--are responsible for supervising about 4,000 savings and loan associations and about 18,000 credit unions, respectively. (See pp. 46 and 47.)

Each bank regulatory agency maintains its own nationwide network of field offices for the purpose of examining and supervising commercial banks. Supervision is divided among the bank regulatory agencies as follows: FDIC supervises all State-chartered banks that are insured but not members of the Federal Reserve; FRS supervises all State-chartered banks that are insured and are members of the Federal Reserve; and OCC supervises all federally chartered banks. (See p. 1.)

PROBLEMS WITH THE PRESENT FIELD OFFICE STRUCTURE

GAO reviewed the field office structure of the bank regulatory agencies to determine if there were inherent problems with each agency having its own national network of examiners. (See pp. 8 to 10.)

GAO identified problems with the present field office structure:

--There are no field offices in some cities and separate field offices in other cities because the agencies do not share their examining capabilities or collocate their field offices. (See pp. 11 to 18.)

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--better coordination in areas where there are overlapping or interrelated responsibilities; and

--more strategically located field offices thereby minimizing travel requirements.

A reduction in travel requirements should result in

--lower examination costs;

--less nonproductive time spent in travel status;

--improved staff morale and productivity; and

--lower attrition of experienced examiners. (See pp. 36 to 39.)

While a consolidated examination force offers significant benefits as described above, it is not without drawbacks. The most obvious are the one-time costs of establishing consolidated field offices and of relocating the examination staffs, the disruption to the agencies' daily operations during consolidation, and the potential loss of some experienced examiners. These and other drawbacks will require further study. (See pp. 42 to 45.)

The Federal Financial Institutions Examination Council acts as a coordinator to promote uniformity among the regulatory agencies in areas such as examination standards and procedures, training, and report forms. (See pp. 6 and 7.)

AGENCY COMMENTS

The Federal Financial Institutions Examination Council and the five member agencies did not favor GAO's proposed recommendations in the draft report to prepare plans to share or consolidate examiners nor did they indicate any plans to further consider the recommendations. The Council said that the development of plans for the exchange and consolidation of examiners would confront numerous practical and institutional obstacles and, more importantly, raised a number of fundamental supervisory questions that had yet to be addressed.

GAO agrees with the Council that examiners play an important role in the examination and supervisory process. Establishing a common pool of examiners, however, does not in itself require a change in the examiner's role. Instead, the Council could design a consolidated examination structure with sufficient flexibility for each regulatory agency to decide what role the examiners should play.

Disruption of relationships with financial institutions

The Council and some of the agencies said that sharing or consolidating examiners will disrupt ongoing supervisory relationships with individual institutions and heighten confusion for those institutions examined by one body and supervised by another body.

GAO agrees with the Council. This disruption and confusion, however, will only be temporary as anyone would expect when changes are made to the customary way of doing business.

Adverse effect on morale of examiners and quality of examinations

The Council and some of the agencies said a pool arrangement for skilled professionals could lower morale and thereby detract from the quality of examination reports.

There is no reason why consolidating the examiners should detract from their professionalism. The additional responsibilities and variety of duties should have positive effects on morale. Also, GAO believes that not having to travel as frequently, in some cases 92 percent of the time, would have an overall positive effect on examiner morale, turnover, and examination quality.

The three banking agencies generally agreed with GAO's recommendation to establish procedures for making periodic evaluations of their internal organizational structure and to take actions to realign their field structure whenever opportunities exist to improve the dispersal of their examiner forces. (See pp. 47 to 56 for further discussion of agency comments and appendixes I to VI for full text.)

field offices and should assure that locations will be consistent with the objective of sharing or exchanging examiners. (See p. 57.)

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CHAPTER 1

INTRODUCTION

Three Federal agencies--the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve System (FRS), and the Office of the Comptroller of the Currency (OCC)--are responsible for regulating and supervising approximately 14,300 commercial banks in the United States:

--FDIC supervises all State-chartered banks that are insured but are not members of the Federal Reserve.

--FRS supervises all State-chartered banks that are insured and are members of the Federal Reserve.

--OCC supervises all federally chartered banks which are both insured and members of the Federal Reserve.

The agencies discharge their responsibilities primarily through onsite bank examinations. Each agency maintains its own structure, including a separate, nationwide network of regional offices, district banks, field offices and examiners to supervise commercial banks.

Throughout the years the agencies' overlapping authority has caused much debate over whether or not they should be consolidated into one agency. In April 1977 we released an issue paper dealing with the structure of the three bank regulatory agencies. The paper outlined the pros and cons of consolidation and noted that one means of furthering cooperation would be to establish an independent council or commission. In 1978 the Congress created the Federal Financial Institutions Examination Council to act as a coordinating mechanism among five financial regulatory agencies, including the Federal Home Loan Bank Board (FHLBB) and the National Credit Union Administration (NCUA).

This report is limited to the three Federal agencies that regulate and supervise commercial banks, namely FDIC, FRS, and OCC. However, as we pointed out in the 1977 issue paper, some proponents of change include two other Federal regulatory agencies in their proposals for changing the current regulatory structure:

--The FHLBB, which charters, regulates, and supervises savings and loan associations and also directs the operations of the Federal Savings and Loan Insurance Corporation and the Federal Home Loan Mortgage Corporation.

--The NCUA, which charters, insures, and supervises Federal credit unions and may insure State-chartered credit unions.

Its supervisory responsibility covers insured State-chartered banks that are not members of the Federal Reserve. It is headed by a 3-member Board of Directors, no more than two of whom may be from the same political party. Two of the directors are appointed for 6-year terms, with Senate approval, one of whom is elected by the Board to be the chairman. The third Board member is the Comptroller of the Currency, who serves on the Board for the extent of his tenure as Comptroller. FDIC is funded by assessments on average total deposits of the banks it insures.

Except for 283 State-chartered banks not covered by Federal deposit insurance, all commercial banks were supervised by one of the three Federal agencies at the end of 1979.

Number of commercial banks

As can be seen from the following table, FRS supervises substantially fewer commercial banks than FDIC and OCC. FDIC is responsible for examining about 62 percent of all federally supervised commercial banks while FRS is responsible for examining about 7 percent.

Number of Commercial Banks Supervised

Type of bank (regulator)	1975	1976	1977	1978	1979
National (OCC)	4,744	4,737	4,655	4,564	4,448
State member (FRS)	1,046	1,023	1,015	1,000	977
State nonmember (FDIC)	8,595	8,651	8,748	8,827	8,939
Total	14,385	14,411	14,418	14,391	14,364

The table also reveals several trends. Since 1977 the total number of commercial banks has decreased. At the same time, as discussed below, the number of bank examiners has increased. State member and national banks have decreased every year during the 5-year period. However, the number of State nonmember banks has increased each year.

Number of examiners

The table on the following page shows the number of bank examiners responsible for examining commercial banks and employed by each agency from 1975 through 1979.

Number of Bank Examinations

Regulator	1976	1977	1978	1979
FDIC	18,303	16,762	15,737	14,346
FRS	(a)	1,663	2,009	2,358
OCC	8,028	7,289	7,014	8,418
Total	26,331	25,714	24,760	25,122

a/Data not available.

GAO ISSUE PAPER ON STRUCTURE

On April 14, 1977, we released an issue paper entitled "The Debate on the Structure of Federal Regulation of Banks" (OCG-77-2). The issue paper discussed the regulatory structure outlined above and summarized numerous restructuring proposals and arguments for and against consolidation. The paper also discussed the possibility of establishing a Federal Bank Examination Council. A council was established in 1978.

The principal arguments for and against consolidation set forth in our issue paper are as follows. A single agency might be able to

1. handle problem or failing banks more effectively,

2. deal with bank holding companies more effectively,

3. operate more efficiently,

4. be more accountable to the Congress and the public,

5. treat all banks more uniformly, and

6. integrate bank supervision and monetary policy.

On the other hand, consolidating the agencies into a single agency runs the risk of

1. removing a system that works well,

2. excessively centralizing power,

--considering the ability of supervisory agencies to discover possible fraud or questionable and illegal payments and practices in the operation of financial institutions or their holding companies,

--developing uniform reporting systems for federally supervised financial institutions, and

--conducting schools for examiners and assistant examiners employed by the regulatory agencies.

To carry out these functions, the Council established five interagency task force committees. These committees deal with such matters as supervision, consumer compliance, uniform reporting systems, examiner education, and surveillance systems. In our opinion, the task forces should have a significant impact on the existing regulatory structure in that the agencies could become more consistent in their regulation and supervision of commercial banks.

The task force on examiner education, for example, is in the process of developing and implementing interagency training courses in a number of areas. These courses will not only involve the three banking agencies but FHLBB and NCUA as well. In addition, this task force is looking into the feasibility of establishing a permanent examiner training facility and has considered sites in a number of cities. The task force also visited other operating training facilities, such as that of the Xerox Corporation, to aid in defining requirements and features that should be incorporated in the Council facility.

Another task force that will affect the regulatory structure is one dealing with uniform reporting systems. One project involves identifying and eliminating differences in agency reports. The objective of the project is to achieve uniform reporting requirements to the extent possible. Initially the project will concentrate on the banking agencies; later it will include FHLBB and NCUA as well. The task force covers such areas as reporting instructions, questions of accounting and treatment of specific transactions, publication and availability of reports, report processing standards and data quality, assessment of reporting burden, and liaison with the Securities and Exchange Commission, the Financial Accounting Standards Board, and the American Institute of Certified Public Accountants.

As can be seen from the objectives of these two task forces, the agencies appear to be moving toward more uniformity. How the existing structure will change is uncertain, but some officials agree that some form of consolidation is only a matter of time.

Since a consolidated examination force could take several years to fully implement, we thought that a new environment could develop in which any major reorganization of the banking agencies should at least consider including FHLBB and NCUA. The Executive Secretary of the Council agreed that any major study to consolidate the field examiners should also consider including FHLBB and NCUA.

We interviewed FDIC, FRS, and OCC personnel and reviewed agency records at various organizational levels in Washington, D.C., and in several field offices. For example, we reviewed agency records in order to determine the locations of their field offices and the functions each regional office and field office performs. We interviewed agency officials to determine their policies and procedures for establishing field offices. We reviewed some recent applications for opening and closing field offices to determine what factors each agency took into consideration. We examined the OCC and FDIC field office structures in Oklahoma in order to determine whether or not the structures could be improved. We did this by plotting all bank locations on a map of Oklahoma and analyzing those locations in relation to field office locations. We selected Oklahoma because of the number of banks in relation to the number of field offices in the State.

We reviewed examiners' salaries and travel costs over a 5-year period in order to identify trends. We also reviewed the travel policies of the three agencies in order to identify similarities and differences. We asked agency officials for their estimates of the amount of time examiners spend in travel status, and reviewed and analyzed agency reports on examiner turnover to determine what impact travel had on turnover. We interviewed agency officials and examiners in order to obtain their reaction to turnover and analyzed an FRS report to determine the effect of turnover on the quality of examinations. Finally, we obtained data from the agencies on how frequently they were required to examine banks. We compared this data with each agency's examination experience in each region or district to determine whether the banks were being examined in accordance with each agency's standards.

