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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Federal Financial Institutions Examination Council Has Made Limited Progress Toward Accomplishing Its Mission

The Federal Financial Institutions Examination Council was established by law in March 1979 to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions. In addition, the Council is to make recommendations to promote uniformity in the supervision of financial institutions, to develop uniform reporting systems for federally supervised financial institutions, and to conduct schools for examiners employed by the five member agencies.

This report shows that the Council has made limited progress in accomplishing its congressionally mandated objectives. It also discusses various additional actions that could be taken to promote uniformity in the Federal supervision of financial institutions, including some form of consolidation of the five member agencies or their functions.



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COMPTROLLER GENERAL OF THE UNITED STATES
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To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the Federal Financial Institutions Examination Council's efforts to achieve its congressionally mandated goals. We believe the report can assist the Congress in evaluating various recommended changes to existing federal systems for regulating financial institutions.

We have issued several reports which identify areas in the federal examination and supervisory processes where greater uniformity was needed. We undertook this review in order to assess the Council's progress in establishing examination and supervision uniformity. Our review was conducted pursuant to the Federal Banking Agency Audit Act (31 U.S.C. 67).

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

Charles A. Bowser

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FEDERAL FINANCIAL INSTITUTIONS
EXAMINATION COUNCIL HAS MADE
LIMITED PROGRESS TOWARD
ACCOMPLISHING ITS MISSION

D I G E S T

The Federal Financial Institutions Examination Council was established by law in March 1979 to prescribe uniform Federal examination principles, standards, and report forms; recommend uniformity in other supervisory matters; develop uniform financial institution reporting systems; and conduct schools for examiners. The five Federal financial institutions' regulatory agencies represented on the Council have primary Federal supervisory jurisdiction over 35,000 financial institutions, which, on December 31, 1982, held total assets of \$3 trillion. The Council's members are the Comptroller of the Currency, the Chairman of the Board of the Federal Deposit Insurance Corporation (FDIC), a member of the Board of Governors of the Federal Reserve System, the Chairman of the Federal Home Loan Bank Board, and the Chairman of the Board of the National Credit Union Administration.

GAO undertook this review to assess the Council's progress in accomplishing its congressional mandates and found that the Council has made limited progress in establishing uniform examination principles, standards, and report forms; made some progress in achieving uniformity in other supervisory matters and reporting systems; and been unable to develop a comprehensive examiner education program.

LITTLE PROGRESS MADE IN
ESTABLISHING UNIFORM
EXAMINATION PRINCIPLES,
STANDARDS, AND REPORT
FORMS

The on-site examination process is the principal fact-finding method used by the Federal regulators to ensure the safety and soundness of the financial institutions. The vast majority of the Federal regulators' resources are consumed by these examinations. The

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Congress, in establishing the Council, emphasized the need for uniformity in examination principles, standards, and report forms.

The Council has made little progress in establishing examination uniformity. Its primary effort in this regard was its Study of Examination Philosophies, Concepts, and Procedures, which identified major examination differences among the agencies. The study, considered by Council members to be the most significant project of the Task Force on Supervision, was terminated without accomplishing its objectives of developing uniform examination policies and procedures. (See pp. 16 to 22.)

The Council has taken 11 actions which it classified as examination principles, standards, and report forms, the areas the Congress stressed when it said the regulators needed more uniformity. These actions, which are binding on the member agencies, did not eliminate major differences the Council identified in its Study of Examination Philosophies, Concepts, and Procedures. Instead, the 11 actions covered areas for which the Congress had already mandated essentially identical responsibilities on each agency or which were peripheral to the agencies' basic safety and soundness examinations. (See pp. 25 to 29.)

SOME SUCCESS IN OTHER
SUPERVISORY MATTERS AND
REPORTING SYSTEM UNIFORMITY

The Council's enabling legislation specifies that the Council, in addition to establishing uniform examination principles, standards, and report forms, shall make recommendations for uniformity in other supervisory matters. From the Council's inception in March 1979 to January 1983, 28 such recommendations were made. These Council actions range from relatively minor matters, such as the elimination of a report that was not being used, to relatively significant matters, such as the establishment of a uniform policy for assessment of civil money penalties. ^{1/}

^{1/}The Council's 1983 annual report, to be issued in Spring, 1984, will report on recommendations made in 1983.

These actions differ from those related to examination principles, standards, and report forms in that they are not binding on the member agencies if the agencies find them unacceptable and so advise the Council. Of the 28 Council actions, 6 were rejected by at least one of the member agencies.

The Council's enabling legislation also authorizes it to develop uniform reporting systems for the financial institutions that are supervised by the Council's member agencies. The Council approved 13 actions in the area of financial institution reporting systems, most notably a uniform bank Report of Condition and Income. (See pp. 44 to 49.)

COUNCIL'S EXAMINER EDUCATION PROGRAM IMPEDED BY LACK OF EXAMINATION UNIFORMITY

To help promote uniformity in the examination of financial institutions, the Congress mandated that the Council conduct schools for examiners and assistant examiners employed by the Federal financial institutions' regulatory agencies. The Council, through its Task Force on Examiner Education, established an objective to standardize and consolidate examiner training programs including commercial examination training. GAO's review of this area showed that the Council has been unable to provide basic training for the member agencies' principal examination efforts because it has not developed uniform principles and standards for examinations. Rather, it has geared its efforts towards developing peripheral courses in such subjects as management, instructor training, trust workshops, and international banking. (See pp. 53 to 57.)

REGULATORY STRUCTURE NEEDS CONGRESSIONAL CONSIDERATION

During the past several years, sweeping changes have taken place within the depository institution structure. Many factors, including increased competition and fluctuating interest rates, helped bring about changes in the laws and regulations separating financial institutions, thereby eroding many of the previous barriers which differentiated them.

GAO found that the Council has made only limited progress in promoting the needed uniformity. There are many barriers to the Council achieving uniformity, such as the reluctance of participating agencies to compromise and relinquish some of their powers used in managing their programs. Some member agencies believe that uniform examination policies and procedures may not always be appropriate or cost effective. GAO recognizes that it may not be appropriate for all policies and procedures to be uniform, but the need for uniformity is at least as great today as it was when the Congress established the Council in 1979 because institutions have become more similar.

Several alternative actions, ranging from strengthening the present Council to make it more effective to abolishing the Council and consolidating the member agencies, were discussed with the member agencies and representatives of the financial institution industry. These representatives generally indicated that some sort of consolidation of responsibilities is needed. Their opinions range from fully consolidating all five regulators into a single independent banking commission to combining the regulatory and supervision functions into one agency, the insurance functions into a second agency, and leaving the Federal Reserve to handle monetary policy.

The concept of consolidation, no matter what form it takes, has a variety of arguments for and against. Arguments for consolidation include simplification of administration, economy and efficiency of operation, elimination of actual or potential policy conflicts, improvement in the handling of failing bank situations, and the ability to better adjust to a rapidly changing environment. Arguments against consolidation include fear of the concentration of banking powers, the elimination of regulatory choice, benefits of diversity, disruption of the Federal/State relationship, and the opinion that the present system has worked well so why change it. In GAO's opinion some form of consolidation of the present regulatory structure may be needed if the Congress wants to effectively deal with policy

differences among the agencies involving such areas as the establishment of uniform examination priorities, determination of examination scope, and timing and communication of examination results. (See pp. 77 to 82.)

The Congress has received proposals to reorganize the Federal structure for regulating financial institutions and expects to receive additional recommendations from Vice President Bush's Task Group on Regulation of Financial Services. GAO believes that the Congress, in considering these proposals, should recognize the difficulties encountered by the Council in promoting uniformity and that some form of consolidation of the five member agencies may be necessary to achieve uniform Federal examination and supervision of financial institutions.

AGENCY COMMENTS

GAO received comments on this report from the Council and its five member agencies. Four of the Council's five member agencies generally agreed that the Council was not effectively accomplishing its legislative objectives. The National Credit Union Administration, while not stating that the Council had been effective, did not believe that the Congress' objective of uniform examination or supervision is practical but, rather, concluded that the Council should be a forum for Federal and State regulators to share common concerns and experiences.

The Council and two member agencies believed that the report did not sufficiently reflect several of the Council's achievements. Although the Council did make some progress toward uniformity in such areas as developing a uniform bank performance report and conducting international banking courses, these efforts never fully met their intended objectives. The uniform bank performance report was intended to be one of three parts of a uniform surveillance system. The project never progressed beyond the first stage of developing the uniform bank performance report. With regard to the training courses on international banking, neither the students nor the Council's manager of examiner education rated the courses highly. (See p. 84.)

Concerning GAO's conclusion that some form of consolidation of the present regulatory structure may be needed if the Congress wants to achieve uniformity, the Council and the Federal Reserve Board deferred comment pending the issuance of recommendations by Vice President Bush's Task Group on Regulation of Financial Services. The Comptroller of the Currency and the Federal Deposit Insurance Corporation favor some form of consolidation of the regulatory structure. The Federal Home Loan Bank Board believes that any move towards uniformity or consolidation should begin with the three bank regulatory agencies. The National Credit Union Administration said, however, that the GAO conclusion is without any factual or theoretical support. The National Credit Union Administration appears to base its observations on the assumption that there is no evidence in this report or in regulatory studies that uniformity increases supervisory effectiveness and thus there is no justification for strengthening the Council or restructuring the regulatory system. It was not an objective of this study to assess the need for uniform examination and supervision. Rather, the principal objective of GAO's review was to determine how well the Council was carrying out its legislative mandate to prescribe uniform principles, standards, and report forms for this Federal examination of financial institutions. A complete set of the agencies' comments are included in appendixes I through VI.

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ABBREVIATIONS

ASC	All-Savers Certificates
BHC	Bank Holding Company
CHIPS	Clearing House Interbank Payments System
EDP	Electronic Data Processing
FDIC	Federal Deposit Insurance Corporation
FIRA	Federal Financial Institution Regulatory and Interest Rate Control Act of 1978
FHLBB	Federal Home Loan Bank Board
FRS	Federal Reserve System
GAO	General Accounting Office
HMDA	Home Mortgage Disclosure Act
ICC	Interagency Coordinating Committee
ISC	Interagency Supervisory Committee
LAG	Legal Advisory Group
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OMB	Office of Management and Budget
TFCC	Task Force on Consumer Compliance
TFEE	Task Force on Examiner Education
TFR	Task Force on Reports

TFS	Task Force on Supervision
TFSS	Task Force on Surveillance Systems
UBHCPR	Uniform Bank Holding Company Performance Report
UBPR	Uniform Bank Performance Report

CHAPTER 1

INTRODUCTION

The Federal Financial Institutions Examination Council (Council) was established on March 10, 1979, pursuant to Title X of Public Law 95-630, the Federal Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRA) (12 U.S.C. §§ 3301 et seq.). The Council's purpose is to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions by the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (FRS), the Federal Home Loan Bank Board (FHLBB), and the National Credit Union Administration (NCUA) and make recommendations to promote uniformity in their supervision of financial institutions. Council principals, agency senior management, and participating staff have generally interpreted the Council's mandate to establish uniform examination principles and standards to include examination policies, rules, procedures, methods, and criteria of general applicability to all member agencies for use in their examination process. Title X of FIRA also specifies that the Council's actions shall be designed to promote consistency in such examinations and to ensure progressive and vigilant supervision. The Council is also required to conduct schools for examiners employed by the five member agencies.

MEMBER AGENCIES

The five Federal regulatory agencies represented on the Council have primary Federal supervisory jurisdiction over approximately 35,000 domestically chartered banks and thrift institutions which, on December 31, 1982, held total assets of approximately \$3.1 trillion. The FRS and the FHLBB also have primary Federal supervisory responsibility for commercial bank holding companies and for savings and loan holding companies, respectively. In addition, the FDIC, FRS, and OCC have authority to oversee the operations of U.S. branches and agencies of foreign banks.

About one-half of the 35,000 financial institutions are State chartered and are supervised by State and Federal authorities. The FHLBB and NCUA have full responsibility for supervising federally chartered institutions and share the responsibility with State regulatory authorities for federally insured, State chartered institutions. On the other hand, the FDIC shares the responsibility with State regulatory authorities for supervising State chartered, non-FRS member, federally insured institutions. The FRS is responsible for supervising State chartered FRS member banks. The OCC is the principal supervisor for national banks.

Supervision is accomplished through a number of functions, such as the approval or denial of applications for charter, membership, insurance, and structural or corporate changes. Onsite examination, however, is the primary mechanism for ensuring the safety and soundness of financial institutions.

Shown below are the number and total assets of financial institutions, as of December 31, 1982, that each agency regulates and supervises, exclusive of holding companies; Edge corporations (corporations chartered by the Federal Reserve to conduct international banking business); and U.S. branches and agencies of foreign banks.

<u>Type of institution</u>	<u>Federal regulator</u>	<u>Number of institutions</u>	<u>Total assets of institutions supervised (Billions)</u>
National banks	OCC	4,579	\$1,297
State member banks	FRS	1,054	423
State insured nonmember banks	FDIC	8,831	475
Mutual savings banks	FDIC	315	155
Federal savings and loan associations	FHLBB	1,727	479
State savings and loan associations	FHLBB	1,616	207
Federal credit unions	NCUA	11,430	46
State credit unions	NCUA	<u>5,034</u>	<u>24</u>
Total		<u>34,586</u>	<u>\$3,106</u>

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of this review were to (1) assess the progress of the Council in accomplishing its congressional mandates and (2) assess potential solutions to any problems prohibiting the Council from meeting these mandates.

Our review included the activities and actions of the Council and its task forces, committees, and subcommittees. In

evaluating the Council's activities, we focused on what the Council has done to

- establish uniform examination principles, standards, and report forms;
- establish uniform financial institution reporting systems and uniform supervision; and
- conduct schools for examiners employed by the agencies.

We reviewed and analyzed Title X of FIRA and its related legislative history to determine congressional intent as it relates to the Council's objectives and responsibilities. We interviewed members of the Council, and its task forces, committees, and subcommittees. We interviewed Council members to solicit their views on the Council's legislative mandate, its successes and failures, and the possibility of its future success. We interviewed task force, committee, and subcommittee staff to determine progress made and problems encountered on various Council projects undertaken by them. We reviewed minutes of Council and task force meetings and examined project status reports, study papers, proposals, and other records, since their inception in March 1979 to December 1982, to determine and assess actions the Council has taken to establish uniform examinations and promote uniformity in financial institution supervision.

We interviewed the initial Council Chairman, a State supervisory agency official who was on a liaison committee to the Council, and officials of banks in New York, Chicago, and San Francisco to obtain their views on the Council and its effectiveness. We interviewed officials from the American Bankers Association and the Independent Bankers Association of America, as well as several State organizations, representing commercial banks.

We identified all mandates and recommendations made to the five supervisory agencies by the Council. We assessed the significance of the Council's actions with regard to its legislative mandate and tested the individual agencies' implementation of them. We interviewed agency officials and analyzed agency records to see if the agencies implemented the Council's mandates and recommendations and to determine how this was accomplished. We verified agency field implementation of Council mandates and recommendations, to the extent possible, in the New York, Chicago, and Atlanta regions. We chose the New York, Chicago, and Atlanta regions because the financial institution regulatory activity in these regions has been relatively substantial and would provide an appropriate environment in which to test agency implementation of Council actions.

In order to determine the amount of agency staff time spent on Council activities, assess staff views on the Council's progress and problems, and identify potential solutions to Council problems, we sent questionnaires to all agency staff who (1) worked on Council projects and activities and (2) the Council was able to identify and locate. Of the 198 questionnaires we sent out, we received 169 completed questionnaires, for an 85 percent response rate.

This review was conducted in accordance with generally accepted government auditing standards.

CHAPTER 2

EVOLUTION OF THE COUNCIL

AND HOW IT WORKS

Because the Federal supervision of the nation's banking system is primarily divided among three Federal agencies--OCC, FDIC, and FRS--there have been many attempts to coordinate the Federal supervision of the banking industry. The first formal interagency coordination committee began in 1952 and functioned until about 1960.

A formal mechanism for coordination was reestablished in 1964, when President Johnson expressed concern about the lack of coordination among the Federal bank regulatory agencies and instructed the Secretary of the Treasury to establish procedures to ensure that the agencies acted in concert and resolved their differences. The procedures were revised in 1965 to set up a Coordinating Committee on Bank Regulation composed of the Chairman of the FRS Board of Governors or a designated Governor, the Comptroller of the Currency, the Chairman of FDIC, and the Chairman of the FHLBB. This committee, known as the Interagency Coordinating Committee (ICC), met at the call of any member, but not less than quarterly.

The next significant development in efforts to coordinate the Federal supervision of financial institutions was the introduction of the Council concept. This concept appears to have originated as a proposal by the Federal Reserve Board's Committee on Bank Regulation and Supervisory Policy. The proposal was outlined in general terms at hearings before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance on July 16, 1975. A Federal Reserve representative pointed out that the disadvantages of the then present system could be read in the number of occasions when voluntary cooperation among the agencies did not produce optimum results. To resolve these problems, he proposed to establish a Federal Bank Examination Council that would be composed of Board members or senior officials responsible for bank examination from each of the three bank regulatory agencies. The distinctive feature of the new Examination Council was that its members would be assigned responsibility for particular areas of bank examination procedures, given decisionmaking power in those areas, and held accountable by their agencies for the development of suitable standards and practices in such areas.

A bill to establish a Federal Bank Examination Council (S. 3494) was introduced in the 94th Congress. The bill was reintroduced in the 95th Congress as S. 711. This bill would have established a Council composed of one representative from each of the three bank regulatory agencies and chaired by the

FRS representative. The expenses of the Council would have been shared equally by the agencies. The Council would establish uniform bank examination standards and procedures; make recommendations for standardizing other supervisory matters; conduct schools for Federal and State bank examiners; and develop uniform reporting systems for banks, bank holding companies, and nonbank subsidiaries.

Its sponsor said that a Council was needed because the three Federal regulatory agencies' bank examination forms and procedures lacked uniformity and thus:

- Complicated the collection of data on the banking system and added to the reporting burden on banks, especially those which were subsidiaries of multibank holding companies, and one Federal agency was not responsible for regulating all of the subsidiaries.
- Produced discrepancies in identifying and supervising problem or failing banks.

To correct these problems, the proposed Council was to

- establish uniform Federal bank examination standards and procedures;
- work out a cooperative arrangement among the agencies for identifying and supervising problem and failing banks;
- better articulate the relationship between State and Federal bank supervision; and
- standardize examination forms and procedures, jointly train bank examiners, and certify State bank supervisory agencies to examine banks instead of Federal examiners.

At about the same time as the Council concept was proposed, several congressional committees, concerned over the failure of two large banks and public disclosure that there were a large number of problem banks, asked us to study the effectiveness of Federal supervision of State and National banks. We identified several areas where the three Federal banking agencies could benefit by working together, sharing experiences about innovations in bank supervision, and undertaking activities jointly or on a reciprocal basis. In our report ¹/ we recommended that

¹/"Federal Supervision of State and National Banks" (OCG-77-1, Jan. 31, 1977).

either the agencies or the Congress establish a mechanism for more effective coordination.

In joint hearings before two subcommittees of the House Committees on Banking, Finance and Urban Affairs and Government Operations, the Comptroller General was questioned as to the advisability of the Congress looking seriously at consolidating the three bank regulatory agencies. The Comptroller General pointed out the specific recommendation in our report that either the agencies or the Congress should establish a mechanism for more effective coordination. The Comptroller General went on to state that:

"Now, I personally believe that legislation on this subject is desirable. We have taken note of the Stevenson bill which would establish a coordinating council. If this approach were taken, it seems to me that the council would need to be strengthened. Instead of a council made up of the three agencies, I would prefer adding at least two more members to that council.

For example, it seems to me that the Federal Home Loan Bank Board, which has a very similar function with the savings and loan associations, might be a member, and there might well be a member representing the State supervisory agencies.

Second, instead of having the council funded by contributions from the three agencies, I would prefer to see it established with its own appropriation so Congress would have an opportunity to provide adequate resources. There is no way of assuring that adequate resources would be provided otherwise, under the arrangement provided for in this bill.

There might be additional ways in which a council approach could be strengthened, but this is clearly one course that it seems to me the Congress might take. I think it is much too important a subject to leave to simply an administrative agreement among the three agencies involved, and I would, therefore, recommend legislation."

In response to our recommendation, the ICC in March 1977 established a permanent staff group entitled the Interagency Supervisory Committee (ISC). The ISC, which was composed of key staff from each of the three banking agencies and the FHLBB, met on a monthly basis and studied areas of mutual interest. In 1977, the ISC was expanded to include the NCUA. As a result of this committee, interagency agreements were reached on numerous

issues, such as the establishment of a uniform bank rating system, uniform consumer examination training, a shared national credits program, and a uniform interagency approach to evaluation and risk criticisms of foreign public sector credits.

FIRA, signed into law on November 10, 1978, was a major revision of several banking laws. The Council, established pursuant to Title X of that act, was intended to be a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions and to make recommendations to promote uniformity in the supervision of financial institutions. The Council was also to develop uniform reporting systems for federally supervised financial institutions, their holding companies, and the nonfinancial institution subsidiaries of such institutions and holding companies. Finally, it was to conduct schools for examiners employed by the five agencies represented on the Council and to make such schools available to employees of State financial institutions supervisory agencies. Overall, it was the intent of the legislation that the Council's actions be designed to promote consistency in Federal examination and to ensure progressive and vigilant supervision.

The Council has five members: the Comptroller of the Currency, the Chairman of FDIC, a Member of the Board of Governors of the FRS appointed by the Chairman of the Board, the Chairman of FHLBB, and the Chairman of NCUA. In addition, to encourage the application of uniform examination principles and standards by State and Federal supervisory authorities, the Council has established, in accordance with the requirement of the statute, an advisory State Liaison Committee composed of five representatives of State supervisory agencies.

The Council was given additional statutory responsibilities under the Home Mortgage Disclosure Act (HMDA) Amendments of 1980 (section 340 of Public Law 96-399, October 8, 1980). The legislation required the Council to (1) implement a system to facilitate public access to data that depository institutions are required to disclose under HMDA and (2) aggregate the annual HMDA data by census tract for each standard metropolitan statistical area.

HOW THE COUNCIL FUNCTIONS

The Council is supported by a small, full-time staff in the Office of the Executive Secretary. Most members of the Council's staff are detailed from one of the five member agencies but are considered salaried employees of the Council. The Council may utilize the personnel, services, and facilities of consenting member regulatory agencies, Federal Reserve banks, and Federal Home Loan banks, with or without reimbursement. The Council may utilize the services of experts and consultants.

Also, the Council was given considerable authority to access information maintained by all its member agencies.

In order to carry out its mission, the Council established the following five interagency staff task forces:

- Supervision (TFS).
- Consumer Compliance (TFCC).
- Reports (TFR).
- Examiner Education (TFEE).
- Surveillance Systems (TFSS).

Each task force includes one senior official from each agency. The Council also established a Legal Advisory Group (LAG) composed of a senior legal officer from each agency. The Council's Executive Secretary is an ex officio member of each task force. The task forces and the LAG provide research and analytical papers and proposals to the Council on applicable issues. The task force members work on Council projects in addition to their normal line responsibilities at their respective agencies.

Council members appoint each task force chairperson to serve for a 1-year period. The decisions of the task force are made on the basis of a majority vote by its members. The task forces make recommendations to the Council concerning their areas of responsibility or establish Council policy through delegated authority. The time spent on task force activities is on an as needed basis, but regular monthly meetings are usually scheduled. The task forces carry out activities through individual projects which are proposed by the Council, individual Council members, or by the task forces themselves. The support services for these task force projects are shared among the Council members working on these groups. Developmental work may also be performed by the Council's professional staff, special study groups, and private consultants.

Each task force typically has several active projects at all times. The combined activities of the five task forces may typically involve 20 to 30 active projects at any one time. The TFS has the largest number of projects. The project staffs report to their respective task forces and present papers, studies, recommended positions, etc., for task force consideration. Project results are then evaluated by the task forces, and votes are taken on whether the results should be presented to the Council for consideration.

We identified 156 projects undertaken by the Council's five interagency task forces from March 16, 1979, to December 31, 1982. This does not include 35 LAG projects which were undertaken to support the activities of the five Council task forces. The results of the LAG projects are substantially reflected in the results of other task force projects. The 156 task force projects as of December 31, 1982, can be categorized as

- 92 projects completed with agreement reached by task force and/or Council members to either approve or disapprove some product associated with a specific project effort;
- 19 projects currently being considered by Council task forces;
- 15 projects terminated without submission of a product to the Council;
- 11 projects suspended pending further developments, which may or may not lead to progress toward future completion;
- 10 projects continuing without a specific completion date or products targeted;
- 8 projects combined with other projects; and
- 1 project reassigned to a study group and given special Council attention because of complex issues which cross-cut task force expertise.

A completed task force project does not necessarily result in a corresponding Council action. Typically, task forces complete projects by developing proposals which are subsequently considered by the Council. Normally, if the Council votes to approve the task force proposal, it becomes a Council action. However, a completed task force project may lead to no Council action or multiple Council actions.

We identified 91 total Council actions from the Council's inception to December 31, 1982. Eleven Council actions which establish uniform principles, standards, or report forms for the examination of financial institutions were approved under section 1006(a) of FIRA and were required to be implemented by member agencies. The Council has taken 11 Council actions under this section of the law.

Section 1006(b) states that the Council shall make recommendations for uniformity in supervisory matters. Twenty-five Council actions have been recommended to the agencies for implementation under this section of FIRA. When a recommendation of the Council under section 1006(b) is found unacceptable by one

or more of the member agencies, the agency or agencies are not required to adopt the recommendation but must notify the Council of its reasons for not adopting the recommendation. The Council has also made three recommendations to the Congress under this FIRA section.

Recommendations made by the Council under section 1006(c) of the act relate to the development of uniform reporting systems for the Federal supervision of financial institutions, and are not considered to be mandatory actions by the member agencies. The Council has recommended 13 section 1006(c) actions for agency implementation.

In addition to the 49 required and recommended Council actions directed for agency implementation and the 3 Council recommendations offered for congressional consideration, the Council has taken 39 other actions. Nine of these other actions were implemented under section 1006(d) and dealt with examiner education issues, such as the approval of student facilities, training courses, staff, and funding for the Council's school. The remaining 30 Council actions do not relate to a specific section of the act and cover a wide range of Council matters. A sample of these actions includes Council approval of annual reports, staff studies, surveys, resolutions, and Federal Register drafts for public comment.

COST TO OPERATE THE COUNCIL

In any discussion of the cost of the Council, a distinction must be made between the reimbursed cost to operate the Council and the nonreimbursed cost to the agencies to support the Council's activities. Each agency pays one-fifth of the assessed costs and expenses of the Council through semiannual assessments based on the Council's projected budget for a given year. Additional assessments can be made during the year, if necessary. In addition, the agencies incur other costs by allowing their staff members to provide unreimbursed support assistance on Council projects and activities and by paying tuition and rental fees for lodging when their examiners attend the Council school.