In order to determine whether or not a different structure for examining banks, i.e., an examiner exchange program, would work better than the existing structure, we selected a random sample of 593 banks--199 supervised by FDIC, 191 supervised by FRS, and 203 supervised by OCC--from the approximately 14,300 commercial banks in existence at the time of our review. For the sample banks, we obtained from each agency the number of examinations that took place during

CHAPTER 2

PROBLEMS WITH THE PRESENT FIELD STRUCTURE

The internal organizational structure of the three Federal bank regulatory agencies has created some serious problems for the regulators. The structure under which three agencies maintain separate nationwide networks of examiners to perform similar functions is conducive neither to minimizing costs nor to retaining experienced examiners to perform quality examinations. This structure has resulted in the following.

--No field offices in some towns and cities because individually none of the agencies supervise a sufficient number of banks to justify a field office even though collectively among the three agencies there are a sufficient number of banks to warrant establishing a local examining capability.

--Separate field offices in some towns and cities because the agencies do not share their examining capabilities or collocate their field offices.

--Travel costs exceeding $26 million for the examination function, not including salary costs related to travel.

--An adverse quality of life for examiners contributing to difficulties in maintaining experienced staff, lowered staff morale, and staff turnover.

--Agencies having limited success in effectively managing their examination workload.

While the existing fragmented structure is the primary cause of these problems, the agencies have not established any type of monitoring system to ensure that their own field office structure is appropriate for performing onsite bank examinations. A monitoring system is needed because such conditions as the mobility of examiners, the number of banks examined, and requests by banks for services frequently change. Because of their failure to adapt their field office structure to changing conditions, the regulatory agencies run the risk of having a field office structure which is excessive or does not suit their needs. Specifically, we found that the agencies

--have delegated responsibility for establishing field offices to regional or district offices,

--review and process bank applications for branches, mergers, relocations, capital increases, conversions, and holding company acquisitions;

--review and process applications for national bank charters and applications for insurance;

--develop and maintain an overall regional plan and budget;

--recruit, hire, and train staff; and

--resolve consumer complaints and respond to inquiries.

FRS districts, on the other hand, perform a much broader range of functions. In addition to most of the above functions they

--provide currency and coin services, electronic funds transfer services, and check clearing services for commercial banks;

--issue, service, and redeem U.S. securities and savings bonds;

--provide continuous surveillance of problem bank holding companies;

--conduct research on the structure and behavior of banking markets;

--process bank holding company applications;

--provide input for determining the monetary policy of the United States; and

--process applications from member banks and others for advances and discounts pursuant to the Federal Reserve Act.

Field offices

The three bank regulatory agencies' regional structures are further divided into subregional networks of field offices. FDIC and OCC have 141 and 138 sites, respectively, which are staffed by examiners. On the other hand, FRS examines its member banks primarily from its 12 district banks and four field offices. In addition, there

To assist in its review of the recommendations, FDIC headquarters does request that the following information be included in the justification: description of the present organization, description of the proposed reorganization, travel implications, and impact on employees. However, headquarters has no fixed criteria with which to evaluate recommendations. Past performance shows that headquarters routinely supports changes which the region recommends. In the case of FRS, the Federal Reserve district bank approves new field offices. In headquarters, the Division of Federal Reserve Bank Operations reviews field office proposals as part of its annual budget review process.

Agency officials, with the exception of OCC, told us that they were not aware of any formal studies that have been or are being conducted on the organizational structure of their agencies. We believe the organizational structure of each agency needs frequent study in order to determine whether examiners are properly dispersed throughout the country.

OCC established a regional restructuring task force in 1978. In discussing the task force and its work, the Comptroller said:

> "* * * the U.S. banking system has changed dramatically in the past decade. As a result, the OCC's examination and monitoring procedures have been modernized to adjust to industry changes. However, in many ways the current regional structure, effected in 1962, is ill-suited to accommodate other changes in the supervisory process which have accompanied the industry changes."

The task force proposed a reorganization of the regional structure from 14 regional offices into 6 district offices. The proposal was rejected by OCC's policy group because of the one-time cost to implement the proposal and because of the adverse effect such a change would have on OCC employees. At the same time, OCC recognized that the "* * * projected managerial and functional changes and consolidations would have enhanced our ability to effectively and efficiently manage our scarce resources." OCC has decided, however, to pursue the consolidation over time of Region 13 with Region 14.

Examples of recently established and eliminated field office locations

The agencies' headquarters are not very active or aggressive in establishing or closing field office locations. Yet, according to the justifications that are

54 percent of the total assets. Denver was chosen as the best location for a field office because it is centrally located in the western half of the district. Travel was cited as the most significant factor justifying the establishment of a new field office. Travel costs were estimated to be reduced by $70,000 each year and savings in travel time were equivalent to about 1 staff year.

OCC made a change in the structure of its Memphis Region in December 1979, when a field office in Lafayette, Louisiana, opened. The field office is responsible for supervising 21 banks. The proposal projected total travel cost savings of between $168,000 and $211,000 over a 3-year period. In addition to measurable savings the following factors were considered: (1) the reduction of travel should result in a reduction in turnover, (2) the fewer banks each examiner-in-charge has to supervise should result in better supervision and increased familiarity with the banks, (3) smaller examination staffs should result in more effective supervision and training, and (4) the creation of another examiner-in-charge position in the region should enhance promotion potential and job satisfaction.

OCC recently closed two field offices in the Minneapolis Region. One in St. Cloud, Minnesota, was closed in September 1977, and another in Rochester, Minnesota, was closed in July 1979. The justifications were quite brief and not as comprehensive as the proposals for additions. For example, the studies did not include analyses of costs or the effect the closings had on the examination staff that had been assigned to the offices. The offices were vacated because of a drastic change in field examining procedures requiring the consolidation of personnel into fewer offices throughout the region.

Officials of the three regulatory agencies claim that the field office structure is under continuous informal review, but the fact remains that the agencies' headquarters have not aggressively pursued this issue or issued guidelines for establishing or closing field offices; therefore, the potential for an improved system still exists.

A look at the field office structure in Oklahoma is an example of a situation that has potential for improvement. Currently OCC and FDIC each maintain a staff of examiners in Tulsa and Oklahoma City. There are 188 national banks and 279 State nonmember banks in Oklahoma.

what they were 5 years ago. With the widespread increase in travel costs, the outlook for reducing the cost of examinations is bleak unless the agencies are willing to change the way they work. One possible change would involve examiners from the closest field office examining a bank irrespective of the type of bank or the agency involved. Another possible change would be complete reorganization and consolidation of the three regulatory agencies.

Examiner salaries and travel costs

Salaries and travel costs are the largest items in bank examination costs. By far, salaries account for the largest portion of the cost of the examination process. Salary costs have increased by $29.3 million, or 37 percent, from 1975 to 1979, while the number of bank examiners has remained fairly constant.

A portion of the cost of examinations included as salary is directly attributable to travel. However, we could not estimate the amount of such cost. Examiners may travel during official duty hours from their field offices to the banks and thus are paid salaries for periods of time when they are not examining banks. In some cases they may return home for weekends and thus make several trips to and from their field locations during a single examination. We noted a number of other cases in which salaries were paid solely for travel. For example, at one reserve bank, examiners qualify for a 10 percent pay supplement for time spent working in travel status in excess of 80 days a year. At another reserve bank, certified examiners are paid a bonus at the end of the year based on 1 day's pay for each 5 days that the examiner was in travel status.

After examiner salaries, reimbursement for the direct cost of travel is the principal cost incurred in the examination of commercial banks. Over the 5-year period, total travel rose from $19.3 million to $26.5 million, an increase of 37 percent. With the present upward spiral in the price of gasoline, air fares, motels, hotels, etc., this trend may continue if the present practices continue.

Travel policies

FDIC and OCC travel policies are set by the agencies' headquarters in Washington, D.C. Federal Reserve district banks set their own travel policies. As a result, each district has a different set of travel regulations. We focused our attention on transportation, lodging, and subsistence.

FRS

Most FRS district banks have no sublocations since the banks they supervise are few in number and tend to be widely scattered throughout the districts. Thus, FRS examiners must travel far greater distances than their counterparts at FDIC and OCC and, consequently, incur higher travel costs per examination.

One examination of a bank in Denver, Colorado, involved travel expenses amounting to $24,382, while another examination involving a bank in Nashville, Tennessee, included travel expenses of $34,063. The examiners came from the FRS district banks in Kansas City and Atlanta, respectively. Generally, examiners were allowed to return home every weekend if they so desired. Air fares alone accounted for a large portion of the travel expenses.

OCC

In examining a bank in Grand Forks, North Dakota, OCC spent $6,994 in travel costs. Its examiners worked out of one location in North Dakota and one location in Minnesota. These locations were 75 and 250 miles from Grand Forks, respectively.

QUALITY OF LIFE PROBLEMS

The excessive amount of travel required of many bank examiners is a major cause of examination staff turnover within the bank regulatory agencies. It is not uncommon for an examiner to spend from 30 to 75 percent of his/her time away from home in travel status. From our discussions with examiners and agency officials, we learned that low salaries and extended periods of travel are the main reasons why the agencies are having difficulty retaining their examiners. Although all three agencies have tried to make travel more bearable, it is still a cause of discontent among some bank examiners.

Time spent in travel status

The typical bank examiner can count on spending some time in overnight travel status. The amount of time spent in travel status varies by location and depends on variables such as the location of the banks in relation to the examining office and the area covered by the suboffice.

Each FRS district bank gave us a rough average estimate of the time a typical field examiner can expect to be in overnight travel status. According to these estimates, examiners in some districts spend as little as 10 to 20

Meanwhile, the OCC and FDIC Dallas regions average 19.1 percent and 15.7 percent, respectively, over the 5-year period. That compares with overall agency averages of 12.8 percent for OCC and 8.9 percent for FDIC.

Most of the turnover for the bank regulatory agencies is occurring among assistant examiners. Typically, this would involve examiners in the first 4 to 5 years of employment.

A recent Federal Reserve Conference of Presidents' report cited some reasons for turnover. The report used two different sources to reach its conclusions: (1) examination department analysis and (2) exit interview data. In the examination department analysis of turnover, seven FRS district banks listed salary as the most important reason for resignations and three had it as the second most important reason. Eleven FRS district banks cited lack of growth opportunity and extensive travel in addition to salary among the three most important reasons for resignations. FRS exit interview data also show salary as the number one reason for resignations with lack of growth opportunity second and travel third. Thus, both sources indicated the same three items as being the major factors behind turnover of FRS examination personnel. The study also went one step further by breaking down the exit interview data into two groups--examiners and assistant examiners. Examiners cited salary as their main reason for leaving followed by growth and travel. Interestingly enough, assistant examiners also cited salary as the number one reason but ranked travel as the second most important with growth third. As noted earlier, assistant examiners in over half the districts spend more time in travel status than senior examiners.

We obtained data from FDIC showing why its field personnel left the agency during 1978 and 1979. The overwhelming majority in both years listed other employment as their reason for leaving FDIC. We believe, however, that FDIC did not go far enough in getting at the underlying causes why examiners seek other employment. "Other employment" is the effect of the reasons examiners leave FDIC or any other agency. Logically, examiners seek other employment for reasons such as job dissatisfaction, excessive travel, or opportunities to make more money.