The assessments pay for the administration of the general operations of the Council while tuition revenues offset education costs. The income from the Council's lodging facilities fully meets lodging expenses without funding assistance. The Council maintains three separate accounts for the areas of operations, lodging, and examiner education. Information from the Council's financial statements indicates the expenses and revenues of the Council are as follows:

	CALENDAR YEAR			
	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Revenues				
Assessments		\$ 213,280	\$ 568,650	\$ 875,000
Rentals		1,312,600	1,505,052	957,498
Tuition		<u>136,925</u>	<u>421,975</u>	<u>83,665</u>
Total Revenues	<u>\$237,322</u>	<u>\$1,662,805</u>	<u>\$2,495,677</u>	<u>\$1,916,163</u>
Expenses				
Operations		\$ 256,942	\$ 590,207	\$ 773,374
Lodging facilities		1,290,939	1,504,590	957,646
Examiner education		137,946	383,524	44,957
Property additions and unfunded accrued annual leave		<u>28,401</u>	<u>2,245</u>	<u>5,594</u>
Total Expenses	<u>\$ 89,162</u>	<u>\$1,714,228</u>	<u>\$2,480,566</u>	<u>\$1,781,571</u>
Revenue over Expenses	<u>\$148,160</u>	<u>\$ (51,423)</u>	<u>\$ 15,111</u>	<u>\$ 134,592</u>

The Board of Governors of FRS provides administrative support to the Council on a cost-reimbursable basis. Other member agencies provide office space and data processing services on a cost-reimbursable basis.

The Council reimburses member agencies for the cost of salaries, employee benefits, and travel expenses of personnel who perform administrative, clerical, and instructional functions for the Council. Member agencies are not reimbursed for the cost of personnel who serve as Council members and for participants who work on the various task forces and project groups. The costs associated with the direct administration of the Council are reflected in the Council's budget. The value of the contributed services expended on behalf of Council-related projects are not reflected in the Council's budget or financial statements.

Council's cost increases considerably
when support staff cost is added

The cost to operate the Council is greater than the \$4.3 million reported in the Council's operating budgets for calendar years 1979, 1980, and 1981. We estimated the cost of support staff provided by member agencies to be about \$2.3 million for calendar years 1979, 1980, and 1981. It is important to include

support costs when calculating the total cost of the Council, since these task forces and project groups do extensive research and investigative work for the Council and are responsible for preparing report and policy recommendations for the Council members.

The Council does not maintain any data on the costs incurred by agencies for providing support staff to the Council. To estimate the cost of providing agency staff for Council activities, we sent a questionnaire to agency employees who are or have been assigned to Council projects and task forces. According to the responses, the typical task force participant has spent about 14 or 15 percent of his or her time on Council activities for 2 or more years. Our estimate of support staff salaries was calculated by multiplying the average time spent per agency staff member by his or her average salary for each calendar year.

We consider our estimate to be conservative because (1) we only included costs for respondents who provided the information necessary to formulate this estimate; and (2) our estimate does not include overhead expenses, the cost of clerical staff, or supplies used by these Council participants. The following chart shows the increased cost of the Council when the support staff estimate is added to the Council's budgeted expenses.

	<u>CALENDAR YEAR</u>			
	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>Total</u>
Council budgeted expenses	\$ 89,162	\$1,714,228	\$2,480,566	\$4,283,956
GAO estimate of support staff studies	<u>639,975</u>	<u>835,434</u>	<u>792,617</u>	<u>2,268,026</u>
Total	<u>\$729,137</u>	<u>\$2,549,662</u>	<u>\$3,273,183</u>	<u>\$6,551,982</u>

Council staff, support staff, and expenses declining

The Council's staff is a combination of permanent full-time employees and agency employees who volunteered or were assigned by their agencies to work on Council projects and activities. In calendar year 1979, the Council had four full-time staff members. The Council staff continued growing until a total of 13 employees were working at the Council headquarters and

Rosslyn, Virginia offices by 1982. The Council identified 198 agency employees as having worked for the Council during 1979, 1980, or 1981 for varying periods of time.

During 1982, the Council began cutting back some of its expenses. When considering the 1983 budget, the Council voted to reduce the Council staff to nine positions with expenses budgeted at \$1,943,219. The following reasons were given for the cutbacks.

- The Council cutbacks were part of the overall reduction in expenditures for the member agencies.
- The Council needed to eliminate staff positions in areas where work had been completed or postponed because of the lack of agreement among the agencies.
- The Council reduced staffing because it felt that task forces were often expanding the scope of assigned work without the consent of Council principals.
- The current problems and issues in the banking industry keep participants too busy working on their own agency problems to work on Council projects.

CHAPTER 3

THE COUNCIL HAS MADE LITTLE PROGRESS

IN ESTABLISHING UNIFORM EXAMINATION

PRINCIPLES, STANDARDS, AND REPORT FORMS

One of the principal objectives of Federal supervision of financial institutions is to maintain a safe and sound financial system. The principal mechanisms for accomplishing this objective are to (1) monitor the activities of the financial institutions through on-site examinations, (2) identify any weaknesses in their operations, and (3) obtain correction of the weaknesses by reporting their findings to the institutions and by other, more stringent, actions as necessary.

One of the Council's most important congressionally mandated goals is to establish uniform examination principles, standards, and report forms. The key project undertaken by the Council to achieve this goal was a study of the conceptual differences in the examination philosophies and approaches of the five agencies. Originally, it was anticipated that this project would be completed in about 1 year and lead to uniform examination principles and standards. After more than 3 years of extensive effort, little progress had been made and the project was terminated. Furthermore, since examination principles and standards are not uniform, the Council has not been able to develop uniform examination report forms or training courses.

Eleven actions involving examination principles, standards, or report forms were approved and mandated to the agencies under FIRA, Title X, section 1006(a). However, nine of these actions were made in response to recent legislation that mandated uniform compliance by the financial institutions or their regulators.

INSTITUTION SAFETY AND SOUNDNESS IS DETERMINED THROUGH COMMERCIAL EXAMINATIONS

Although the member agencies have numerous responsibilities, all of the agencies are primarily concerned with the safety and soundness of the institutions that they regulate. The on-site examination process is the principal fact-finding arm used in discharging that responsibility. Federal regulators use various types of examination programs to meet their responsibilities. The most common type of examination is called a "commercial" or "safety and soundness" examination and is used to analyze such financial institution operations as deposit-handling, loan-making, securities investment, liquidity, capital

adequacy, earnings, and management. Commercial examinations are also used to monitor internal controls, policies, procedures, and compliance with laws and regulations. Additionally, the regulators have developed special programs for examining trust and international departments, electronic data processing services, and compliance with consumer protection laws and regulations. Some of the agencies conduct separate examinations for their special programs while other agencies combine some or all of their special programs with their commercial examination. The regulatory agencies spend the vast majority of their resources on commercial examinations.

The Congress, in establishing the Council, emphasized the need for uniformity and improvements in determining the condition and performance of financial institutions. Since commercial examinations are the main vehicle for determining financial condition and performance, uniformity in commercial examination principles, standards, and report forms is essential to realizing the congressional expectations concerning Title X of FIRA.

A MAJOR TFS STUDY
ILLUSTRATES COUNCIL PROBLEMS

The Task Force on Supervision (TFS), in attempting to address commercial examination uniformity, established the Subcommittee on Examination Philosophies, Concepts, and Procedures which intended to lay the groundwork for establishing uniform commercial examination principles, standards, and report forms. We selected this comprehensive study for in-depth discussion because it was critical to accomplishing the Council's mission and because the study clearly illustrates key underlying problems that have faced the Council.

TFS's Study of Examination Philosophies,
Concepts, and Procedures

This study, begun in May 1979 and terminated in August 1982, is generally considered by Council members to be the most significant TFS project in terms of its attempts at establishing examination uniformity. It was intended to lay the groundwork for establishing uniform examination principles, standards, and report forms. The study was to be done in two phases. The first phase was to identify each agency's examination philosophies and concepts in the following five areas: (1) inherent agency characteristics which influence its examination program, (2) broad policy directives, (3) examination planning and control, (4) use of sampling in the examination, and (5) structure and use of examination workpapers. The second phase was to identify and attempt to establish uniform examination policies and procedures by functional area.

The first phase began in May 1979 and was to be completed in 6 months. However, this phase was not completed until late 1980. In April 1981, the Council established a special task force to study the degree to which uniformity was feasible and to develop a uniform format for commercial examination reports. This second phase, focusing on examination policies and procedures by functional area, was never completed.

Almost from the study's beginning, major differences in significant examination and supervision areas surfaced among the agencies. The following is a synopsis of the most important issues which remained unresolvable at the study's end, as presented in the subcommittee's final report to the Council.

Differences in agency characteristics influence its examination program

The study subcommittee found that certain agency and constituent institution characteristics caused differences in examination approaches. It concluded that these differences were often not conducive to compromise short of legislative changes. First, the agencies supervised several different types of institutions with varying purposes and characteristics (savings and loans, credit unions, and banks). Also, there were significant differences in the legal framework (laws and regulations) among these institutions, depending upon the type of institution and source of its charter. For example, some agencies shared regulatory authority with State supervisors while others exercised sole authority over their supervised institutions. The agencies' own purposes and functions were also a source of difference. For example, the FHLBB functioned as savings and loan charterer, insurer, liquidity provider, and promoter of housing. The FHLBB believed that this was a unique role, different from the Federal bank supervisory agencies. Two other important differences were the size and operating environment of the institutions supervised. For example, the FDIC and NCUA supervised essentially small, domestic institutions while the OCC supervised substantially large, multinational organizations.

Differences in broad policy directives

The study subcommittee found that differences among the agencies existed regarding the establishment of examination priorities, determination of examination scope, and timing and communication of examination results.

Examination types varied on the basis of the scope of the procedures performed. These examination types ranged from comprehensive scope examinations used primarily for problem institutions to narrower scope examinations, visitations, or other

special purpose examinations. Some agencies placed differing emphasis on examination scope. For example, the FRS, unlike the OCC, utilized a comprehensive scope examination for all regularly scheduled examinations but gave discretion to each Federal Reserve Bank to modify the scope of its examinations.

The agencies differed somewhat in their use of separate examinations and examination reports for trust, electronic data processing (EDP), holding company inspections, and consumer compliance areas. These specialty examinations could be conducted simultaneously with the safety and soundness review or they could be done separately. For example, the FHLBB conducted its specialty examinations with its safety and soundness examinations, whereas the FDIC and FRS often conducted specialty examinations separate from safety and soundness examinations.

Generally, all the agencies examined problem institutions more frequently and comprehensively, but frequency guidelines differed somewhat among the FRS, FDIC, and OCC. Also, the OCC and NCUA frequency guidelines considered the institution's size. In problem institutions, most agency policies required examiners to physically meet with the institution's board of directors, but policies differed regarding when such a meeting was required.

Differences were noted in the way that the Federal agencies coordinated their examinations with State authorities. The FDIC, FHLBB, and FRS conducted some joint and concurrent examinations with various State regulators; FDIC and FRS conducted "divided" or "alternate" examinations with some States. The NCUA relied more heavily on State-performed examinations for its State-chartered credit unions.

Differences in examination planning and control

The study subcommittee found that differences existed in the following areas:

1. Surprise versus nonsurprise examinations--Some agencies preserve the element of surprise in scheduling examinations so institutions would not hide adverse conditions or wrongdoing. The FHLBB and OCC did not view surprise in the examination as essential and, therefore, notified institution management of upcoming examinations. The FRS and NCUA shared this view but still examined on a surprise basis in most examinations which involved smaller institutions. The FDIC used the nonsurprise option only on larger, "clean" banks and only with agency management's prior approval.

2. Review of internal controls and audits--The agencies used different procedures and techniques to review internal

controls and audits. For example, some agencies used internal control questionnaires as part of the evaluation of internal controls and expanded their examination scope early on if weaknesses were found.

3. Management information requests (litigation, contingencies, etc.)--FDIC's examiners were encouraged to hold special information requests to a minimum. The NCUA did not request prepared data other than computer generated data when available. The FRS ordinarily requested certain preliminary data. The OCC and FHLBB utilized extensive management information requests.

Differences in control of the examining team and work performed

The study subcommittee found that the following differences existed among the agencies:

--FRS: basic examination policies were communicated primarily via policy directives, and the examiner-in-charge determined examination scope and procedures to be followed.

--FDIC: made limited use of standardized examination procedures, and examiners had considerable flexibility to tailor examination procedures.

--OCC: had the most detailed and structured examination program with procedural instructions that not only indicated examination and verification procedures but also aided in formulating judgments and conclusions.

--NCUA and FHLBB: procedural instructions were not as highly formalized as OCC's, but instructions amounted to minimum procedures to be performed.

Differences in the use of sampling in the examination

Examiners selected items for review during an examination using either the judgmental selection process or the statistical sampling process. The study subcommittee found that there were two different views on the use of statistical sampling. One held that statistical sampling achieved the same quality of results as judgmental selection but included fewer items to be reviewed. The other view was that the random selection feature of statistical sampling eliminated the negative bias which those agencies believed existed within judgmental selection, thereby permitting a more objective evaluation of the item universe. The FDIC and FHLBB used judgmental selection primarily. The

NCUA and FRS used judgmental and/or statistical sampling depending upon the circumstances. The OCC used statistical sampling in almost all examination areas.

Differences in the structure and use of examination workpapers

The study subcommittee found that there were differences in agency approaches regarding standardized formats and the detail and volume of workpaper documentation. Basically, these differences related to the agencies' differing attitudes towards examination control and the most effective and efficient method to carry out examinations. One approach used step-by-step procedures and specific documentation requirements on decisions made. The other method provided policy-oriented instructions, with formal and on-the-job training programs giving procedural guidance.