OCC tabulated the responses to followup questionnaires submitted by former OCC employees who resigned in 1979. The responses were divided into two categories: (1) examiners who worked 2 years or less and

--Inexperienced staffs take longer and make more errors in doing a task. This creates a need for larger staffs with the more experienced people becoming increasingly involved in supervising the inexperienced people.

--Inexperienced staffs make it difficult to assign an experienced examiner to every examination. Occasionally, the examiner-in-charge does not have the desired experience.

--The most important impact of inexperienced staffs is on work quality. Inexperience may limit the examiner's ability to identify and deter financial problems in banks and holding companies and has caused concern at many FRS district banks. If significant numbers of financial institutions encounter problems, FRS examiner resources would be strained.

In one OCC regional office that we visited, an official said they were having problems in the area of trust examinations. Trust examiner turnover was approximately 50 percent in 1979. Nine of the 13 trust examiners have less than 1 year of experience. As a result, the region has been unable to meet its trust examination frequency requirements. To partially alleviate problems in this area, the region is training commercial examiners to examine some small trust departments. However, quality may suffer because the commercial examiners are unfamiliar with the trust area.

DIFFICULTIES IN MANAGING WORKLOAD

The problems with the Federal bank regulatory agencies' present parochial operations are especially evident in those areas of the country where small numbers of banks are widely dispersed geographically. Under such a rigid structure, one agency does not examine banks under the jurisdiction of another agency nor does the same agency usually examine banks outside of its regional boundaries. Some banks are therefore not being examined as frequently as the agencies require, while others are being examined more often than the agencies think is necessary.

In recent years OCC and FDIC have extended the intervals between examinations because limited resources precluded them from complying with their former standards. Still, some regional offices are unable to conduct as many examinations as called for by these new standards. On the other hand, many FRS districts examine banks more often than required by their standards.

those presenting supervisory concern. The former still had to be examined yearly, but the latter now only had to be examined once every 18 months. Banks with no financial or supervisory problems are now examined once every 18-month period. Although these new policies called for less frequent examinations, FDIC encouraged its regions to conduct an adequate monitoring and visitation program at banks between examinations.

In March of 1980, OCC's statutory examination frequency requirements were eliminated. The previous year the Congress allowed the agency to adopt less demanding examination standards and these less demanding standards were maintained when the Congress granted the Comptroller discretionary bank examination authority as part of the Depository Institutions Deregulation and Monetary Control Act of 1980. Under the new criteria, national banks designated as "problem" institutions must be examined twice yearly. Nonproblem institutions must be examined once every 12 months if they have assets over $100 million and every 18 months if their asset size is less than $100 million.

The FRS also has been subject to the same increasing regulatory responsibilities as OCC and FDIC. At the same time, however, the number of State member banks had decreased steadily while the agency has increased its examination force from 511 in 1975 to 568 in 1979. As a result, the FRS districts generally have met their prescribed examination workload and therefore the agency has not extended its frequency criteria.

One development which could have further impact upon the bank regulatory agencies' ability to meet their examination frequency standards is the Federal civilian hiring restrictions. With the current turnover rates discussed earlier, a significant decrease in each agency's bank examination force is quite possible if the hiring restrictions stay in effect. Compounding the seriousness of this problem is the present situation in which many departing examiners are relatively experienced and are being replaced by persons new to the profession. Thus the agencies may encounter simultaneous declines in staff level and staff experience. This situation will no doubt make it very difficult to examine banks as often as the agencies believe is necessary.

How agencies schedule and plan bank examinations

All three agencies schedule examinations at the field office or regional level, although the frequency with which schedules are prepared varies. FDIC and FRS must also coordinate their schedules with State banking agencies which are

However, it is important to note that in the case of FRS, only 20 banks are classified as problem institutions, while FDIC and OCC supervise a considerably greater number of such institutions.

The overall statistics on agency frequency performance fail to give a clear picture of some of the problems inherent in the present bank regulatory structure. To identify specific weak points, it is necessary to make comparisons between the three agencies' regions or districts which serve the same basic geographic areas, and also between adjacent regions or districts within the same agency. The following examples show that there is a need for a better utilization of resources by the three bank regulatory agencies. They demonstrate that situations now exist in some areas of the country where the Federal Government's bank regulatory resources are not being used in the most efficient and effective manner possible.

Among agencies, there are instances where one does well and another does poorly in meeting examination frequency standards. For example, in five regions/districts, we found that either FRS or OCC had difficulty meeting its 12-month frequency standards in examining nonproblem banks with assets greater than $100 million. At the same time, the other agency was exceeding its examination frequency standards. This is illustrated in the following table.

	Average months between examinations	
Region/district	FRS	OCC
Boston	14	11
New York	11	14
Richmond	7	13
Atlanta	10	16
Chicago	10	24

Disparities also exist between agencies in their abilities to examine problem institutions as often as required by policy. We noted previously that all three agencies were not always meeting their examination frequency standards for problem banks. However, as with nonproblem banks, we found examples where one agency's regional or district office was more successful in examining its problem banks than the other agencies' offices in the same general geographic area. For instance, OCC's Chicago region not only was unable to examine its problem banks according to agency criteria but on average allowed more than 13 months to elapse between examinations. On the other hand, FDIC's entitled "Federal Supervision of Bank Holding Companies Needs Better, More Formalized Coordination" (GGD-80-20, Feb. 12, 1980), we discuss the problem of coordination among the three Federal banking regulatory agencies.

The coordination problem comes up because FRS is responsible for examining holding companies but the holding companies' subsidiary banks are examined by whichever Federal agency has regulatory responsibility, i.e., FDIC (State nonmember banks), FRS (State member banks), and OCC (National banks). The field offices of each Federal agency are required to coordinate inspections of a bank holding company and its bank subsidiaries. In our report, however, we pointed out that the Federal agencies must better coordinate their efforts to supervise bank holding companies.

CONSOLIDATED BANK EXAMINATION FORCE

Once the Examination Council establishes uniform examination procedures and reports and the agencies implement them, we believe there will be very little reason for not eventually consolidating the bank examination forces. A consolidated bank examination force with field offices more strategically located would reduce travel time and costs, which are presently necessitated by the broad geographic areas FDIC, FRS, and OCC examiners must now cover. In this section we discuss how a consolidated bank examination force would best utilize resources and reduce costs.

At the present time, two or three agencies may have a regional/district or field office in the same cities. Yet, in some other cities, none of the agencies can support a field office individually because of the small number of banks each supervises. The agencies, however, could support a consolidated field office to examine all banks in and around such cities. Such an office would be staffed by examiners who would examine banks under the jurisdiction of all three agencies.

For four specific geographic areas of the country (see page 35), we estimated that $1.6 million in travel funds could have been saved if all the banks in these areas had been examined from consolidated field offices. The other benefits would include less time spent in travel status, more time spent examining banks, improved examiner morale, less attrition of experienced examiners, and better workload management. At the present time, bank examinations are the principal supervisory tool used by the agencies to regulate banks and account for the largest proportion of resources and costs. Consolidating field offices should result in more efficient use of resources and reduced costs.

Where should consolidated field offices be located?

Consolidated field offices should be located in those cities where the examination force can examine the maximum number of banks without incurring the substantial overnight travel costs which contribute to high examination costs. The bank regulatory agencies use different criteria for establishing whether or not to authorize subsistence for overnight travel. For example, OCC uses 50 miles or more as a general rule for paying subsistence for overnight travel.

Effect of GAO's Proposed Restructuring In Four Areas of the United States

States	Banks OCC	Banks FDIC	Banks FRS	Existing field offices OCC	Existing field offices FDIC	Existing field offices FRS	Proposed field offices
Area I: Maine, Vermont, New Hampshire, Massachusetts, Connecticut, Rhode Island	161	197	17	5	5	1	6
Area II: Minnesota, North Dakota, South Dakota	278	745	62	7	11	1	21
Area III: California, Utah, Nevada, Arizona	64	260	22	4	4	3	10
Area IV: Oklahoma, Texas, New Mexico	841	1,079	64	17	11	1	36
Totals	1,344	2,281	165	33	31	6	73

As the table indicates, there would be a few more field offices under the proposed restructuring. However, these field offices would be more strategically located throughout each of the four geographic areas. For example, none of the 73 proposed field offices would be located in the same city, whereas under the existing structure 26 offices were in duplicate locations.

Mathematical techniques could prove useful in locating field offices

Decisions on where field offices should be located and how they should be staffed are complex. We believe that the quality of these decisions can be improved through the use of optimization techniques such as linear programming. These techniques have been successfully applied by businesses to decisions such as determining the optimal number and locations of plants, and considering the locations of suppliers and markets; and by the military in determining the optimal locations of air defense forces. If successfully applied, these techniques can be used to determine which combinations of locations (out of several costs, both situations resulted in lowered travel costs. From the sample results, we estimate that for all banks in the 16 State area, $.9 million could be saved by interchanging examiners and $1.6 million (sampling error of $520,000) could be saved by using a consolidated examination force.

The following three examples, including one not in our sample, illustrate some practical applications of a consolidated examination force or an examiner exchange program:

1. FDIC has a suboffice in Grand Forks, North Dakota, but OCC, with only a few banks in that area, does not. As a result, eight OCC examiners traveled the 75 miles from Fargo, North Dakota, and five traveled the 250 miles from Minneapolis, Minnesota, to conduct examinations of a Grand Forks bank in fiscal year 1979. If OCC used FDIC examiners or if a consolidated field office were located in Grand Forks, OCC could have saved $6,994 in travel costs.

2. FRS does not have a field office in Maine because of the limited number of banks under its jurisdiction in that State. Therefore, examiners were sent from Boston, Massachusetts, 240 miles away, to examine a bank in Bangor, Maine. A consolidated field office under the jurisdiction of all three agencies, however, probably could be justified to serve all 41 banks in Maine. In examining this one bank during fiscal year 1979, FRS incurred $32,221 in travel costs.

3. FDIC currently maintains a field office in Honolulu, Hawaii. It is responsible for supervising 18 State nonmember banks: 7 in Hawaii, 9 in Alaska, and 1 each in Guam and American Samoa. The field office is staffed with 10 examiners. Of the approximately 2,000 staff days we estimated to be available for the field office in fiscal year 1979, 191 or about 10 percent were used to conduct examinations outside of Hawaii, Alaska, Guam, and American Samoa. On the other hand, in the past 2-1/2 years, the field office has needed occasional help from other field offices to conduct examinations in both Hawaii and Alaska.

   OCC, in contrast, does not have a field office in Hawaii and therefore uses examiners from its San Francisco and Reno field offices of bank holding companies and the examination of bank subsidiaries.

--More strategically located field offices, thereby minimizing travel requirements.

In addition to the lowered examination costs discussed above, minimizing travel requirements should result in less nonproductive time spent in travel status, improved staff morale and productivity, and less attrition of experienced examiners.

Reaction to consolidated field offices

Though agency officials agree that the current organizational structure does not provide the most logical and effective geographical dispersal of examiners, they are hesitant to endorse a common examination force. The current structure, they believe, offers the best way to examine banks because Federal and State laws vary, and agency examiners best know the laws pertaining to their agency. Examiners, in their view, would find it difficult to learn new laws and regulations. Also, new legislation would be needed. Agency officials believe that, on the whole, they have not had many problems with the current structure and one agency could be too bureaucratic. Yet through the formation of the Examination Council in March 1979, and because of the recent passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, they also believe that it is just a matter of time before the common examination force is reality.

INTERCHANGE OF EXAMINERS

The three bank regulatory agencies function independently of each other in the examination of commercial banks. At the present time, the agencies do not exchange examiners. The burden of extensive travel could be reduced if examiners stationed closest to a bank could conduct the examination irrespective of which Federal agency he or she was employed by. Such an interchange of examiners would of course have to be approved by each affected agency and in most cases would require legislation.

In reviewing travel costs for a sample of 593 banks from the three regulatory agencies, we found that savings could have been achieved had the examiners come from the closest field office, regardless of agency or regional boundaries. Specifically, we estimate that for all commercial banks throughout the country, $5.4 million in travel costs, about one-fifth of the total, could have been saved over a 1-year period. More importantly, examiners would not have had to as shown below in each of these examples, one of the other agencies had a field office either in the same city as the bank or one nearby. If the agencies could exchange examiners, the more conveniently located agency could have conducted the examination, thus saving considerable dollars and travel time. The following examples illustrate this point.

--FDIC sent examiners from elsewhere in Virginia and North Carolina to conduct an examination in Norfolk, Virginia. OCC has an office in Norfolk.

--FRS conducted examinations in Denver, Colorado, and Nashville, Tennessee. FRS sent examiners from Kansas City, Missouri, and Atlanta, Georgia, respectively, to conduct these examinations. However, OCC has an office in Denver and FDIC has one in nearby Littleton, Colorado. Also, both FDIC and OCC have field offices in Nashville.

--OCC conducted examinations in Grand Forks, North Dakota, sending examiners from Minnesota and elsewhere in North Dakota. However, FDIC has a field office in Grand Forks.

Reaction to interchange of examiners

Agency officials said that there could be some problems with exchanging examiners but most thought the problems could be worked out. They said the main drawback was that national and State banks are regulated under different laws. They indicated that examiners would have to understand and be familiar with both sets of laws under such an arrangement. But the officials agreed that they examine banks for the same reasons and, therefore, an interchange of examiners would be workable.

The majority of the examiners we talked to thought that they could adequately examine any bank, national or State-chartered. Generally, they felt that while there might be some problems with the different sets of regulations, the problems could be worked out since the overall objective of examinations is the same regardless of the agency.

Impact of travel costs on the costs of examinations

Travel costs resulting from bank examinations have increased over the past 5 years. These costs are recurring and, assuming the inflation rate remains what it has been over the last several years, will continue to grow. There is no immediate relief in sight if the present system and structure are allowed to continue.

in knowing what the applicable Federal or State law says. For example, both 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. Therefore, once the examiner knows the lending limit for a particular bank, he can test whether or not the bank is complying with the lending limit. In other words the principle is the same, but the rules are different.

Some regulators already deal with several States, and therefore several State laws, without noticeable problems. For example, both the Kansas City FRS District Bank and the San Francisco FDIC Regional Office supervise banks in seven States. The examiners in these offices have to be knowledgeable about laws in all these States. Therefore it can be done and, in our opinion, is not much of a barrier to an interchange of examiner program or a consolidated bank examination force.

There are numerous problems that would have to be resolved before one agency could use the examiners of another agency. We have identified some of the problems that we believe will come up.

The first problem to consider is the need for legislation to allow one agency to use another agency's examiners. In our opinion, legislation is needed to authorize the Federal bank regulatory agencies to share examiners and for each to conduct examinations of financial institutions other than those under its own jurisdiction. From our review of the existing legislation, there is no clear authority for bank regulators to share examiners. The Federal statutes providing examination authority are generally specific only in authorizing examinations to be conducted by the examiners of the particular agency in question. These statutory provisions neither specifically prohibit nor authorize the agencies' use of other than their own examiners. One exception is found in 12 U.S.C. 481, which specifically authorizes OCC to examine foreign operations of State-member banks upon request of the FRS. Another exception is found in 12 U.S.C. 1725 (c)(5), which appears to permit the Federal Savings and Loan Insurance Corporation to use the services of examiners from other agencies with the consent of such agencies. Otherwise, the lack of specific authority for the supervisory agencies to share examiners implies, in our view, a prohibition against such activity.

--disrupting the agencies' daily operations during consolidation;

--relocating examination staff and the potential loss of some experienced examiners; and

--resolving salary differences which currently exist among the three agencies.

12,637 federally chartered and 4,971 State-chartered, federally insured credit unions. The inclusion of FHLBB and NCUA in any consolidation plan could further reduce travel costs, improve the quality of life of examiners, and improve management of the workload.

We believe that the Depository Institutions Deregulation and Monetary Control Act of 1980 provides added support for including FHLBB and NCUA in any feasibility study of consolidation. The act goes a long way towards making savings and loan associations and credit unions more like banks. Therefore, if FHLBB or NCUA require future expertise in areas that traditionally have been limited to banking, that expertise would already be available in a consolidated examination force.

While a common or consolidated examination force and the flexibility to exchange examiners among agencies is still in the future and requires further study and planning, each agency can and should be evaluating its own internal structure now to assure that it is adequate to meet current needs. Yet they have been remiss in doing this. As a result there is no assurance that there is an optimal distribution of examiners among regional and district offices. Such assurances are necessary in order to achieve better balance among regional and district offices in examining banks and in meeting examination frequencies.

In evaluating their internal structures, the agencies should consider collocating field offices whereby two or more agencies locate offices together in the same building. Since suboffices are generally not used to house employees on a full-time basis but rather to provide storage space for supplies and files and interim desk space for short periods for examiners to write reports, additional potential for sharing such facilities should exist.

AGENCY COMMENTS AND OUR EVALUATION

The Federal Financial Institutions Examination Council and its member agencies unanimously disagreed with our conclusions and recommendations that there now should be some impetus for changing the present organizational structure for the Federal examination of financial institutions and that planning and further study should begin which could lead to initially sharing and eventually consolidating the examiner forces of the Federal regulatory agencies. Their comments raised a series of problems which, we agree, need to be addressed before our solution for correcting the basic inherent weaknesses in the existing structure could be adopted.

We recognize that organizational change can cause turmoil and should be approached carefully. It is imperative planning phase, consideration would be given to a number of alternatives including splitting the chain of command--one for program management and another for resource and administrative matters. We also expect that a formal mechanism to measure the effectiveness of examiners' outputs would be established, including feedback to those responsible for supervising the examiners. Such a mechanism would actually be an improvement in accountability over the present systems under which there is virtually no formal feedback to administrators of each of the regulatory agencies on the quality of examinations being conducted by their examiners.

It is interesting to note that FDIC, FRS, and FHLBB apparently have already solved the accountability problem with regard to relying on work performed by examiners where the primary regulator does not have direct supervisory control over the examiners. These agencies have various types of cooperative programs under which they either rely on examinations conducted by State regulators or share the work with the State examiners. Even though the State examiners are not directly accountable to Federal regulators, the quality of their work apparently meets Federal standards.

Separation of supervision and examination functions

The Council believes that consolidation of the examiner forces of the regulatory agencies would entail separating supervision from the examination function and that this separation could undermine the agencies' ability to carry out their statutory supervisory responsibilities. They said that, in practice, examiners play an important supervisory role in identifying problems, developing remedial programs, and monitoring progress in correcting financial and operating deficiencies.

We agree with the Examination Council that examiners play an important supervisory role in identifying problems, developing remedial programs, and monitoring progress in correcting financial and operating deficiencies. Establishing a common pool of examiners does not in itself require a change in the examiner's role. A consolidated examination structure could be designed with sufficient flexibility for each regulatory agency to decide what role the examiners should play. We do not agree, however, that splitting the supervision and examination functions between different organizations would undermine the agencies' ability to carry out their statutory responsibilities. We noted that, in varying degrees, some Federal regulators have split the supervision and examination function between different amount of travel required of many bank examiners is a major cause of examination staff turnover within the bank regulatory agencies. We noted that some examiners said they travel as much as 92 percent of the time.

In the report we make reference to an FRS study on examiner turnover. Recognizing that a high turnover rate can prevent regulators from developing experienced staff, the FRS study said the most important impact of inexperienced staffs is on work quality. The study says inexperience may limit the examiner's ability to identify problems at the institutions. Because the Dallas region had the highest turnover rate for any field office of FDIC, FRS, and OCC, we analyzed the experience level of the examiners who participated in examinations of our sample banks at that region. We found that most examiners had less than 3 years of experience. For example, 53 percent of the FDIC examiners, 69 percent of the FRS examiners, and 66 percent of the OCC examiners were in this category. While most of these examiners were at the assistant examiner level, they are the ones who do the leg work of the examination.

The following two examples illustrate this problem.

- --OCC spent 1 week conducting a specialized commercial examination of a bank with more than $75 million in assets. Of the seven examiners assigned to the examination, only the examiner-in-charge had any significant experience. The remaining six examiners all had less than 3 years experience. One had less than 1 year of experience, three had from 1 to 2 years of experience, and two had from 2 to 3 years of experience.

- --FDIC also spent 1 week conducting a regular commercial examination of a bank with more than $15 million in assets. As above, only the examiner-in-charge had significant experience; the remaining six examiners all had less than 3 years of experience. Three had 1 to 2 years of experience and another two had 2 to 3 years of experience. The sixth examiner was a co-op student who was temporarily employed at FDIC and had limited experience.

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The Examination Council says that any consideration of alternate supervisory structures must go beyond an analysis of travel costs. We believe our study did go beyond an analysis of travel costs. For example, in chapter 2 of our report, we however, to point them out so that the Council could consider them in planning for restructuring the examiner work force.

OCC and FHLBB raised a question about the Council's statutory authority to devise a plan to consolidate the examining staffs. OCC and FDIC raised a similar question on our earlier report "Federal Examinations of Financial Institutions: Issues That Need To Be Resolved" (GGD-81-12, Jan. 6, 1981). In that report, they questioned whether some of the issues raised were proper issues for the Council to address. At that time, we said it would be in the Council's interest to define its role. One of the functions of the Council is to make recommendations in "other supervisory matters." In our opinion, this function is broad enough to permit the Council to study the feasibility and merits of consolidation and to prepare a consolidation plan, including draft legislation. We discussed this matter with the Council's Executive Secretary and, in his opinion, the Council has the authority to prepare such a plan. Also, the Council did not raise this concern in its written comments.