The NCUA, FHLBB, and OCC had more standardized basic workpaper forms than the FRS and FDIC. The OCC required substantial documentation of evidence which supported examiner report comments. The FRS and FDIC used a less formal and extensive workpaper format.

Other study subcommittee results

In April 1981, the study subcommittee presented a progress report of its work over the preceding 2 years on "the application of uniform examination principles and standards." The report suggested that the agencies were basically compatible in terms of "examination objectives and policies," but that they were a long way from uniformity in the techniques and mechanics of "examination methods" or procedures. The subcommittee requested guidance from Council principals and suggested two alternatives: (1) begin an immediate, comprehensive effort to standardize all examination activities of the agencies or (2) concentrate initially on achieving uniformity of examination objectives and policies, with a more gradual effort to develop uniform procedures. The TFS recommended the latter alternative since it provided more time to test and experiment and the costs involved would be less burdensome. The Council found neither alternative an optimum solution because it felt that the first alternative was too ambitious and the latter alternative unacceptable given the directive of FIRA's Title X.

The Council, as a result of the problems noted above, established a special task force within the TFS to prepare, within 120 days, (1) a progress report which would provide a blueprint spelling out the degree to which uniformity was feasible in some 30 functional examination areas and (2) a paper outlining the basic core elements that should be contained in a uniform commercial examination report.

The TFS, in response to the Council's directive, planned to address this charge through a three-phased approach. The first phase involved the establishment of uniform examination objectives in the 30 functional areas. This list of examination objectives was approved by the TFS in January 1982.

The Council recommended that the objectives be adopted by all five agencies in February 1982. The objectives approved by the Council appear to have contributed little to the establishment of examination uniformity. In fact, we found the following with respect to actual agency implementation of the adopted objectives: (1) the OCC made no changes in its existing objectives since they were substantially identical and the differences were only editorial; (2) the FDIC did not issue the list of objectives since they were already incorporated in its examination manual and instructions, directly or by inference; and (3) the FHLBB has taken no action to implement the objectives. Furthermore, Council principals felt that the objectives would only be applicable to comprehensive examinations, while the agencies were increasingly performing examinations of more limited scope. In approving the objectives, the Council inserted language which allowed deviation from the objectives in appropriate circumstances.

In undertaking the second phase of the project, an attempt was made to develop a uniform approach to the loan portfolio examination function (including objectives, policies, and procedures). It was intended that the principles and standards developed would serve as a blueprint for establishing uniformity in other functions of the examination. The project was tabled in early 1982 after extensive member agency disagreements on various project aspects could not be resolved.

Two key points were generally expressed by the member agencies in commenting on the project's summary paper to the Council. The first was that development of uniform examination policies and procedures should be subject to a cost/benefit test and result in an improved examination process. The agencies noted that budgetary constraints affected their onsite examination programs and that this condition had been worsened by current problems in the financial services industry. Due to these problems, the agencies felt that their ability to expend substantial time and resources on developing more uniform approaches was severely limited. The second point generally expressed was that current examination procedures were considered satisfactory and that implementing changes to programs "would be very disruptive and perhaps detract from an agency's ability to carry out its examination responsibilities effectively."

In February 1982, the TFS reported to the Council that after reviewing the results of the Loan Portfolio Management Project, "the project did not produce a uniform set of procedures

or methods, and that further efforts to develop common procedures or methods in the remaining functional areas would be unproductive." Furthermore, the TFS

"* * * expressed serious reservations about proceeding beyond the level of uniform examination objectives and suggested that future efforts should concentrate on achieving uniformity in specific areas of supervisory concern where general agreement is likely, rather than attempting major overhauls to present agency examination programs before an evaluation is made of the costs and benefits of such significant changes."

Most of the Council principals agreed with this point of view in that although they felt that the issues were resolvable, the agencies have limited staff and were unable to dedicate sufficient resources to address the issues given current circumstances. As a result, the Council adopted the course recommended by the TFS and, in April 1982, dropped the project. In a letter to the Council's Executive Secretary, the Chairman of the Council recommended that:

"* * * the project should be tabled, and that we should follow the Task Force recommendation to proceed with ad hoc tasks that have higher priority or seem more likely to result, without undue effort, in a consensus view."

Council principals, agency senior management, and others who were involved gave various reasons for the TFS's failure to achieve meaningful progress in establishing uniform examination principles, standards, and report forms. These reasons included bureaucratic turf problems, lack of cooperation, failure to communicate (statements made by a Council principal), and the agencies' inability to divert scarce and valuable resources given budget constraints and pressing financial industry problems.

GAO identified issues that
needed to be resolved through
the Council

Prior to the commencement of the TFS study, GAO had begun a review to assess the changes made in Federal examinations by the Federal bank regulatory agencies since 1976. In this review ^{1/} we limited the scope of our work in order to avoid duplicating or inhibiting the Council in conducting its study. As a result of our review, we made a number of recommendations to the

^{1/}"Federal Examination Of Financial Institutions: Issues That Need To Be Resolved" (GGD-81-12, Jan. 6, 1981).

Council concerning the need to develop certain examination principles and standards. Specifically, we recommended that the Council:

- Develop criteria for Federal regulators to assess the quality of examinations performed by State agencies and monitor the States' examination programs to assess changes which may affect the acceptability of the States' programs for Federal needs.
- Develop a Federal Government-wide policy under which Federal regulators, using the above criteria, would assess and monitor the quality of State examinations and accept examinations that are competently performed by State agencies in lieu of their own. The Government-wide policy should authorize Federal regulators to make special examinations of any State-chartered financial institutions whenever in the judgment of the agency such examinations are necessary. The policy should emphasize that the special examination authority should only be utilized in exceptional cases and should not be used to perform regular periodic examinations of the institutions.
- Develop a system for determining the timing of examinations which is based on a perceived need to examine, rather than on the basis of a static time frame.
- Develop examination standards which limit the amount of detailed work performed during a routine examination unless potential problems are detected.
- Develop examination principles which require Federal examiners to rely on functions adequately performed by others, such as internal and external audit and internal loan review departments. The Council should develop criteria for testing and assessing the quality of these systems before the agencies could rely on them.
- Develop uniform standards for reporting the results of examinations which limit the amount of detailed data to that which is necessary for effective supervision.
- Define the various regulators' supervisory role, in particular as it relates to the routine and systematic examination of management in financial institutions without unsafe and unsound financial conditions.
- Define, with the guidance of the congressional legislative oversight committees, how forcefully the regulators should promote the establishment and maintenance of sound management.

- Prescribe uniform principles and standards consistent with the above identified supervisory role and commensurate with an acceptable level of risk and costs.
- Include in its prescribed principles and standards the requirement that Federal regulators develop examination procedures that clearly identify (1) examination objectives; (2) examination tasks required to achieve the objectives; and (3) documentation required to fully support report comments, conclusions, and recommendations and to provide a basis for supervisory review.

In response to these recommendations, the Council stated that:

- With regard to the first two recommendations concerning State examinations, the TFS was asked to explore ways in which the agencies could place greater reliance on examinations of banks and thrift institutions performed by States.
- The remaining recommendations would be appropriately addressed upon completion of the TFS's Examination Philosophies Study.

The Use of State Examinations by Federal Supervisory Agencies Project was dropped on June 23, 1981, within 30 days of its start. In explanation for dropping the project, Council records state that the "sense of the Task Force seemed to be that the issues have already been appropriately addressed." While some of the member agencies have taken some actions individually on our recommendations, the Examination Philosophies Study did not successfully address our recommendations.

COUNCIL'S MANDATORY AUTHORITY
UNDER TITLE X LITTLE USED

Section 1006(a) of FIRA, Title X authorizes the Council to establish uniformity in the examination principles, standards, and report forms of all member financial institution regulators. However, from its inception in 1979 through year-end 1982, only 11 out of 91 Council actions have been mandatory.

Relatively recent congressional legislation other than FIRA's Title X has been used as the basis for most Council actions requiring agency compliance. The Council's decisions to use section 1006(a) to implement these actions were made without difficulty because the Congress mandated essentially identical responsibilities on each agency.

Other legislation provided
impetus for Council action

In 9 out of the 11 Council section 1006(a) actions, congressional legislation, other than FIRA's Title X, provided the incentive for the Council to act. Specific provisions of these legislative enactments required Federal regulators to ensure compliance with the implementing Federal regulations. The following nine section 1006(a) Council actions were prompted by the need for its member regulatory agencies to comply with relatively recent legislative requirements:

- Uniform interagency examination procedures for determining institution compliance with the Electronic Fund Transfer Act of 1978 (15 U.S.C. § 1693 et seq.):

Electronic fund transfer refers to a transaction initiated through an electronic terminal, telephone, computer, or magnetic tape that instructs a financial institution to either credit or debit a customer's asset account. The act's primary objective is the protection of individual consumer rights in their dealings with participants in electronic fund transfer systems. The examination procedures are for determining financial institution compliance with Federal Reserve Regulation E which implements the act. The Council-approved uniform procedures consist of a list of eight examination procedures and an examiner's checklist for the regulation. The procedures include reviews of various policies, agreements, forms, statements, internal controls, and consumer complaints.

- Uniform interagency examination procedures for determining institution compliance with the Right to Financial Privacy Act of 1978 (12 U.S.C. § 3401 et seq.):

The act establishes specific procedures for Federal Government authorities which seek information from a financial institution about a customer's financial records. It also imposes limitations and duties on financial institutions prior to the release of information sought by government agencies. The Council-approved examination procedures for determining compliance with the act consist of a list of seven procedures and an examiner's checklist. The procedures include reviews of financial institution request handling procedures, internal controls, and record-keeping activities.

- Uniform interagency examination procedures for determining institution compliance with the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. § 2601 et seq.):

The act's purpose is to provide borrowers with pertinent and timely disclosures regarding the nature and costs of the real estate settlement process and to protect borrowers against certain abusive practices. The Council-approved examination procedures consist of a list of 13 procedures and a general questionnaire. The procedures include reviews of financial institution policies, procedures, practices, forms, and statements related to the act's requirements, and compliance with its prohibitions and limitations.

- Uniform interagency examination procedures for determining institution compliance with the Flood Disaster Protection Act of 1973 (42 U.S.C. § 4001 et seq.):

The act's objective is to provide adequate amounts of federally subsidized flood insurance to owners of improved real property located in flood hazard areas of communities that participate in the National Flood Insurance Program. Also, it attempts to reduce or avoid future flood losses and to provide a preventative alternative to massive doses of Federal disaster relief funds normally made available to flood stricken areas. The Council-approved examination procedures consist of a list of five procedures and a checklist. These procedures include a review of an institution's flood insurance policies, internal controls, records, notices, borrower acknowledgments, loan files, and previous violation correction steps.

- Uniform interagency examination procedures for determining institution compliance with the Fair Credit Reporting Act (15 U.S.C. § 1681 et seq.):

The act is designed to regulate the consumer reporting industry; to place disclosure obligations on users of consumer reports; and to ensure fair, timely, and accurate reporting of credit information. The Council-approved examination procedures consist of a list of procedures and a checklist. The procedures include a review of a sample of an institution's rejected loan files and discussions with appropriate lending personnel.

- Uniform interagency examination procedures for determining institution compliance with provisions of the Economic Recovery Tax Act of 1981 (26 U.S.C. § 128):

These provisions of the act authorize depositors a maximum lifetime exclusion of \$1,000 to \$2,000 from gross income for interest earned on All-Savers Certificates (ASCs). The Depository Institutions Deregulation Committee adopted regulations that permit federally insured

financial institutions to issue deposits that enable depositors to profit from the tax benefits of ASCs. These regulations impose limitations on the issuing institution with respect to the use of deposit funds derived from ASCs. The Council-approved procedures are used to verify financial institution compliance with the act and attendant rulings. They consist of a list of eight procedures and certain related definitions. The procedures include a review of an institution's ASC-related policy statements, internal control procedures, advertising circulars, compliance certification, and supporting documentation.

--Uniform procedures for testing compliance with financial recordkeeping and reporting regulations of the Bank Secrecy Act of 1970 (12 U.S.C. § 182gb; 31 U.S.C. § 5311 et seq.):

The act requires that certain large currency transactions and interests in foreign financial accounts be reported to the Federal Government for use by Federal law enforcement and regulatory authorities in (1) tracking the financial resources associated with criminal activities and (2) investigating persons using foreign financial accounts to conceal profits gained from these activities. The approved examination procedures for testing compliance with the act are composed of two modules which are progressively extensive in scope. Module I includes reviews of financial institution operating and auditing standards, methodology, and implementation. Module II includes guidelines for sampling actual transactions and related documentation.

--Uniform interagency examination procedures for determining institution compliance with provisions of the Monetary Control Act of 1980 (12 U.S.C. § 248(a)(2)):

The act requires every depository institution that has certain accounts or deposits to report this activity to the FRS. Such reports are used for the calculation of required reserves and for the construction of the monetary aggregates used by the FRS in the formulation and conduct of monetary policy. The Council-approved examination procedures include a list of five procedures, and certain references, examiner instructions, and forms. The procedures include reviews of a financial institution's internal operating and auditing procedures regarding report preparation control and monitoring, and checks to assure compliance with reporting requirements and accuracy of reported data.