FDIC's overall reaction to the report was that we are attempting to restructure the regulatory framework by reducing three agencies to one. It implied that we prejudged the merits of consolidation without really focusing on the issues involved. It said reorganization should be approached directly, openly, and rationally and not indirectly, simplistically, or on a piecemeal basis. FDIC also said that it has no basis for agreeing or disagreeing with our estimated reduction in travel expenses because we did not explain our methodology or make our workpapers available. In any event, FDIC said the savings of $2.2 million (for FDIC only) were too small in relation to its budget. Finally, FDIC maintained that it does have procedures for reviewing the need for new and existing field offices and said we contradict the criticism of no procedure by delineating the factors considered by the agencies in establishing field offices.

FDIC misinterpreted the objectives of our review. On page 8 of the report we state that our objective is to determine if there were inherent problems with each agency having its own national network of examiners. In chapter 2 we identify some basic problems all the regulators are having examining banks under their present organization structure. In chapter 3 we point to potential solutions by consolidating or exchanging the bank examining force. In chapter 4 we recommend that the Council prepare a plan to exchange examiners and to study consolidation of the bank examining force. The report never suggests complete restructuring of the regulatory agencies. As we said earlier, it was never our intention to do a complete analysis of all the from reorganizing the existing system substantially outweighed the costs. OCC, however, did not explain how the existing system should be reorganized. OCC did raise a good point which we believe the Council will need to consider. OCC said that sharing examiners based on their proximity to the financial institution ignores other criteria such as asset size and composition, overall financial condition, and examiners' individual abilities. We concur that these other criteria need to be taken into consideration.

FHLBB and NCUA also raised some good points which should be considered by the Council. For example, FHLBB said that creating a new agency would add to communication problems between agencies. NCUA said that its examiners would require training before they would be able to examine banks, and bank examiners would require training to examine credit unions. NCUA also said using bank examiners to examine credit unions would require complex and time-consuming scheduling arrangements and create operational problems in dealing with problem credit unions. NCUA also said that, initially, turnover might increase. We agree that the Council should look into these problems.

The Federal Financial Institutions Examination Council and the five member agencies did not favor our proposed recommendations in our draft report to prepare plans to share or consolidate examiners, nor did they indicate any plans to give our recommendations further consideration. The Council, in commenting on our recommendations, said that the development of plans for the exchange and consolidation of examiners would confront numerous practical and institutional obstacles and, more importantly, raised a number of fundamental supervisory questions that had yet to be addressed.

It was never our intent to fully address and resolve all the obstacles and questions that would come up in an exchange or consolidation program. Our objective was to point out some of the problems with the present organizational structure and offer some alternatives for improving the present structure. In our opinion, we have demonstrated that the concepts are viable alternatives while recognizing that there are a lot of problems and questions that still have to be addressed. The Council is in the best position to resolve these problems and questions. Therefore, we have revised our proposed recommendations somewhat to more clearly reflect that these problems and questions need to be assessed before deciding on the feasibility of consolidation.

The three banking agencies generally agreed with our recommendation to establish procedures for making periodic evaluations of their internal organizational structure and to take actions to realign their field structure whenever opportunities exist to

Should the Federal Financial Institutions Examination Council reaffirm our initial assessment that consolidation of the examination forces is a viable alternative to the present organizational structure, we recommend that the Examination Council prepare a plan, including proposed legislation, to consolidate the examination forces of the Federal regulatory agencies.

RECOMMENDATION TO THE COMPTROLLER OF THE CURRENCY; BOARD OF DIRECTORS, FDIC; AND BOARD OF GOVERNORS, FRS

We recommend that, until a policy of sharing or exchanging examiners becomes a reality, the Board of Directors, FDIC; the Board of Governors, FRS; and the Comptroller of the Currency establish procedures for making periodic evaluations of their internal organizational structure and take actions to realign their field structure whenever opportunities exist to improve the dispersal of their examiner forces.

The headquarters of each banking agency is in the best position to set policy and to evaluate the entire internal organizational structure and to assure that practices are consistent with policies. In establishing procedures to evaluate their internal organizational structure, the agencies should build on any procedures they have for establishing field office locations. Finally, in making periodic evaluations, the agencies should consider collocating field offices and should assure that locations will be consistent with the objective of sharing or exchanging examiners.

Mr. Anderson - 2 -

would be undermined to the extent that examiners ceased to be accountable to the primary supervisory authority as a result of the exchange of examiners or consolidation into an interagency pool. Moreover, such a pool arrangement for skilled professionals could have a depressive effect on morale and thereby detract from the quality of examination reports. Implementation of the proposal would disrupt on-going supervisory relationships with individual institutions and heighten confusion for those institutions that would be examined by one body and supervised by a different agency. The proposal, in effect, would constitute the creation of a new Federal examination commission that would not improve the examination process but which could undermine the effectiveness of the agencies' supervisory efforts.

It is the Council's view that any consideration of alternate supervisory structures must go beyond an analysis of travel costs and address these more fundamental concerns. Under present circumstances, the Council believes that the best way to improve efficiency is to continue interagency efforts to strengthen uniformity and consistency in examinations. Council subcommittees are currently developing a broad range of proposals to improve coordination and consistency in examination policies and procedures, examination report format, reporting requirements and examiner training. Until these projects have been completed and the issues raised above addressed in greater detail, the Council believes it would be premature to undertake a full scale consideration of alternatives to the present structure of the agencies' examination forces.

The Council recognizes that resource sharing can be particularly effective in certain examination areas, and remains committed to expanding these areas and encouraging such arrangements where appropriate and cost-justified. The shared national credit and interagency country risk evaluation programs represent effective examples of interagency cooperation and resource sharing. Moreover, where permitted by law and resource availability, the Federal agencies stand ready to assist each other in the examination of institutions that have changed supervisory jurisdiction as a result of charter changes, mergers or emergency acquisitions. The Examination Council and its task forces provide an on-going mechanism for the agencies to exchange information on current resource needs and establish arrangements to cooperate through the sharing of supervisory and examination personnel on a case-by-case basis.

Because significant changes in the organizational structure of the Federal financial institution supervisory agencies could impact State supervisors of financial institutions, the Examination Council requested the views of its State Liaison Committee on the Draft Report. The Committee's response is attached.

Sincerely,

Robert J Lawrence

Robert J. Lawrence
Executive Secretary

Attachment

noted in the draft and could result in a decrease in competition between federal bank regulators, a process we believe is healthy. The more relevant problem from a state regulatory perspective is the potential for disruption of on-going relationships and cooperation that has developed between federal and state regulators over the years.

A more productive approach to improving the efficiency and reducing the cost of the examination process for both banks and federal agencies would be the acceptance of state examinations as an alternative to federal examinations. The General Accounting Office, in a prior study, proposed that the Examination Council assess the quality of examinations performed by state agencies and, where a state's work is considered adequate, require that Federal regulatory agencies to accept the work of the state in lieu of their own examination. The Federal Deposit Insurance Corporation has taken a giant step in implementing this recommendation by adopting the Divided Examination Program with several state agencies. The Examinations Council should review the GAO's recommendations in light of these innovative procedures and initiate federal withdrawal from the examination process where appropriate, either completely or in some modified form.

The Committee rejects the concept that a consolidation of the federal examiner personnel would achieve the stated goals of the study. In fact, the effect of creating the additional layer of federal regulatory authority necessary to coordinate the consolidation would be counterproductive.

The State Committee feels the development of an efficient and economic examination process can best be achieved by a cooperative and closer working relationship between the federal and state regulatory agencies. Rather than create another layer of bureaucracy we believe that, where possible, more productive use should be made of work being done by state authorities having primary supervisory responsibility.

Very truly yours,

Chairwoman
State Liaison Committee

cc: Walter Madsen
John Olin
Rex Fair
William Cole

of on-site examinations and in ensuring the overall safety and soundness of the banking system. The Corporation endorses the proposition that the regulatory agencies should work diligently toward achieving the goals of optimizing their examination effort for effective bank supervision and minimizing supervisory costs. However, we perceive no improvement in the effectiveness or quality of the on-site examination resulting from the recommendations made in the Report.

As we read the Report, the recommended proposals are premised, for the most part, on an estimated reduction on a nationwide basis in travel expenses associated with on-site examinations of $5.4 million per year and, as a consequence of reducing travel, on an assumed improvement in examiner morale. We note in passing that we have no basis for agreeing or disagreeing with the estimated reduction in travel expense and time since neither the methodology employed was explained in the Report nor the GAO workpapers made available to us. The GAO estimates that the FDIC share of that estimated total saving is $2.2 million per year. Viewed in its proper perspective and assuming that the GAO estimates are correct, the purported saving of $2.2 million per year amounts to 1.7 percent of the entire FDIC budget and 2.5 percent of the budget of the Division of Bank Supervision, the division charged with the responsibility of examining State nonmember insured banks. Weighing the serious disruption of the supervisory process that we anticipate and the undoubtedly large implementation costs that we believe would result from adoption of the GAO proposals against the estimated dollar savings in travel expenses and the unsubstantiated assumed improvement in examiner morale, the scales tilt heavily against adoption of the GAO proposals.

The GAO lists, but offers no solution to, numerous statutory, administrative, and procedural impediments inhibiting or perhaps preventing effectuation of the recommended proposals. Chief among the impediments cited by GAO are: the need for legislative initiatives authorizing the sharing of examiners and the expansion of examination powers; coordination of scheduling of an examination by an agency other than the responsible agency; differences in the examination procedure and reporting formats among the agencies; differences in the applicable laws and regulations both on the Federal and State levels administered by the various agencies; problems with supervising financial institutions between examinations; disruption of the agency's daily operations during consolidation; relocation of examination staff and the potential loss of some experienced examiners as a result of relocations; resolving salary differences currently existing between the three agencies; dealing with examiner morale problems which result from loss of identification with a specific agency; and funding the initial costs to establish consolidated field offices and relocate examination staffs. The significance and sheer number of these obstacles argue strongly for the rejection of the GAO recommendations. The Corporation's major concern with the recommendations is, however, their tendency to lessen the quality of the on-site examination.

In sum, the Corporation is concerned that effectuation of the GAO recommendations could seriously erode the morale of examiner personnel, undermine the quality of on-site examinations, and perforce reduce the effectiveness of the entire supervisory process.

GAO is critical of the three Federal bank regulators because, alleges GAO, they "have no procedures for reviewing the need for new and existing field offices." It is interesting to note that in the same paragraph in the Report GAO seems to contradict the criticism of no procedure by delineating the factors considered by the agencies in establishing field offices. Recognizing that there is always room for improvement in the procedure employed, in the case of FDIC the criticism is simply inaccurate. A brief review of the Corporation's procedure would perhaps be useful.

The FDIC is geographically divided into 14 regions nationwide with each region headed by a regional director. The regions are in turn divided into numerous field offices. As indicated in our comments on previous GAO reports, the regional directors are considered by the Board of Directors as part of the top management of the Corporation upon whom we rely with confidence to be fully cognizant of and to recommend necessary measures to correct or improve the supervisory process in their regions. Furthermore, the centerpiece of the Corporation's management philosophy has been and is decentralization, with oversight performed by the Washington Office, both in the form of establishing policy guidelines and making performance evaluation. Consistent with that philosophy, the Corporation has made extensive delegations of authority to our regional directors. Among the delegations is the authority to initiate proposed changes in field office alignment, locations and staffing within each respective region. Of course, before effectuating the reorganization of any field offices, Washington Office review and approval must be obtained. The logic of delegating to each regional director and his staff the authority to initiate field office reorganizations is that they are in a better position to know the banking structure, economic conditions, travel conditions and overall workload of their geographic area. In recommending any field office reorganization within a region, the following information must be contained in the regional request to the Washington Office: a description of the present and proposed field office organization, including the number of employees, grade structure, number of banks, number of problem banks, total bank assets, total examination hours, and reasons for realignment; the travel implications of the proposed reorganization; the extent of any positive or adverse implications for State banking authorities; the extent of any positive and adverse impact on employees; and the extent of any delegated authority to the field office supervisor under the proposal. This procedure has been in place for a number of years.

GAO recommends that the three Federal bank regulatory agencies "take actions to realign their field structure whenever opportunities exist to improve the

Finally, our overall reaction is that the underlying thrust of the Report is a de facto restructuring of the Federal bank regulatory framework whereby the three agencies are, in effect, reduced to one. To the degree that such result follows, it prejudges the merits of consolidating the Federal bank regulatory structure without really focusing on the issues involved in such a centralization. Any such reorganization should be approached directly, openly, and rationally and not, as here, indirectly, simplistically, or on a piecemeal basis.

Sincerely,

Quinton Thompson

Quinton Thompson
Director

Mr. William J. Anderson

and office personnel; the disruption of agencies' daily operations; and the decline of examiner morale resulting from loss of identification with a specific agency. In addition, however, the Board believes that a number of other more serious consequences would result from the exchange or consolidation of examiners.

Of primary concern to the Board are problems relating to examiner accountability and control. The conduct of examinations on behalf of the primary supervisory authority by examiners accountable to another agency or independent examination commission would erode the primary authority's ability to fulfill its statutory supervisory responsibilities. It is, as a practical matter, difficult to separate supervision from the examination function since examiners carry out many important on-site supervisory responsibilities relating to corrective action, meetings with management and monitoring of compliance with enforcement actions. Identification of supervisory problems and the timeliness of the supervisory response are in part a function of the clear lines of authority, control, and communication that presently exist between supervisory agencies and their examination staffs. Consequently, implementation of the proposals would undermine the quality of supervision to the extent that supervisory officials from one agency were required to rely upon examiners accountable to a different examination agency. The creation of an additional supervisory agency with the sole purpose of conducting examinations would do little, in the Board's view, to improve the efficiency or effectiveness of the examination process. In addition, implementation of the GAO's proposals would disrupt existing relationships between financial institutions and supervisory authorities and create confusion for those banking organizations that would be examined by one agency and supervised by yet another. Moreover, placing examiners into a large nationwide pool with no accountability to or identification with a primary supervisory agency would have an adverse impact on the effectiveness of the examination as a supervisory tool. Pools generally have not proven conducive to maintaining morale in skilled professionals. Consequently, the Board is concerned that such a plan would erode the examiner's role in the supervisory process and possibly undermine the quality of examination reports.

The Federal Reserve shares the GAO's overall concern that examinations be conducted in as efficient and cost effective manner as possible, consistent with the System's statutory responsibilities for safety and soundness and compliance with laws and regulations. To this end, the Board has cooperated with the other banking agencies where appropriate in several efforts that have resulted in enhanced uniformity and efficiency in the use of examination resources. Both the shared national credit and the interagency country risk evaluation programs have produced considerable economies in the use of examination resources while protecting the integrity of the examination process. Moreover, the Board is committed to cooperation and resource sharing in other appropriate areas such as the examination of banks that have come under a different agency's jurisdiction as a result of a merger, charter change or emergency acquisition.

The GAO recommends that the agencies make periodic evaluations of their internal field structures to achieve greater economies in the examination process. The Board endorses the establishment of regional field examination facilities where appropriate and cost justified. Recently, the Federal Reserve Bank of Kansas City opened an examination office in its Denver branch and the Federal Reserve Bank of San Francisco has similar facilities in Los Angeles and

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

December 17, 1980

Mr. William J. Anderson
Director
General Government Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

We appreciate the opportunity to comment on your November 17, 1980 draft of a proposed GAO report entitled, "Economy and Efficiency of Financial Institution Examinations Can Be Improved."

In the report, GAO notes that each bank regulatory agency maintains its own nationwide network of offices for the purpose of supervising and examining commercial banks. GAO points out that potential savings exist if the banking agencies were to reduce their travel requirements and also share common field office locations. Specifically, GAO recommends that the Federal Financial Institutions Examination Council develop a plan to consolidate the examiner resources of the three banking agencies into one examination force. Until such a long-term goal is realized, GAO suggests an interim interchange of examiners in which examiners from one bank regulatory agency would examine banks supervised by another agency.

We share GAO's overall concern for economy, efficiency, and effectiveness in the examination process, yet we differ with GAO on how best to achieve these worthy objectives.

In the 1980's financial institutions and their regulatory framework undoubtedly will be reshaped. We feel the Depository Institutions Deregulation and Monetary Control Act of 1980 accomodates the necessary process of evolution toward a more competitive environment for all regulated depository institutions. Indeed, the financial marketplace continues to become broader and more competitive within particular market segments, and across traditional industry lines and geographic barriers. As GAO observes in the draft report, savings and loan associations and credit unions, for example, are soon to offer a wider range of banking services and compete for the same customers as commercial banks.

composition, overall financial condition, complexity of structure, and the examiners' individual abilities, talents, and experiences. We believe that the most effective examination, and thus supervision, is obtained by matching these criteria and not merely the incidental location of an examiner.

The draft report lacks any extensive discussion on the measurement of costs or the identity of obstacles which would have to be surmounted to insure that the quality of the examination and supervisory function would not suffer. GAO's rationale for implementation of an interchange apparently rests solely on a reduction of travel expenses without any measurement of the immediate and long term costs in other areas of operation. In our opinion, effective and objective analysis of these questions requires that all costs and all benefits be similarly quantified, an aspect not covered in the report.

Finally, GAO recommends that the three federal bank supervisory agencies establish procedures for making periodic evaluations of their internal organizational structure and take actions to realign their field structure whenever opportunities exist to improve the disposition of their examiner forces. It is not apparent that there have been any significant inefficiencies resulting from the decisions made in the past to open or close a subregional office. However, we agree that a more formal review of internal organization relating to the examination function could be implemented to supplement the present informal delegation of this responsibility to the various regional offices. Clearer guidelines are warranted and will be developed shortly. As you know, we have recently completed an extensive study of our entire regional alignment geographically from a management perspective. We have furnished your staff with this study.

Once again, we appreciate the opportunity to comment on this important matter.

Very truly yours,

John G. Heimann
Comptroller of the Currency

The Honorable Elmer B. Staats
Page Two

Second, the creation of a new agency would add another player to the system, rather than result in consolidation. This would not only add to communication problems between agencies, it would force financial institutions to deal with yet another agency, with the attendant shortcoming of allowing the institutions the ability to play off one agency against yet another.

In summary, we ask GAO to reconsider its recommendations in light of the absence of any statutory authority for the proposed Council activity and of the inherent management problems that implementation of the recommendations would entail.

Sincerely,

Jay Janis

Jay Janis

 APPENDIX VI

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

examiner and management personnel would be extensive. These are just a few of the initial costs; there would obviously be others. A large portion of GAO's presentation is dependent upon the premise that travel costs would be less. There is to date no evidence to support the premise that consolidation of examiners, at this time, would be less expensive on an overall operational basis. In fact, the draft report pointed out that the Office of the Comptroller of the Currency rejected a similarly supported realignment of its personnel based on the very high initial costs involved.

The source of funds for the initial costs in establishing the "examiner pool" concept is especially significant. NCUA funds are not appropriated from Congress but are derived from fees assessed on credit unions. As a self-supporting agency, NCUA could not afford such costs without unusually excessive charges to the Federal credit unions supervised or a specific appropriation from Congress.

Since GAO did not include NCUA in the study efforts, some of the key differences between NCUA examinations and those of the other agencies studied may not be clear. The objectives of an examination conducted by NCUA staff pertain not only to financial soundness of the institution but also to a large set of requirements that are unique to credit unions. This is because there are wide variances in the operating practices of banks and credit unions and the laws that pertain to them. Most credit unions are small scale operations when compared to commercial banks. For example, over 65% of Federal credit unions have assets under $1 million and many are managed by a volunteer staff. NCUA examiners often provide assistance to the less experienced credit union officials and frequently respond to basic inquiries about financial management practices. NCUA's objectives when conducting an examination of a credit union are as follows:

"To determine:

(1) That financial transactions are recorded and disclosed in accordance with the Statement of Accounting Principles and Standards for Federal Credit Unions and the Accounting Manual for Federal Credit Unions;

(2) That management policies and practices are sufficient to prevent unnecessary losses and provide the optimum basic services for credit union members;

(3) The extent of compliance with the Federal Credit Union Act, NCUA Rules and Regulations, the Federal Credit Union Bylaws, NCUA manuals and other applicable laws and regulations and sound business practices;

(4) If there are undisclosed events or material losses, either internal or external, that would substantially impair the credit union's ability to continue normal operations or materially affect the financial condition of the credit union;

(5) The financial condition of the credit union; and

APPENDIX VI

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

Other problems in consolidating examination forces that NCUA views as significant are:

(1) Complex and time consuming scheduling arrangements would be needed.

(2) Supervisory duties would have to be carried out by examiners on behalf of an agency which may have no authority over the examiners involved. The "pool" concept would undermine examiner accountability and create further communication problems between agency management and the examiner.

(3) The proposal would disrupt on-going supervisory relationships with institutions supervised. It is NCUA's practice to assign responsibilities for supervising a credit union to a specific examiner who attempts to establish a degree of rapport with the credit union officials. In most cases, the examiner is a Federal credit union's only contact with the supervising agency. If a degree of rapport is not established, the examiner's effectiveness in assisting to resolve credit union problems is impaired. Confusion would be increased for institutions that would be examined by one agency and supervised by another.

(4) Operational problems would be particularly serious in dealing with problem case credit unions. Agency initiated administrative actions require large amounts of specifically prepared documentation. Examiners operating in a pool would need to have extensive information about the administrative action processes for each of the agencies in order to perform this important function.

The report also concluded that consolidation of examination forces would "improve the life of the examiner." This was based on an analysis of why examiners resign and that a frequent (but not the primary) reason was the high degree of travel. An internal NCUA study stated that NCUA examiners were most concerned about the rapidly changing, increasingly complex economic environment in which they must function when examining credit unions, not travel. Another examiner related aspect of the proposed consolidation is the probable relocation of staff. Many NCUA examiners have stated that they would resign rather than accept an involuntary transfer to another location. The reason is, primarily, high mortgage interest rates and resulting financial losses which impact anyone who moves their household at this time. Thus, the turnover rate might increase dramatically, at least at the onset of consolidation, and the "life of the examiner" may not be improved.