--Uniform examination report for U.S. branches and agencies of foreign banks for use in connection with responsibilities under the International Banking Act of 1978 (12 U.S.C. § 3101 et seq.):

The act gives the three Federal bank supervisory agencies the authority to supervise the U.S. banking operations of all foreign banks regardless of the structure of their banking business in this country. Under the act, the three Federal banking agencies share responsibility for supervising the operations of U.S. branches and agencies of foreign banks. The Council's uniform examination report project originated as an ISC project. The ISC project, in late 1978 through early 1979, focused on developing examination forms and procedures to coordinate implementation of the act's provisions. The Federal bank supervisory agencies were in fundamental agreement on the report as of May 1979, the second meeting of the TFS. A key TFS official said that the ISC had completed a significant amount of developmental work on this project.

The first six of the above required actions deal with consumer-oriented issues which are not directly related to safety and soundness. In fact, these examination procedures are related to areas generally considered to be peripheral with regard to commercial examinations. The remaining three actions, while possibly indirectly related to determining safety and soundness, were not undertaken on the basis that they would make a major contribution to overall commercial examination uniformity. Furthermore, in contrast with major proposals which were considered repeatedly by TFS members and/or Council principals before being acted upon, eight out of nine of these actions were approved unanimously at the task force level under delegated authority with the final proposals merely circulated to Council principals for comment.

Remaining two section 1006(a) actions
have made limited contribution to
commercial examination uniformity

The following two actions account for the Council's remaining section 1006(a) directives:

--Standardized examination policies and procedures for examining institutions participating in the Clearing House Interbank Payments System (CHIPS) developed by the New York Clearing House Association.

CHIPS is a computerized funds transfer network which was developed in 1970 by the New York Clearing House Association to automate and streamline interbank payments in New York City. Since CHIPS operates only in New York

City, applicability of the CHIPS examination procedures is limited to examinations of the financial institutions located in the New York City area.

--EDP examination handbook for use by the three banking agencies in examining data processing centers subject to the 1978 interagency EDP policy statements.

The EDP examination handbook is a guide for examining independent data centers and data processing within financial institutions. The handbook provides the examiner with an overview of common data processing concepts and examples of sound EDP controls and constitutes general interagency guidelines regarding sound EDP internal control practices. The EDP examination, while related to safety and soundness issues, is generally considered a "specialty" examination.

Council principals have said they generally prefer to issue actions under section 1006(b) rather than under section 1006(a)

Comments from top agency officials further illustrate why there are so few section 1006(a) Council actions and why these required actions are of limited significance. Two Council principals said that the reason there are so few required agency actions is because the applicability of section 1006(a) is generally interpreted by the agencies as narrowly as possible. Thus, as one Council principal indicated, if the proposed implementation of a Council action allows for any agency discretion at all, that action is recommended under section 1006(b), rather than required under section 1006(a). One Council principal said that the reason the Council has been successful in requiring some section 1006(a) actions is that recent consumer regulations have given the same responsibilities to each agency, notwithstanding their particular statutory missions.

GAO QUESTIONNAIRE RESULTS SUPPORT LIMITED COUNCIL SUCCESS

The responses on three particular questions from GAO's survey questionnaire provide additional insights on the Council's inability to establish uniform examination principles, standards, and report forms. Agency staff members who had worked or were working on (at the time of the questionnaire) Council projects or activities were asked to what extent the Council has been successful in its attempts to achieve uniformity in examination principles, standards, and report forms. The following chart shows the extent to which those who responded to

our questionnaire believe that the Council has achieved these goals.

	<u>Very great extent</u>	<u>Great extent</u>	<u>Moderate extent</u>	<u>Some extent</u>	<u>Little or no extent</u>
	----- (percent) -----				
Examination - principles (note a)	1	8	32	31	29
standards	1	5	26	29	39
report forms (note a)	0	4	23	23	51

^a/Does not total 100 percent due to rounding.

As can be seen in the above chart, 60 percent or more of the responses in all three examination areas indicate that these agency officials believe the Council has been less than moderately successful in its attempts to achieve uniformity through section 1006(a) actions.

We also asked Council staff the extent to which they felt uniformity could be achieved in examination principles, standards, and report forms through additional Council efforts. The following chart shows the extent to which those who responded to our questionnaire believe that the Council can achieve additional uniformity in those areas.

	<u>Very great extent</u>	<u>Great extent</u>	<u>Moderate extent</u>	<u>Some extent</u>	<u>Little or no extent</u>
	----- (percent) -----				
Examination - principles (note a)	3	15	22	19	40
standards (note a)	3	16	22	21	39
report forms	5	15	20	23	37

^a/Does not total 100 percent due to rounding.

Not only was "little or no extent" the largest single response category in all three examination areas, but approximately 60 percent of all respondents in each examination area believe that the Council will be less than moderately successful in achieving uniformity through additional Council efforts.

Finally, we asked Council staff their opinions as to whether the following factors hindered or facilitated the Council's ability to establish uniform examination principles, standards, and report forms. The following chart shows how they responded.

	<u>Greatly facilitate</u>	<u>Somewhat facilitate</u>	<u>Neither facilitate nor hinder</u>	<u>Somewhat hinder</u>	<u>Greatly hinder</u>
----- (percent) -----					
The existing philosophies of member agency (note a)	1	3	6	35	54
Amount of compromise agency staff are willing to make	2	10	15	45	28
Amount of compromise Council principals are willing to make	3	14	27	36	20

^a/Does not total 100 percent due to rounding.

The above responses indicate that divergent philosophies of member agencies and the unwillingness of agency principals and staff to compromise may have hindered the Council's ability to establish uniform examination principles, standards, and report forms.

CONCLUSIONS

In its attempts to establish uniform examination principles, standards, and report forms, the Council has not been able to achieve agreement among its member agencies. As its primary

effort to establish uniformity in this area, the Council initiated the Study of Examination Philosophies, Concepts, and Procedures. This study, which continued for over 3 years, did not result in any significant gains in uniformity in the examination area.

The Council has approved only 11 actions under its section 1006(a) authority requiring agency implementation. Most of these actions were adopted to implement recent consumer legislation which mandated essentially identical responsibilities on each agency. Generally, none of these actions have resulted in the agencies making significant progress toward the establishment of uniform commercial examination principles, standards, or report forms. Some Council principals have said that the Council tends to implement fewer actions under the mandatory section 1006(a) provision because the agencies prefer to have a choice of whether or not to implement under the more flexible requirements of section 1006(b).

Given these results and the Council's apparent decision to interpret the use of section 1006(a) so narrowly, we believe that the Council has not succeeded in making any significant gains toward eliminating the differences between the agencies in examination principles, standards, and report forms.

CHAPTER 4

COUNCIL ATTEMPTS TO PROMOTE

UNIFORM SUPERVISION

AND REPORTING

Included in the Council's congressional mandates are (1) to make recommendations for uniformity in supervisory matters and (2) to develop uniform reporting systems for federally supervised financial institutions, their holding companies, and affiliated nonfinancial institution subsidiaries. We reviewed the Council's task force projects, studies, other activities, and related Council recommendations to its constituent agencies in order to evaluate its progress in accomplishing these two legislatively established goals. Our review showed that the Council's efforts have resulted in limited success in carrying out these mandates.

COUNCIL ACTIONS DEALING WITH SUPERVISORY MATTERS HAVE SHOWN LIMITED SUCCESS

The Council made 28 recommendations for uniformity in supervisory matters under section 1006(b) during the period from its inception in March 1979 to December 31, 1982. These recommendations dealt with a variety of issues, ranging from relatively minor matters, such as the elimination of a report that was not being used, to relatively significant matters such as the establishment of a uniform policy for assessment of civil money penalties. Three of the recommendations were to the Congress and involved amendments to FIRA. Nineteen of the remaining 25 recommendations made by the Council to promote uniform supervision were accepted by the member agencies; however, six were rejected by at least one agency.

Technical and substantive amendments to FIRA result in three section 1006(b) Council actions

The Council submitted three FIRA amendment actions to the Congress from June 1980 to December 1981. In order to develop these actions, three Council task forces and the LAG contributed staff to review FIRA. The purpose of this review was to develop and submit to the Congress technical and substantive FIRA amendments to improve the efficiency of Federal regulators in administering the statute and to reduce the burden on financial institutions imposed by some FIRA provisions. The three Council actions were comprised of proposals for two technical amendments and one substantive amendment. Although essentially the same,

the Council had to submit its proposed technical amendments twice because the Congress adjourned before considering the first submission.

Technical amendments

Although the LAG considered both technical and substantive amendment issues in its initial review of FIRA provisions, the Council decided that its first proposal submitted to the Congress, on June 26, 1980, would include only technical changes. The Council said that further review was needed to develop changes on more substantive FIRA issues. The initial technical amendment proposal contained 40 technical changes and a section-by-section analysis of these changes to FIRA provisions. According to a Council document:

"* * * several of the proposed changes are merely definitional and typographical; others accomplish procedural changes clearly contemplated by the statute but which are technically deficient or ambiguous under the law."

These technical changes were designed to correct procedural problems which had been encountered by the agencies in implementing and administering some FIRA provisions. In addition, the Council believed the changes would contribute to a more efficient enforcement of the statute. Because of other congressional priorities, however, the Congress adjourned without taking any action on the proposed technical amendment.

In March 1981, the Council reviewed and updated its original proposal and again unanimously recommended that the technical amendment to FIRA be submitted to the Congress. The next proposal, submitted on March 30, 1981, was substantially the same as the first.

Substantive amendment

The TFS had the primary responsibility for developing and the LAG had the primary responsibility for drafting the proposal for a substantive FIRA amendment. Sixteen individual changes were considered by all five member agencies during development of this proposal. These 16 changes included such substantive FIRA issues as the imposition of civil money penalties for trust and consumer law violations and several issues regarding the limits on and reporting requirements for loans to a financial institution's executive officers, directors, or principal shareholders. During the Council voting process, member agencies approved 13 proposed changes (5 by split votes), defeated 1 proposed change, and withdrew from Council consideration 2 other proposed changes pending further review and analysis. Therefore, the final substantive FIRA amendment proposal sent to the

Congress included 13 Council approved changes. Although primarily composed of substantive changes, the proposal also contained three technical changes to FIRA.

As with the technical amendments, the Council felt that the proposed substantive amendment would strengthen and improve the administrative efficiency of Federal regulators and reduce the burden on regulated institutions imposed by some FIRA provisions. Unlike the two previously submitted technical amendment proposals, however, the substantive amendment proposal was not unanimously supported by member agencies. Only the FRS, NCUA, and OCC supported the changes contained in the final substantive amendment proposal. The FHLBB abstained on most of the changes contained in the final substantive amendment proposal. The FDIC took no action on the proposal because, while the FDIC Chairman supported most of the individual changes, he found several to be unacceptable and therefore could not support the package.

Significance of projects

Variance in the significance of Council projects can be seen from the following examples. Although the first project discussed eliminates an unnecessary report, it does not deal with as major an area of supervision as the second project.

1. Council action eliminates a report form

In July 1981, the Council recommended that member agencies amend their regulations concerning physical security devices and programs at supervised institutions. These regulations were originally adopted in 1969 pursuant to the Bank Protection Act. The Council action eliminated the requirement that supervised institutions routinely file standard reports of external crimes with their Federal regulators. The TFS subcommittee which developed this recommendation found that these reports were not useful for their original purpose in formulating policies to assist in deterring external crimes and to apprehend perpetrators. According to the TFS subcommittee, "the data collected have been of minimal value and in recent years have gone largely unused by the agencies."

The standard form was replaced by a simple recordkeeping procedure that would make information on external crimes available for review by examiners. By substituting the informal recordkeeping requirements for the requirement that institutions file a formal Report of Crime, the agencies relieved an administrative burden on financial institutions without detracting from the Federal regulators' ability to supervise these institutions.

2. Supervisory policy for
assessment of civil money penalties

This project, begun in April 1979 and completed in July 1980, resulted in the adoption of a supervisory policy for the assessment of civil money penalties for violations of certain provisions of designated laws. These laws were: The Change in Bank Control Act, the Change in Savings and Loan Control Act, the Savings and Loan Holding Company Act, the National Banking Act, the Bank Holding Company Act, and the Federal Reserve Act. The maximum civil money penalty that may be assessed under FIRA is generally \$1,000 per day for each day the violation continues. The maximum civil money penalty is \$100 per day for a violation of section 19 of the Federal Reserve Act and \$10,000 per day for a violation of the Change in Bank Control Act and the Change in Savings and Loan Control Act. To promote consistency among the agencies, the Council recommended

- procedures for each agency to keep the others informed by exchanging summary information on assessment actions taken or, in the case of the three banking agencies, to exchange detailed reports on such actions; and
- specific factors that the agencies should take into consideration in deciding whether, and in what amounts, civil money penalties should be imposed.

In assessing a civil money penalty, the agencies are required to consider the size of the financial resources and good faith of the respondent, the seriousness of the violation, the history of previous violations, and other matters as required. The policy identifies 13 factors as relevant in determining the appropriateness of a civil money penalty assessment proceeding. Among these factors are: evidence of intentional violation(s), frequency and duration of violations, any loss or other harm to the institution, evidence that participants received financial gain, history of prior violations, and tendency to create unsafe and unsound banking practices.

Problems in developing recommendations
for uniform supervision

We noted that several key projects undertaken to develop recommendations for uniformity in supervisory matters encountered significant problems. Three projects discussed below illustrate some of the problems noted.

TFS project on capital adequacy
did not result in uniformity

The issue of capital adequacy has been a topic of banking agency concern for some time, both before the Council's creation

and during its existence. The Council's forerunner, the ISC, formed a subcommittee in August 1978 to study whether an institution's subordinated debt should be included as part of the institution's capital. In addition, each agency had previously reviewed the issue in depth. In April 1979, the TFS established two subcommittees which were the forerunners of its Capital Adequacy Subcommittee. These two subcommittees were the Definition of Capital Subcommittee and the Subordinated Debt Subcommittee. The Definition of Capital Subcommittee's initial charge, while not precisely delineated, was essentially to develop a uniform definition of "capital", specifically addressing what role capital notes played in a financial institution's capital structure.

The Subordinated Debt Subcommittee's initial assignment was to develop uniform techniques to be used in analyzing subordinated capital notes issued by banks and bank holding companies and to determine whether or not a uniform policy could be reached on (1) maturities of subordinated capital notes, (2) whether they could be sold on an interbank basis, and (3) how they should be reported for financial accounting purposes.

In response to a GAO report ^{1/} and concerns of Senator Proxmire about capital adequacy, the Subordinated Debt Subcommittee was renamed the Capital Adequacy Subcommittee in June 1979 and its charge was expanded to include the review of adequacy of capital in general. In February 1981, after the Definition of Capital Subcommittee did not establish a uniform definition of capital, it was disbanded.

In November 1981, the Council proposed a uniform definition of bank capital for the purpose of determining capital adequacy. The Council vote on this matter was 2 to 1, with the OCC and FRS approving and the FDIC dissenting (the PHLBB and NCUA abstained). The definition of bank capital approved by the OCC and FRS consisted of two elements--primary and secondary capital--as follows:

- Primary capital would consist of common and perpetual preferred stock, surplus and undivided profits, contingency and other capital reserves, mandatory convertible instruments, and 100 percent of the allowances for possible loan losses.
- Secondary capital would consist of limited-life preferred stock and subordinated notes and debentures.

^{1/}"Comparing Policies and Procedures of the Three Federal Bank Regulatory Agencies" (GGD-79-27, March 29, 1979).

Limited-life preferred stock and subordinated notes and debentures are viewed by the Council as having some, but not all, of the characteristics of capital and thus, in the recommended definition, would be considered eligible for consideration as secondary capital only if:

1. These instruments have an original weighted average maturity of at least 7 years.
2. Any serial or installment repayments, once begun, are made at least annually, with each payment no less than the previous one.
3. In the aggregate, such financing considered as capital equals no more than half of the amount of primary capital.
4. The percentage of such financing considered as capital declines by one-fifth each year beginning when it has a maturity of less than 5 years. This would mean that secondary instruments would have no capital value when they have a maturity of less than 1 year. An issue having installment repayments would be treated as a series of distinct maturities for this purpose.

The FDIC, in its official dissenting position, found that the proposed definition, since it included subordinated debt as part of capital, would "obscure the necessity of maintaining an adequate level of equity capital." The FDIC believed that subordinated debt instruments, such as limited-life preferred stock or subordinated notes and debentures lacked permanence, were not available to absorb losses in a going concern and imposed mandatory servicing requirements. The FDIC believed that to the extent that such instruments were used to increase lending and other legal limits, they may increase the level of risk in an institution by decreasing asset diversification and may, thus, trigger a requirement for a greater proportion of equity capital. Furthermore, the FDIC believed that this definition of capital, "without an established standard of adequacy of capital, would be of little value."

TFS's project on capital adequacy was intended to be two-phased, first defining capital and then establishing techniques or standards for evaluating capital. We were advised that when the FDIC rejected the Council's definition of capital, the project was terminated. The OCC and FRS, however, took the Council approved capital definition and developed guidelines to be used in assessing the adequacy of capital in the financial institutions they supervise. Institutions affected by these guidelines were categorized as either multinational organizations (as designated by their respective supervisory agency), regional

organizations (all other institutions with total assets in excess of \$1 billion), or community organizations (less than \$1 billion in total assets). Capital guidelines for the relatively small number of multinational institutions were established and monitored primarily on a case-by-case basis. Banking institutions in the regional and community groupings fell into one of three zones on the basis of their respective total capital base to total assets ratio. These zones were:

	<u>Regional</u>	<u>Community</u>
Zone 1	Equal to or above 6.5%	Equal to or above 7.0%
Zone 2	Above 5.5% but less than 6.5%	Above 6.0% but less than 7.0%
Zone 3	At or below 5.5%	At or below 6.0%

Generally, banking institutions in zone 1 are presumed to be adequately capitalized, for those in zone 2 the presumption is that they may be undercapitalized, and for those in zone 3 the agencies' approach is that there is a very strong presumption that the bank is undercapitalized.

In June 1983, the OCC and the FRS amended these guidelines. These revisions:

- Established a 5 percent minimum ratio of primary capital to total assets for the 17 banking organizations designated by the agencies as multinationals.
- Expanded the definition of primary capital to include the allowance for possible loan and lease losses and minority interest in equity accounts of consolidated subsidiaries.
- Expanded the definition of secondary capital in considering the capital adequacy of consolidated bank holding companies.

The end result of TFS's extensive efforts in the capital adequacy area has not been fully effective when viewed in the perspective of the Council's uniformity mandate. After 2-1/2 years and a significant amount of agency senior staff time expended, a uniform definition of capital was not adopted by all the bank regulatory agencies nor was the Council able to develop guidelines for determining capital adequacy.

Bank holding company
supervision

Bank holding company (BHC) supervision was a priority subject as established by the Council in its initial organizational meeting. In our recent interviews with agency officials, two bank regulatory agency heads and numerous other agency officials said that BHC supervision still needs to be improved to eliminate duplication of effort and other inefficiencies. To evaluate the Council's success in addressing this issue, we analyzed the two specific areas of project activity directly related to BHC supervision. These areas are (1) the BHC Supervision Subcommittee's projects and (2) the Uniform BHC Performance Report (UBHCPR) Project.

BHC Supervision Subcommittee projects--In April 1979, the TFS formed a standing subcommittee to look at short, medium and long term issues affecting the examination and supervision of BHCs. The Council formed this subcommittee to address one of its "functions" pertaining to BHC supervision as required by section 1006(b)(1) of Title X of FIRA, which states in part:

"* * * the Council shall make recommendations regarding the adequacy of supervisory tools for determining the impact of holding company operations on the financial institutions within the holding company and shall consider the ability of supervisory agencies to discover possible fraud or questionable and illegal payments and practices which might occur in the operation of financial institutions or their holding companies."

In late 1979, a Council principal recommended that the Council instruct the TFS to (1) develop proposals for increased interagency coordination in BHC supervision matters and (2) undertake a long-term effort to develop a legislative proposal in the area of BHC supervision. The Council decided that each banking agency would address separately the legislative proposal matter and that the TFS should proceed only with its proposals regarding increased coordination among the agencies. On the basis of our review of Council records and discussions with agency officials involved, we found no evidence that this suggested legislative proposal was ever subsequently formulated or considered. Also, we found that the subcommittee had initiated only two projects from its inception through 1982.

The subcommittee's first project, and its only completed project, began in April 1979 and was encouraged to completion by a GAO recommendation. The final GAO report ^{2/} recommended that

^{2/}"Federal Supervision Of Bank Holding Companies Needs Better, More Formalized Coordination" (GGD-80-20, Feb. 12, 1980).

the Council develop procedures to better coordinate holding company inspections and bank examinations and establish procedures to coordinate and document holding company supervisory actions. The subcommittee proposed two policy statements regarding inter-agency coordination of BHC supervision. The two policy statements were entitled (1) "Interagency Coordination of Formal Corrective Actions By The Federal Bank Regulatory Agencies" and (2) "Interagency Coordination of Bank Holding Company Inspections and Subsidiary Bank Examinations." The Council approved these two policy statements unanimously and the policies were subsequently adopted by the three banking agencies.

The subcommittee's second project, begun in June 1980, was a "continuing" project; it had no specific completion date. This project was initiated to evaluate OCC's proposed "top down" approach to examining banks and BHCs. The evaluation of the top down approach (examining bank subsidiaries through BHC information systems) was conducted for the purpose of ensuring the elimination of redundancies with Federal Reserve inspections. The result was a December 1981 agreement between OCC and FRS entitled "Program for Conducting Examinations of Certain Banking Organizations." Essentially, this agreement provided for the coordination of examinations of certain national banks and their holding companies through annual concurrent examinations by the FRS and OCC of BHCs with total assets greater than \$1 billion and their lead national bank subsidiaries. In late 1982, the FDIC signed a similar agreement with the OCC and FRS. A key Council principal we interviewed expressed doubts about these agreements, especially with regard to their utility when disagreements arise between agencies on specific cases.

Project on uniform BHC
performance report

One of the TFSS's original and primary goals has been to establish a uniform financial surveillance system for banks and BHCs. A uniform financial surveillance system has three parts; information, a screen, and an action system. The information part of the surveillance system is the data report on the financial institution. The screen part refers to the analysis of data provided to identify undesirable or problem situations. The action system refers to what the regulator does about the financial institutions that are identified by the screen as concerns. Although a uniform surveillance system has been viewed as having a high priority, the Council has not succeeded in establishing this system. Furthermore, most senior-level TFSS participants feel that a uniform surveillance system is unlikely in the foreseeable future.

In our review of TFSS activity, we examined each of the TFSS' 10 projects initiated over the past 4 years. The UBHCPR

project illustrates the kinds of problems which have prevented the TFSS from reaching surveillance uniformity. The UBHCPR was intended to be the information part of a uniform BHC financial surveillance system.

The UBHCPR project was begun in July 1979 with the intended goal of establishing a uniform bank holding company performance report. The FDIC, OCC, and FRS each had their own interest for establishing a UBHCPR. Basically, FDIC's interest was in improving financial data on small (under \$50 million total assets) BHCs. The FRS has two BHC financial data forms, the form Y-9 and form Y-6, which are completed by BHCs and submitted to FRS periodically. The Y-9 is a standardized, detailed financial statement which is readily computerized and is used for medium and large BHCs (those over \$50 million total assets). The Y-6, on the other hand, is a one page, free-form document filled out in the manner desired by each BHC and cannot be readily computerized according to key FDIC officials. Since the FRS does not require a Y-9 from small BHCs, the FDIC believes there is a significant lack of financial information on those small parent companies. This lack of information is in the areas of parent company liabilities (borrowing and debt servicing levels) and equity levels. FDIC officials believe that this information is necessary in order to be able to determine a small BHC's overall financial condition, i.e., to consider what would happen to the subsidiary bank if the parent company changed its method of operations. FDIC officials are also concerned with the lack of Y-6 and Y-9 timeliness. The FRS allows BHCs 1 month longer than it allows banks to complete similar reports in order to consolidate parent company and subsidiary data. FDIC officials believe that the BHC and bank data should be submitted within the same time period.

The OCC also has somewhat similar problems with FRS' Y-9 form, in that they are essentially concerned with data timeliness and quality. OCC officials believe these problems with the FRS' Y-9 will become more significant due to current financial industry conditions. OCC officials indicate that they can get better data from the Robinson-Humphrey Company, Inc., a private industry financial analyst, because the FRS information on BHCs lacks certain data and is as much as 4 months old by the time it is received by the OCC. As for data quality, particularly regarding those BHCs with consolidated assets in excess of \$100 million, the OCC believes it needs substantive Y-9 changes which would provide information on average balances, nonperforming assets, asset/liability composition and rate sensitivity detail, and other supplemental summary information on BHC and subsidiary operations. OCC officials believe that the FRS' Y-9 has continuing problems with regard to definitions of item categories. OCC officials indicated that in the present Y-9, mortgage loans may include different types of loans depending on who is doing the classifying.

Key FRS officials agree that a new and improved BHC performance report is needed. The FRS, in considering a UBHCPR proposal made jointly by the OCC and FDIC through the TFSS over 1 year ago, asserted that the proposed increase in data items was unjustifiable. The FRS, citing the Paperwork Reduction Act and Office of Management and Budget (OMB) cost justification requirements, requested that the TFSS postpone development of a UBHCPR while the FRS staff worked on a new BHC report proposal. This postponement has continued and, at the completion of this review, no UBHCPR has been established.

COUNCIL RECOMMENDATIONS HAVE NOT ALWAYS
BEEN ADOPTED BY ALL COUNCIL AGENCIES

The effectiveness of the Council to promote uniform supervision of financial institutions has been diluted because, one or more member agencies found some Council actions unacceptable and did not implement them. Of the 28 section 1006(b) Council recommendations, 6 were rejected by at least one of the member agencies.

FHLBB dissensions

The FHLBB has declined to adopt four section 1006(b) Council recommendations. First, FHLBB officials did not adopt the Council's recommendation regarding a uniform consumer compliance rating system. According to their written statement, FHLBB officials believed that there was no "legitimate need" for changing the way they supervise compliance with consumer laws; the proposed system would be a major administrative burden, and it was not appropriate to establish another recordkeeping system which could not be shared with their regulatees. Second, according to their written statement, FHLBB officials did not accept the Council's uniform Community Reinvestment Act Rating System because it would not have improved their ability to carry out their responsibilities under the act--indeed, they said, it would probably detract from it. They also said that the new system was incompatible with their existing examination and supervisory procedures and it would have required considerable change in their existing procedures to implement in a meaningful way. Finally, the FHLBB did not implement either the Council's recommended Equal Credit Opportunity Act and Fair Housing Act enforcement policy statement or supervisory policy. According to their written statement, FHLBB officials believed that their current policy satisfied the spirit of the Council policy statement and supervisory policy; adopting the Council policy statement and supervisory policy would create an "unnecessary" layer of policy and instructions at the FHLBB; adopting the policy might erroneously imply to staff and regulated institutions that the FHLBB had changed its policy, even though adopting the enforcement efforts; and the existence of two differently worded

policies might create technical problems of interpretation that could jeopardize the FHLBB's ability to secure compliance with formal enforcement actions.