Finally, the report concluded that the financial regulatory agencies were not making periodic evaluations of their internal organization structures nor taking action to realign their field structures, when needed, to improve the distribution of examiners. At NCUA, this is routinely done as part of the standard management practice, not as a separate "study." Internally, the NCUA Regional Offices and field supervisors routinely, at the beginning of the fiscal year, meet and assess the workload. At that time, the examiner districts are modified, if warranted, to equalize the workload among the field supervisors and at the examiner level. Less frequently, the workload among the six regions is assessed and changes in the regional boundaries are made. The only difference

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NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

between this and the approach GAO favors is that rather than relocating staff to accommodate changes in workload, NCUA redefines geographic boundaries at all organizational levels, which saves money in terms of reducing the needs to relocate staff. Also, through the annual budgeting process, the distribution of examiners resources is also assessed. Although the examination resources are totaled for presentation external to NCUA, the process of developing the resource needs involves forecasting, based on standard quantified criteria, and the examiner needs of each regional office, supervisory group, and examiner district. During this annual process, the examiner resources may be redistributed, if necessary. This information, although generally not published for external distribution, is used for planning purposes and to support NCUA's budget requests. NCUA staff, this year, has conducted an extensive study of regional and field organization and structure. In this draft study, several alternatives for our own internal structure were identified and assessed.

In summary, NCUA agrees that it would require extensive time and effort to consolidate the examiner staffs of the three banking agencies. NCUA does not agree that the two non-banking agencies can or should be included in the consolidated "examiner pool" efforts. The disagreement is based on the differences between the corporate entities that the various agencies are charged with regulating and examining, coupled with the fact that there has not been careful study of the practical problems and the potential benefits. Finally, NCUA believes it would be premature and unproductive to devote resources to a full scale consideration of alternatives to the current structure of agency examination forces especially in view of the current economic uncertainty. NCUA believes the Examination Council should continue its mission of providing more uniformity, where uniformity is possible, in examination procedures. Only when this goal has been accomplished and assessed would it be practical to undertake consolidation of examiner staff. However, even then, some degree of specialization by financial institution type would be necessary because of the differences in the laws pertaining to each type of institution.

I hope these comments have provided you with useful information about NCUA and if I can be of any further assistance please let me know.

Sincerely,

LAWRENCE CONNELL, JR.
Chairman

cc: Elmer B. Staats
Comptroller General

(233040)

NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C 20456

(6) The degree of risk the credit union presents to the insurance fund."

The present examination program requires knowledge and background in legal areas that pertain only to credit unions. The laws, regulations and standards of the banking industry are substantially different from those for credit unions. In fact, the examination objectives of NCUA are significantly different from those of other agencies. Other agencies concentrate primarily on regulatory compliance and safety and soundness. NCUA examiners perform this function, but also provide assistance to credit union officials, who often do not have a financial background, in improving financial management practices. NCUA's obligations are based on statutory requirements that are different from the other agencies.

One indication of the differences between NCUA financial examiner positions and examiner position in the other agencies is that position classifications as established by the Office of Personnel Management differ. Examiners from the other agencies are classified as GS-570, financial institution examiner; whereas NCUA examiners are classified as GS-510, accountant/auditor which requires a more in-depth accounting background. NCUA examiners require an intensive accounting background to provide sufficient assistance to the credit unions in resolving their financial problems. Similarly, NCUA examiners do not necessarily have sufficient expertise to resolve the problems that arise in commercial banking. For example, there are substantial differences in the analysis of loans made to commercial enterprises as opposed to the individuals with which credit unions most often lend. This, as the report suggests, shows that NCUA examiners may require further training to perform bank examinations. Bank examiners would also require substantial further training to perform credit union examinations. Most state supervisors, with more limited resources, also make a distinction between examiners for banks and those for the thrift institutions. There clearly are differences in the examination objectives and approaches to examinations conducted in credit unions and those in banks. NCUA is concerned about the extensive amount of training that would be required to acclimate examiners in all procedures.

NCUA is actively participating in several training programs conducted by the Examination Council. These programs cover areas that all agencies have as a common base--EDP Training, Consumer Affairs, and Instructor Training. However, these courses do not deal with the basic examiner training areas pertaining to financial condition and compliance. These programs cannot be conducted jointly until uniform examination techniques are developed. If accomplished, work on the development and implementation of the required training programs can proceed. However, it cannot be assumed that a good bank examiner will, or even can be, a good credit union examiner. The laws, regulations and operating objectives are too different. Therefore, even if full joint training can be developed, it will be necessary to conduct additional training programs specifically for credit union, savings and loan, and bank examinations. Even with an agency as small as NCUA, there is already a need to have two types of specialized examiners; those for financial examinations and those for consumer regulation compliance.

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

December 15, 1980

Mr. William J. Anderson
Director, General Government Division
U.S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

This is in response to your letter dated November 17, 1980 requesting comments on your draft report entitled "Economy and Efficiency of Financial Institution Examinations Can be Improved." In compliance with Public Law 95-630, the National Credit Union Administration (NCUA) supports the overall goal of strengthening the examination process and of conducting examinations in a cost-effective manner. NCUA welcomes the opportunity to share expertise with the other financial institution regulatory agencies. In areas such as examination of large financial institutions and EDP, NCUA can gain considerably from the expertise already developed. NCUA is also anxious to share the expertise established through our internal activities. In this sense, the Federal Financial Institutions Examination Council is already achieving positive results.

Since NCUA was not included as part of the review and study efforts but has been included in the recommendations, I must express my concern that some of the points raised relating to the Federal banking regulators can not be validly extrapolated to NCUA. While the bank regulatory agencies were addressed in some detail, it appears as if NCUA and the Federal Home Loan Bank Board were included as an afterthought in the recommendations. NCUA believes GAO's recommendations face a number of practical constraints that could actually undermine the effectiveness of the examination process and would very likely increase the total costs to the agencies in carrying out responsibilities. Although overall examination costs may include increasing travel cost, such costs are only one portion of the costs associated with conducting an examination program. Many costs are a function of external factors and are beyond the regulatory agencies' control. These include, but are not limited to, inflation, institutional asset growth, increased regulatory and statutory responsibilities, economic instabilities and the increasing complexity in the operation of each type of financial institution. Looking at increases in examination costs in the absence of these considerations provides a misleading view of potential reductions associated with travel.

In the report, GAO concluded that the financial institution regulatory agencies would reduce travel costs by consolidating examiner workforces; however, overall operating costs were not addressed. GAO estimated the benefits in reduced travel costs that would be derived from a consolidation of field examining activities. That analysis is misleading without directly comparing the start-up costs. Closing existing field offices and opening new ones would undoubtedly result in relocation of some staff. Based on our experience it costs an average of $15,000 to relocate one examiner with real estate. The cost of renegotiating office space arrangements and also the training costs of

Federal Home Loan Bank Board

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

JAY JANIS
Chairman

December 15, 1980

The Honorable Elmer B. Staats
Comptroller General of the United States
General Accounting Office
441 G Street, N.W.
Washington, D. C. 20548

Dear Mr. Staats:

The draft GAO report entitled "Economy and Efficiency of Financial Institution Examinations Can Be Improved" recommends that the Federal Financial Institutions Examination Council (Council):

- prepare a transition plan whereby examinations of financial institutions would be conducted by the closest federal financial institution regulatory agency;

- determine how best to consolidate the examination forces of the five agencies and prepare a plan for such consolidation; and

- develop and propose legislation to permit the transitional program and authorize a consolidated examination force.

I will remain brief in this letter, since the FHLBB will be participating with the Council in the Council's response. But, both as the head of this agency and as a member of the Council, I strongly object to GAO's attempt to have the Council undertake activities which clearly are outside its statutory authority. GAO certainly is well aware that previous efforts to accomplish merger or consolidation of the agencies have failed to muster any significant amount of legislative approval. Under the circumstances, I consider it to be entirely inappropriate for GAO now to urge the Council to engage in activities for which the Council has no mandate and no legislative authority.

From a management perspective, the GAO recommendation would seriously disrupt accountability for regulating financial institutions and would increase, rather than decrease, communications and interagency problems. First, the recommendations would result in a new, separate entity examining the financial institutions which would continue to be regulated by the existing agencies. In essence, this would split the accountability between the existing agencies and the proposed Federal Examination Commission for safety and soundness of the respective industries. The resulting diffusion of responsibility could only decrease the effectiveness of the examination function.

Anticipating this metamorphosis, Congress created the Federal Financial Institutions Examination Council to attain greater uniformity in the training of examiners and the methods of examination and supervision used by the three federal bank supervisory agencies, the Federal Home Loan Bank System, the National Credit Union Administration, and the states. We support the Examination Council's goal of achieving consistency among the agencies' various regulatory and supervisory standards. However, we also recognize that it is both time consuming and difficult to achieve agreement among the agencies on the principles of how to proceed in the substantive areas of regulation and supervision. While the agencies continue to differ in supervisory philosophies and maintain unique organizational structures, the Examination Council's task of achieving uniformity remains formidable and costly. Therefore, we are now convinced that the benefits to be derived from reorganizing the existing system substantially outweigh the costs. We must design a framework that is suitable for today and sufficiently flexible to accommodate change. For obvious reasons the existing framework is increasingly inefficient. In our judgement, therefore, it is time to move beyond the Examination Council.

GAO's recommendation that the three bank regulatory agencies consolidate their examination forces into one entity falls considerably short of what we believe the objective should be. We disagree with this suggested "bottom-up" approach to modernizing the regulatory framework. Whatever the ultimate structure of an updated regulatory body, three agencies sharing one examination force would not be workable.

The most troubling feature of the recommendation is the separation of the examination function from the supervisory function which would result from its implementation. The integration of supervision and examinations is in our opinion essential for an efficient and effective regulatory scheme. Similarly, the management principles of responsibility and accountability are recklessly discarded by the recommendation. It is impractical to expect examiners to carry out duties on behalf of a supervisory agency having no authority over them. Apparently, GAO feels that the relatively modest cost efficiencies that may be realized administratively would outweigh the ramifications of a fragmented regulatory, supervisory, examination framework. We disagree.

Even if the agencies and the Examination Council were to agree with GAO's recommendations, we question whether the Council has the statutory authority to devise such a plan to consolidate the examining staffs.

Interchange of examiners is being done where feasible (and necessary) on a program by program basis. For example, we have joined the other agencies in sharing resources, for the shared national credit program, the country risk evaluation program, new bank holding company inspection program, and several international examination matters, etc. However, to begin sharing examiners based solely on their proximity to a bank ignores vital criteria such as a bank's asset size and asset

APPENDIX III

Mr. William J. Anderson - 3 -

Salt Lake City. In certain other Districts, Federal Reserve examiners live in the regions in which they are primarily assigned to examine banks. This arrangement minimizes travel between the Reserve Bank and the commercial bank to be examined and helps hold down travel expenses. The feasibility and potential benefits from opening offices in other locations are currently under consideration.

While the Board disagrees with the GAO recommendation for a consolidated examination agency, the Federal Reserve remains committed to cooperating in the sharing of resources on an ad hoc basis where appropriate and feasible. The Board believes that it has been successful in controlling expenses during a period which has witnessed the rapid growth and expansion of banking activities, the passage of numerous far-reaching new banking statutes and a broadening of the agencies responsibilities to protect the interests of consumers, borrowers and other bank customers.