FDIC dissensions

The FDIC has declined to adopt two section 1006(b) Council recommendations. The FDIC did not adopt the supervisory enforcement policy for the Equal Credit Opportunity Act and Fair Housing Act recommended by the Council. According to their written statement, agency officials believed that these statutes leave administrative enforcement to the discretion of the agencies, but the Council's proposed enforcement procedures were "unduly detailed" and did not allow FDIC examiners to exercise their judgment regarding the particular circumstances associated with each corrective action. The FDIC also rejected the Council's recommended definition of bank capital for reasons discussed earlier in this chapter on page 38.

FRS dissensions

The FRS did not adopt the Council's recommendation to impose a mandatory accrual accounting bookkeeping requirement on constituent banks. The FRS, however, adopted a related Council action which recommended a phasing in over time of accrual-based reporting for supervisory purposes affecting federally supervised banks under \$25 million in assets. According to its written statement, the FRS felt that the new reporting requirement would encourage banks to adopt accrual-based accounting systems for internal bookkeeping purposes. Moreover, by not imposing an accrual accounting bookkeeping requirement, the FRS felt that the management of smaller banks would have some flexibility to select the least costly and disruptive method to modify their existing procedures and to accommodate the Council's accrual-based reporting requirement. The FDIC, in a related action, subsequently withdrew its proposed rule change regarding this matter, essentially citing the same reasons. OCC has never withdrawn its proposed rule change regarding this matter.

SOME COUNCIL ACTIONS HAVE ACHIEVED GREATER REPORTING SYSTEM UNIFORMITY AND UTILITY

Council actions to promote uniform agency reporting systems are adopted pursuant to the authority under section 1006(c) of FIRA, Title X. These actions are developed primarily by the Council's Task Force on Reports (TFR). Twenty-eight TFR projects have resulted in 13 Council approved actions over the past 4 years. Six Council actions have improved interagency reporting uniformity in Condition and Income Report forms and instructions; four in trust surveys and reports; one in foreign

loan reports; one in FIRA reporting requirements; and one in mandatory accrual-accounting reporting. All of these actions were implemented by the three banking agencies.

Development of uniform Call Report

Agency officials believe that section 1006(c) actions have produced useful products for the reporting systems used by Federal bank regulators. Most Council principals and top agency officials consider the revisions to the Report of Condition and Income (Call Report) as particularly significant.

The Call Report revisions were achieved despite considerable controversy during their development. Although the reasons for and effectiveness of some Call Report revision actions were challenged by affected banks and banking interest groups, bank regulators persisted in their revision efforts. Banking agency officials say that Call Report revision products will enhance the three Federal banking agencies' capabilities concerning off-site monitoring of individual bank condition and performance.

The need for Call Report revision

The reasons behind the need for revised Call Reports are numerous and complex. Two of the foremost reasons, however, are the changing financial services industry and the development and expanding use by bank regulators of the Council's Uniform Bank Performance Report (UBPR) as a supervisory tool.

The economic environment has undergone recent dramatic changes. Market conditions such as high and fluctuating interest rates, increased competition for deposit-type funds from stock brokerage houses and large retail outlets, and the easing of interest rate restrictions can make a bank's asset and liability management more difficult. In this new and changing environment, therefore, Federal banking regulators feel that new and revised data will provide information needed to identify and predict the impact of new risks on the safety and soundness of banking institutions on a more timely basis.

New supervisory uses of the UBPR by all Federal banking regulators have also required changes in the Call Report. The UBPR is compiled based upon Call Report data. Until 1976, the Call Report was used almost exclusively as a statistical tool. In 1976, the OCC began using the Call Report as a supervisory instrument. Since the development of the UBPR, however, all three banking agencies have begun using the Call Report for supervisory purposes by way of its uniform data contributions to the UBPR. Therefore, since the Call Report provides the source

data for the UBPR, when the Call Reports were being revised a high priority was given to the multi-agency supervisory uses of the data presented in them.

A key problem in the development of the Call Report revision projects was reconciling the differences between the needs of those who advocated offsite supervision and the traditional users of the reports of condition and income (i.e., economists who used the reports for macro analysis of the banking industry). The TFR, which has the responsibility for agency reporting systems, and the TFSS, which has the responsibility for offsite supervisory monitoring systems, attempted to incorporate the needs of each task force into one workable, uniform Call Report format. The initial problem was solved when the two task forces realized that the new supervisory data requirements were not compatible with the old Call Report format. They decided that there was a need for a comprehensive redesign of the Call Report and its attendant instructions. This project was undertaken by the TFR and nine special interagency working groups which examined 16 separate issue areas. Each working group was responsible for submitting to the TFR a final package containing form content, recommendations, burden justifications, and final instructional language. The revised Call Report package was presented to the Council in April 1982. A Council principal remarked that the 1983 Call Report (revision) would be "the greatest modification to the Call Report since 1938."

Approval process delays and limits implementation

Following initial project approval by the Council, it was the Council's goal to move rapidly ahead with the revision project in order to meet the planned implementation date of March 1983. However, several problems developed which both slowed and limited implementation of the revised Call Report.

Near the expiration of the initial comment period, few comments had been received from major multi-national banks or trade associations. For the comments which had been received, a 45- to 60-day extension of the comment period was requested. Moreover, OMB did not want to be rushed in its review of the proposal. OMB was particularly concerned about the increase in the reporting burden for small banks.

Views on how to proceed were divergent, but the Council reached a compromise. It decided that it was necessary to give priority to past due and nonperforming loans, interest rate sensitivity analysis, and contingencies and other off balance sheet items. The Council indicated that this additional information was necessary because it was not currently available in the Call Report filed by a majority of banks. Therefore, the Council voted unanimously to proceed with this "priority

supervisory data" request at the original implementation pace, extend the comment period for 30 days, and delay implementation of the remainder of the revision package to 1984.

Acting as the lead agency, the FDIC submitted its "priority supervisory data" proposal to OMB on August 20, 1982. This initial submission covered only the Past Due Loan Schedule because of the urgent time restraints regarding implementation by September 30, 1982. The FRS and OCC submitted identical proposals for OMB approval. The FDIC expected a response from OMB by August 25th. OMB denied this request on August 27th. Citing a Council press release which gave the public until August 30th to comment on the Council's proposed revisions, OMB disapproved the requests saying they were premature. Among other things, OMB said that the Past Due Loan Schedule should be considered at the same time as the other proposed changes to the Call Report. OMB was concerned that "all of the revisions taken together could aggravate rather than reduce the regulatory problems financial institutions now confront."

Following the disapproval of its initial submission, the FDIC submitted a second request covering "all FDIC-insured commercial banks." The need for this contingency was anticipated by the TFR. Even before the initial round of agency submissions to OMB, the TFR decided that the FDIC should be the lead agency by saying, "The supporting statement prepared by the FDIC should emphasize their need to have these data for all insured banks to lay the groundwork for a possible FDIC override of OMB if necessary." Therefore, in a letter accompanying the second FDIC submission, the FDIC said it might invoke its right under Section 3507(g) of the Paperwork Reduction Act of 1980 to override OMB unless OMB approved the "priority supervisory data" request. The letter said in part,

"* * * the FDIC cannot reasonably comply with the provisions of Chapter 35 of Title 44, United States Code (The Paperwork Reduction Act of 1980) within such sixty-day period because public harm will result if normal clearance procedures are followed."

Moreover, it said,

"* * * we note that the Council's intention in extending the comment period on the proposed revised Report of Condition was to provide additional time for comments only on those portions of the Report not scheduled to be implemented as of September 30."

In accordance with an agreement between OMB and the three banking agencies, OMB approved the request for all three

agencies on September 13, 1982. The agreement stipulated that implementation of the Past Due Loan Schedule be delayed from September 30 to December 31, 1982, and public disclosure be delayed from March 31 to June 30, 1983. Subsequently, OMB approved the other supervisory priority data items for implementation beginning with the June 30, 1983, report.

Banks and trade associations
object to Call Report revisions

Banks and trade associations sharply opposed many of the new Call Report changes. They made numerous critical comments regarding the Call Report revisions during the proposal comment period. Many comments contended that bankers and trade association representatives were substantially excluded from the Call Report revision development process. Additionally, many bankers said that the burden and expense associated with collecting new Call Report data were excessive. Beyond these issues, bankers were concerned about compliance and disclosure requirements. For example, some bankers made the following statements:

- "Inadequate lead time for making changes to information systems will make timely compliance extremely difficult for many banks."
- "The new expanded information contained in the Report (of Condition) could be misleading in its raw form when made available to unsophisticated users, even though it is perceived to be useful by regulators."

Bankers were also concerned that the amount of data collected in revised Call Reports was both inconclusive and inappropriate. For example, some bankers made the following statements:

- "Under the current proposal, the 'eliminated' information (from the previous Call Report) can continue to be requested by one or another of the individual regulators."
- "The collection of vast amounts of data from all offices of an individual bank is no substitute for strong controls and strong management."
- "The amount of data generated for senior bank management is generally a fraction of the amount prepared for submission in the present as well as the proposed Call Report."

The Council made several changes to its priority supervisory data revisions as a result of these bank and trade association concerns. Prominent among them, because of the debate over

increased public disclosure, was deleting the "past due 30 through 89 days and still accruing" category from public disclosure on the new Past Due Loan Report. The Council voted unanimously not to make the Past Due Loan Schedule a part of the Call Report. Instead, it is a separate report filed concurrently with the Call Report in order to ensure its confidentiality.

CONCLUSIONS

The Council's efforts towards promoting uniformity in other supervisory matters and developing uniform reporting systems have met with limited success. Task force projects dealing with other supervisory matters have resulted in 28 section 1006(b) recommendations. These recommendations have encompassed a rather broad range of supervisory issues, some of which may be considered substantive, but most have had relatively minor impact on supervision uniformity because they did not deal with major safety and soundness issues. For example, such actions as technical amendments to FIRA and the elimination of a report form, while resulting in desirable changes, did not represent major improvements in supervision uniformity. All 13 Council approved section 1006(c) actions led to improved reporting system uniformity among the three banking agencies.

CHAPTER 5

LACK OF UNIFORMITY

IMPEDES THE DEVELOPMENT OF

UNIFORM EXAMINER EDUCATION

The Council's Task Force on Examiner Education (TFEE) has been unable to develop and administer a comprehensive examiner education program. Until the Council develops uniform examination principles and standards, it will not be feasible for the Council to administer a uniform interagency examiner education program or conduct a uniform commercial examination course. Unable to conduct a uniform commercial examination course, the Council's training efforts have been relegated to developing peripheral training, i.e., courses on management, data processing, and trusts.

To promote uniformity in the examination of financial institutions, the Congress mandated that the Council conduct schools for examiners and assistant examiners employed by the Federal financial institutions regulatory agencies. The schools are also open to enrollment by employees of State regulatory agencies. To carry out these responsibilities, the Council established the TFEE to foster and supervise the Council's examiner education program. Prior to the Council, each of the five agencies developed their own examiner training program. We noted that each agency often offered courses that appeared to be unique to its regulatory function.

INTENT OF EXAMINER EDUCATION PROGRAM

The enabling legislation provides the Council with broad latitude on how to establish its training schools. Section 1006(d) states that the Council shall conduct schools for examiners and assistant examiners employed by the Federal financial institutions regulatory agencies. The legislative history indicates that the Congress expected the agencies to voluntarily cooperate with each other in administering interagency training, although the Council is not authorized to require that agencies participate in this training. It appears that the Congress expected the Council training to emphasize the safety and soundness of financial institutions and the uniformity and consistency of examinations.

Council establishes educational objectives

The Council placed responsibility for the development of

the examiner education program in the TFEE. The TFEE established specific objectives to carry out its responsibilities. The initial objectives were to

- standardize and consolidate examiner training programs, including commercial examination training;
- identify, plan, and establish training programs to meet future training needs;
- establish appropriate training facilities;
- assist in developing training opportunities for employees of State and foreign financial institution supervisory agencies; and
- act as a forum for the exchange of ideas and information on matters impacting on examiner training.

Educational program modified

The initial education program was directed toward developing training courses for examiners that could be offered on an interagency basis, i.e., conducted in the Council's educational facility by instructors from the five agencies represented on the Council. Experience with some Council courses indicated that benefits were being derived from the uniform interagency training of examiners. These benefits included the coordinated development of a single course which could be used by all of the agencies compared to the independent development of the same course by each of the agencies.

Concerns, however, soon developed about the cost effectiveness of centralizing examiner training in the Washington, D.C., area. Some believed that interagency training could impose additional travel costs on agencies that normally train their examiners in their regions and districts. Also, differences in agency policies on career development were bringing together students with different backgrounds. We concluded that this practice produced problems in course preparation for some teachers and learning problems for some students.

Because of these concerns, the Council shifted much of its educational emphasis from developing and conducting courses for use exclusively by its training facility to the development of courses used either at its facility and at the training facilities of individual agencies. The TFEE currently develops courses that are to be taught on an interagency basis at its training facility. The TFEE also develops courses that are to

be administered at the individual agencies' training facilities, with the contents of these courses being adjusted to meet the special needs of the administering agency.

Envisioned Council training facilities requirements have been modified

The TFEE's training facility objectives had both short- and long-term requirements. For the short term, the TFEE needed facilities immediately to begin teaching its 1980 courses. In addition, the TFEE wanted suitable training facilities to accomplish its long-term training needs. In 1979, the TFEE established a Subcommittee on Facilities to conduct a logistics and cost study regarding physical facilities.

The TFEE recommended that a school be located in Washington, D.C., and that a number of smaller facilities be established in other cities (perhaps three). These regional centers would be utilized to teach a number of basic courses that would not need to draw on instructors from the agencies' Washington offices. Such an arrangement was intended to reduce travel costs for students and relocation costs for personnel assigned to supervise these facilities. The Council, however, agreed to have a central educational facility with the provision that a limited number of offsite courses could be held using existing agency facilities (no permanent staff or facilities for regional courses).