Very truly yours,

Theodore E. Allison
Secretary of the Board

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 10, 1980

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

The Board appreciates the opportunity to respond to the draft GAO report entitled "Economy and Efficiency of Financial Institution Examinations Can Be Improved." The report discusses the field examination office structure of the banking agencies and the costs, primarily travel, associated with the Federal examination of commercial banks. The report concludes that savings could be realized if banks were examined by examiners from the closest field office irrespective of the type of bank or the identity of the primary supervisory agency. Following this reasoning, the GAO advocates the interchange of examiners in which examiners of one agency would examine banks supervised by another. This is seen by the GAO as an interim step toward the complete consolidation of the Federal agencies' examination forces. GAO contends that consolidation of examiner forces would permit locating offices throughout the country to minimize required travel from field office to the institution under examination. Such a step would presumably establish a new Federal body or commission responsible solely for examinations while the supervisory function remained with the existing Federal regulatory agencies.

The Board believes that the present supervisory structure and the existing relationship between the Federal agencies and their field examiners have played a crucial role in ensuring the effective examination of commercial banks and the overall safety and soundness of the U.S. banking system. In the Board's view, the argument for consolidating examination forces is not supported by the existence of deficiencies in the present supervisory structure or by the potential long run benefits described in the report. The Board is of the opinion that the hypothetical savings from consolidating examination staffs would not outweigh the serious disruption of the supervisory process and the substantial implementation costs that consolidation of examiners would entail. The Board concurs with the GAO finding that a number of statutory, administrative and procedural problems preclude implementation of the proposals in the near term. Among these, the GAO cites the lack of a statutory mandate allowing exchange of examiners; differences between Federal laws and regulations and those of the States; interagency differences in examination procedures and report format; coordination and scheduling difficulties regarding examinations conducted by one agency on behalf of another; the costs associated with establishing new offices and relocating field dispersal of their examiner forces." The Corporation agrees that periodic realignment of field offices is desirable where cost effective and otherwise justified. In 1965 a major internal study was completed involving the alignment of regional offices. As a direct outgrowth of that study, the number of regional offices was increased from 12 to 14 and one was relocated. In 1977, the St. Louis regional office was moved to Kansas City, Missouri. The primary reasons for the move were to provide a more central location to the regional office within the region and to reduce the amount of travel expended by examiners, bankers, and the banking public in traveling to and from the regional office. Another internal study of regional office alignment has recently been completed and the findings are now being considered by senior management of the Corporation. During 1979 and to date in 1980, some type of field office realignment was effectuated in eight regions. The realignments range from complete restructuring of all field offices in two regions to the establishment of new or the consolidation of old field offices in the others. Available records indicate that a total of eight field offices were closed and 12 were opened during calendar years 1978, 1979 and 1980.

Page 22 of the Report contains a chart indicating the field examiner turnover rate in percentages of the three Federal bank regulatory agencies for the five-year period ending January 1979. We note in passing that the five-year turnover rate for the FDIC is well below 10 percent. It is also noteworthy that Corporation records show that the vast majority of our field examiner turnovers occurred at levels below that of commissioned examiners. In other words, the turnovers were among the less experienced examiner work force. For example, in 1978 in excess of 64 percent of the field examiner turnovers were in grades GG-9 and below, and in 1979 in excess of 68 percent. While the Corporation is concerned with and is striving to reduce the rate of examiner turnover, these statistics belie the GAO implication that the Corporation's turnover in field examiner personnel significantly impacts on the experience level of our examiner corps.

To reiterate, the Corporation is committed to reduce the cost of supervision while maintaining its effectiveness. We believe that the Corporation's record of accomplishment in that regard is by any standard impressive. Among the initiatives put in place by the Corporation to effect such economies are the expansion of the divided examination program with State authorities, the utilization of modified examination techniques, the stretching out of the frequency of examinations of soundly operated banks, the streamlining of the examination report, and participation in the interagency shared national credits and evaluation of country risk programs. While the Corporation disagrees with the recommended proposals in the GAO Report, the FDIC is receptive to any reasonable suggestions, including the sharing of resources where appropriate and feasible, which will minimize supervisory costs and yet maintain or enhance effective supervision of banks.

The on-site examination is central to the supervisory process. It is the primary surveillance mechanism by virtue of which, in most instances, the FDIC learns of near and actual supervisory concerns or financial problems in banks. It is also the primary means by which the Corporation maintains a continuing dialogue with managements to, among other things, assist the banks in complying with applicable rules and regulations and fundamental concepts of safety and soundness, and to obtain from them their reaction to changing conditions and industry practices. The knowledge gained through the on-site examination is often the basis for taking corrective measures, both on a formal and informal basis. Few would deny that the morale of the examiner force is a crucial factor in the maintenance of high quality on-site examinations. Contrary to the GAO's assumption, the Corporation believes the sharing arrangement recommended by GAO would have a serious detrimental effect on examiner morale and render difficult, if not impossible, proper management of examiner resources.

Conventional wisdom holds that identification with an organization is one of the core elements in sound management practice and high employee morale. Under the recommended consolidation of the three separate examiner forces into one common pool or, to a lesser extent, the interim interchangeability of examiners among the agencies, identification or association with an organization by the examiner work force would be blurred or nonexistent. Without a distinct organizational tie, there is every likelihood that examiner morale would suffer. Substantial change or the threat of substantial change in working conditions is also well recognized as a primary cause of low morale among workers. The GAO proposals would almost certainly produce widespread and substantial change in the working conditions and environment of each examiner. These include elemental factors such as the potentiality for examiners to work for a different organization, questionable potential for growth and promotion, and the possibility of extensive relocations.

Inherent in the supervisory process are existing lines of authority, communication, accountability, and responsibility between each agency's management and its examination force. The Corporation is fearful that consolidation or large scale interchange of the examiner force among the three Federal bank regulators would undermine, and in some cases destroy, these critical features of the supervisory process. For example, implementation of the GAO recommendations would create serious problems stemming from: the need to rely on examiners accountable to another agency; increased obstacles in lines of authority, communication and control between the agency and its examiners resulting in a reduced ability to identify problems and to take timely action where needed; extreme difficulties in scheduling examinations; a breakdown in the cooperative initiatives currently in place and anticipated with State authorities; confusion on the part of financial institutions regarding the identity of their primary supervisor; difficulties in evaluating and maintaining the quality of examiners and examinations; and additional complexities in maintaining adequate lines of communication with field personnel.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C 20429

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

December 16, 1980

Mr. William A. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

We appreciate the opportunity to review and comment on the GAO Draft Report ("Report") entitled "Economy and Efficiency of Financial Institutions Examinations Can be Improved." The Report reviews the field office structure of the Federal banking agencies and stresses primarily the travel costs incurred in the examination of commercial banks. The Report maintains that the Federal bank regulatory agencies "lack policies and procedures for establishing new and for monitoring existing field office locations." The present field office structure, states the Report, has resulted in high travel costs for the examination function and an adverse quality of life for examiners contributing to staff turnover.

GAO finds that economies could be achieved and the morale of examiners boosted if examinations were conducted by examiners located at the field office closest to the bank regardless of the type of bank or the primary Federal supervisor. GAO recommends (i) first, as an interim measure, the interchange of examiners whereby "examiners from one agency would examine the banks supervised by another agency" and (ii) as the ultimate solution, the consolidation of "the three separate examiner groups into one overall examiner force." GAO argues that consolidation of the examiner corps would allow the co-location of field offices throughout the country, apparently in closer proximity to the institutions to be examined, thereby reducing travel expenses and improving examiner morale. According to the GAO proposals, the three Federal bank regulatory agencies would maintain their individual identities and manage the common pool of examiners from each agency's separate headquarters in Washington.

In our judgment the present Federal bank regulatory structure and the close association with and identification between the individual agencies and their examiner corps have been instrumental in maintaining the high caliber

STATE OF NEW YORK
BANKING DEPARTMENT
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NEW YORK, N.Y. 10047

MURIEL SIEBERT
SUPERINTENDENT

December 19, 1980

Mr. Robert J. Lawrence
Executive Secretary
Federal Financial Institutions
Examination Council
490 L'Enfant Plaza, S.W., 8th Floor
Washington, D.C. 20219

Subject: Draft Report "Economy and Efficiency of Financial Institution Examinations Can Be Improved"

Dear ~~Mr. Lawrence:~~ Bob

The State Liaison Committee has reviewed the preliminary draft prepared by the U.S. General Accounting Office entitled "Economy and Efficiency of Financial Institutions Supervision Can Be Improved" and the proposed response by the Examination Council. The Committee, whose role is to encourage the application of uniform examinations and standards by state and federal supervisory authorities strongly endorses the GAO's objective of strengthening and streamlining the examination process. While the Examination Council's response adequately addresses the federal regulatory viewpoint on the consolidation of examiner personnel, the Committee feels that some input from a state regulatory perspective is required.

The creation of a pool of examiner personnel and the inevitable establishment of a commission mandated to coordinate and implement such a complex undertaking, is an unnecessary centralization of bank regulatory authority at the federal level. The study overlooks the fact that under the present regulatory framework, every state chartered insured institution is subject to a federal examination. This blanket of federal regulation, which ignores the state regulatory role and is in itself inefficient, would be compounded by the creation of yet another layer of bureaucratic authority. Such a consolidation of bank regulatory authority at the federal level will not accomplish the objectives

Federal Financial Institutions **Examination Council**, Washington, D.C. 20219

December 24, 1980

Mr. William J. Anderson, Director
General Government Division
United States General Accounting
Office
Washington, D.C. 20548

Dear Mr. Anderson:

The GAO draft report entitled "Economy and Efficiency of Financial Institution Supervision Can Be Improved" addresses a number of recommendations to the Federal Financial Institutions Examination Council. The principal recommendations call for the Council to prepare 1) a transitional plan, including the development of supporting legislation, to enable the agencies to use each others' examiners; and 2) a long run plan for the complete consolidation of the examination forces of the five Federal financial institution regulatory agencies.

The Council shares the GAO's overall objective of strengthening uniformity and conducting examinations as efficiently and economically as possible, consistent with the agencies' responsibilities for safety and soundness and compliance. However, the Council believes that the development of plans for the exchange and consolidation of examiners would confront numerous practical and institutional obstacles and, more importantly, raises a number of fundamental supervisory questions that have yet to be addressed.

The GAO report clearly points out that consolidation is not now feasible and that several problems would have to be resolved before one agency could use examiners of another agency. Chief among these problems are differences in Federal and State laws and regulations; coordination and scheduling difficulties inherent in the conduct of examinations by one agency on behalf of another; differences in examination procedures and report format; the need for immediate and extensive cross training; and distinctions between thrift institutions and banks.

While these problems alone are significant, the GAO recommendations raise several more fundamental issues relating to examiner accountability and control and, ultimately, to the quality of Federal supervision. Although the GAO proposal would leave intact the supervisory agencies and consolidate only the examination function, the Council believes that such a separation could undermine the agencies' ability to carry out their statutory supervisory responsibilities. In practice, examiners play an important supervisory role in identifying problems, developing remedial programs and monitoring progress in correcting financial and operating deficiencies. The Council is concerned that the quality of supervision