The Council directed the TFEE to identify comparative cost and other factors bearing on the location of a permanent training facility. The TFEE, in turn, directed its facilities subcommittee to prepare a report. Their analysis envisioned a facility composed of residential, training, and administrative elements sized to accommodate the training requirements for a total of about 6,000 Federal and 2,000 State bank examiners. If possible, the subcommittee saw the facility being located on a university campus where library, recreational, and computer areas would be available for use and where classroom and dining areas in excess of university needs could be utilized.

Immediate Council training facility needs were met in 1980 by subleasing classrooms at the FDIC training center in Rosslyn, Virginia. Also, the Council leased a nearby apartment facility to provide reasonably priced housing for students attending Council training. The agencies agreed to reimburse the Council in proportion to their usage of the apartment facility. This arrangement was to be used until a permanent facility could be selected. However, after extensive study, the Council decided to discontinue its efforts to obtain a permanent facility and

continue to sublease the FDIC space and the nearby apartment facility. Also, the Council has conducted some sessions at or near the regional offices of the agencies.

LACK OF UNIFORMITY IMPEDES EXAMINER EDUCATION

We found that the Council has been unable to develop an examiner education program that includes training in the major areas of examination responsibilities because of agency differences in training needs and approaches to examinations, as well as the lack of uniform interagency examination principles and standards. This diversity directly affects the kinds of training the Council can or cannot include as part of their examiner education program.

The regulatory agencies generally have four areas of examination responsibilities--commercial (safety and soundness), consumer compliance, EDP, and trust. We determined that the Council school does not provide examiners with commercial examination training even though commercial examinations represent a majority of the agencies' examination efforts. Furthermore, the Council does not offer training courses in the examination area of consumer compliance but does offer limited training courses in the examination areas of trust and EDP.

Development of a commercial examination course hindered by lack of uniform procedures

Because of differences in the agencies themselves, their differing approaches to examinations, and their differing training needs, the TFEE has been unable to develop a uniform commercial examination course. Initially, Council members agreed that there was a need for a uniform commercial examination course. However, in an April 1981 Council meeting, the Council decided that it made little sense to attempt to develop a uniform examination education program without uniform examination principles and standards. Although Council members agreed that the agencies had compatible examination objectives and policies, they said that they were a long way from achieving uniformity in the techniques and mechanics used in their examinations.

All member agencies basically provide the same training for new examiners during their first 6 to 12 months. This training is a combination of classroom and on-the-job training, with most of the training being concentrated on how to conduct a commercial examination. As examiners move along in their careers, differences in training needs become more pronounced because of the differences in each agency's approach to regulatory functions and differing philosophies.

Other educational courses
have not been developed
because of the lack of uniformity

We have found that the lack of uniform examination principles and standards has had a significant impact on developing other examiner education courses. We analyzed the development by the TFEE of proposed examination courses on consumer compliance and white collar crime and found that the Council has also been unable to develop uniform courses in these common examination areas because of a lack of uniformity and differing approaches to examination.

Consumer compliance course discontinued

Because consumer compliance is one of four basic areas of examination conducted by the financial institution regulators, the TFEE spent considerable time and effort in attempting to develop this course. Consumer compliance was one of the seven courses that the TFEE originally identified for development at the Council school. Between April 1979 and May 1981, the TFEE tested and revised a consumer compliance course several times. Even though the Task Force on Consumer Compliance (TFCC) developed some uniform examination procedures for examining compliance with consumer laws and regulations as required by FIRA, the TFEE and TFCC were unable to translate these laws, regulations, and procedures into a consumer compliance course that was acceptable to all Council agencies.

In August 1981, the Council attempted to modify its approach to examiner training and develop consumer compliance as a core course. The core course approach provided for the Council to develop a uniform set of lesson plans to be used by participating agencies. This concept, however, allows each participating agency to adjust the contents of the course lesson plan to meet the agency's specific needs. This approach also failed, and efforts to develop a separate course were abandoned in June 1982.

Senior Council personnel closely associated with the development of this course indicated it was not accepted because of (1) differing agency examination procedures and (2) differences in the levels of experience of the examiners receiving this training. An examiner education quality assessment report further stated that the course materials received no substantive criticism from any of the constituent agencies. However, the agencies thought it was more beneficial to offer the course individually because each agency provided consumer compliance training at different career path levels for their examiners. Another senior Council official expressed the opinion that the agencies were unwilling to work out a compromise concerning the

consumer compliance course because consumer compliance does not affect the safety and soundness of financial institutions and the agencies are placing less emphasis on consumer compliance examinations.

White collar crime course
cannot be developed

White collar crime was the subject of another course that failed development as a Council course because of a lack of agency uniformity and differing agency approaches to examinations. The OCC and FDIC conducted a joint course on white collar crime in September 1981. On the basis of the results of this joint effort, Council members agreed that such an inter-agency approach to training was not possible. The major difficulty cited was the differences in agency perceptions of their roles in examining for white collar crime.

The Council requested the assistance of the TFS in resolving differences in agency policies and procedures because Council members thought there was a need for a specialized course in white collar crime. However, the TFS could not resolve agency differences. It concluded that putting something together for all five agencies would end up being something that would not fulfill any of the agencies' needs. Moreover, the FDIC and NCUA felt that much of the proposed training did not apply to situations encountered by their examiners. Thus, they felt there was no need to expand on the training their examiners were receiving. The FDIC representative on the TFS did not see a need for a comprehensive course, preferring instead to cover the various related topics, where appropriate, in existing courses.

The TFEF officials indicated they will again attempt to develop courses in consumer compliance and white collar crime that will be acceptable to all agencies once the Council has adopted uniform principles and standards.

COUNCIL'S APPROACH TO EXAMINER
TRAINING HAS HAD SOME SUCCESS

We believe the Council has had some success in providing examiner training. The Council does provide limited training in two of the four examination areas--trust and EDP. However, as discussed above, it has been unsuccessful in providing training in the two examination areas which comprise the major portion of the examinations conducted by financial regulators. Also, the school has been successful in providing courses in management and instructor training, subjects which are tangential to the duties and responsibilities of most examiners but only incidental to the uniformity and consistency of examinations.

The TFEE has been successful in meeting some of the objectives it established for itself and the Council's examiner education program (see p. 51). The TFEE has an ongoing project to develop training programs to meet present and future interagency training needs. Also, the TFEE allows State and foreign financial institution supervisory examiners to attend the Council school and coordinates training matters with the Council's State Liaison Coordinator. Finally, the Council school acts as a forum or clearinghouse for the exchange of training information. To some extent, however, it should be noted that these coordination and communication efforts were being done prior to the Council under the Interagency Supervisory Committee.

The TFEE has been successful in obtaining facilities for the school and in obtaining permanent, full-time professional and support staff. The TFEE has also made arrangements for examiners to have access to reasonably priced lodgings while attending the Council school.

Current approach to examiner training

In 1981, the Council's examiner education program began using a different approach to training in an effort to overcome some of the difficulties it was encountering because of the lack of uniform examinations. The Council decided it should strive to develop two kinds of training curricula: (1) specialized courses involving relatively few people from agency field staffs, and (2) consumer and safety and soundness courses that apply to the majority of examiners. The specialized courses would be taught on an interagency basis while the more basic courses would be decentralized. Specialized courses are interagency courses taught only by the Council which would have total control of the course content. Other courses dealing with consumer and safety and soundness issues would be developed as core courses and taught by the individual agencies and modified to suit each agency's training needs.

In the Council's 1981 Annual Report, the TFEE indicated that it would continue to identify subject areas in which uniform training, either interagency or core, would be appropriate. It did state, however, that its major emphasis in 1982 would most likely be on the development of core material. The TFEE planned to continue this approach until further progress is made in reaching uniformity in examination philosophy and procedures. The Council school plans to continue this practice in 1983, according to the Manager for Education and the TFEE Chairman. The TFEE emphasized that this change in the approach to training examiners is not the end of the Council's cooperative interagency training effort.

Training courses offered
by Council school

The Council's examiner training school offers interagency courses in

- Instructor Training,
- Management Workshop,
- EDP Workprogram,
- Trust Workshop,
- Basic International Banking School,
- Intermediate International Banking School,
- EDP Technology Seminar,
- Bank Municipal Dealers/Municipal Securities Rulemaking Board Seminar, and
- Regulatory Perspectives: International Banking.

The school also offers core courses in the Fundamentals of Data Processing and Basic Entry Level Trust. Prior to the Council, the individual agencies administered courses similar to seven of the nine interagency courses and both the core courses. The remaining interagency courses were recently developed by the Council and reflect changes in technology and the financial environment. These courses represent the successful efforts of the Council to overcome agency differences in approaches to these subjects.

Methodology for development
and evaluation of courses

Once the TFEE has determined a need for a particular course, a development group is assembled to create a course that will be of maximum usefulness to all the agencies. This group is normally staffed by an individual from each agency with the group leader being a recognized expert in the subject being developed. Agencies that are heavy users of a course are more actively involved in the development of that course than an agency which rarely or never uses the course.

Each Council course is developed with formal or informal inputs from the agencies. Agency officials have the opportunity to express themselves concerning the appropriateness of course

materials, lesson plans, class schedules, etc. Specific prerequisites and experience requirements are established for each course, but the agencies' training needs have precedence over these prerequisites and requirements. Course development groups use information from student evaluations to refine and update lesson plans and class materials.

The school has an ongoing effort to assess the quality of each training course. At the end of each session, students are required to complete evaluation questionnaires on the strong and weak points of the course with suggestions for improvements where appropriate. A 1981 report on the quality of examiner training stated that several courses were revised because of low ratings on evaluations. These courses showed higher ratings after being revised.

Future approach to examiner training courses

In a July 1982 interim report on the Council school, the TFEE acknowledged that possibilities for creating additional courses had nearly been exhausted because of a lack of uniform examination standards and principles. It said further course development would only involve the disruptive exercise of attempting to create new courses by taking material from current practical and useful courses. Furthermore, the report stated that if the Council training program is to remain a viable program, it must offer training courses that will supplement the regulators' own training programs.

The most promising avenue of future course development appears to be specialty seminars. It is envisioned that the school will develop and sponsor special topic seminars that will initially be offered on demand. These seminars will be aimed primarily at senior examiners and will feature guest speakers from the private sector. Seminars appear to be a good approach to the future development of examiner training because (1) detailed lesson plans are not needed, (2) seminars can be produced within a very short period of time, and (3) there is often such a small number of examiners who need training in a specific area that it is not always cost effective for an agency to develop a specific course. Seminars can be utilized to expand examiner knowledge in areas related to emerging new examination techniques with a minimum of effort.

In 1982, the TFEE developed, piloted, and approved two seminars--Bank Municipal Dealers/Municipal Securities Rulemaking Board and EDP Technology. The school piloted a third seminar entitled "Regulatory Perspectives: International Banking" in February 1983. The TFEE is currently considering development of

other seminars but emphasized that the future development of Council courses would not be limited to seminars. It indicated that any type of training course will be developed if the benefits of interagency activity exceed the costs.

OTHER ISSUES AFFECTING
EXAMINER EDUCATION

A variety of issues must be considered in the development of an examiner education program. These issues become more intricate when the program being developed must be acceptable to five different agencies with similar examination functions but with differing philosophies and approaches to examinations. Some of these issues have already been discussed in this chapter, but there are other important issues that affect the Council's examiner education program. They are

- the agencies' need for and use of the training being offered,
- the overall cost of the training to the agencies,
- the impact of interagency training on an agency's individual training program,
- the quality of the training being offered, and
- the support from agencies that are developing and using the training courses.

The following provides some insight on how the above issues affect the Council's examiner education program. These issues were repeatedly mentioned during our discussions with Council principals, Council project participants, and agency officials and were noted in our questionnaire responses.

Agencies' use of Council school
may be disproportionate in
relation to their obligations

The law that created the Council provides that each agency must pay one-fifth of the cost of operating the Council. Some agencies, however, are paying a disproportionate share of the Council's budget for examiner training in relation to their use of the courses offered by the school. Differences in regulatory functions and examination approaches among the agencies determine each agency's use of the Council school. The courses sponsored by the school are of a general business nature (management or instructor training) or concern the specialty areas of banking (municipal securities or international banking). For

example, the NCUA and FHLBB often do not need to train their examiners in these specialty courses and generally have not been sending examiners to these courses. However, because of legislative changes giving savings and loan associations more bank-like powers, the FHLBB has begun to use more Council courses.

On the basis of 1982 and 1983 student enrollment figures, NCUA examiners represented about 4 percent of the examiner attendees at the Council school while the OCC provided about 40 percent of the attendees. However, both agencies share equally in the fixed costs that support this training. Some NCUA officials feel this current method of sharing examiner education costs is unfair. Attempts to change to another method for sharing the fixed costs have been unsuccessful.

When the Council school opened for classes in 1980, it charged all students a \$35.00 daily tuition fee. This tuition fee was sufficient to recover the full costs (fixed and variable) of operating the school. After complaints that \$35.00 a day was too much for tuition, the Council voted to change its allocation method beginning in January 1982. The agencies now share equally in the fixed costs of operating the school and recover the variable costs by charging a \$10.00 a day tuition fee.

Some State and foreign examiners also attend the Council school. These examiners pay only the \$10.00 a day tuition fee. The Council agencies absorb the fixed costs associated with providing training to non-Council examiners.

Centralized versus decentralized training

Another important issue concerning the cost and use of training is whether or not an agency's training program is centralized or decentralized. The FRS, FDIC, and NCUA have centralized training facilities in the Washington, D.C., area. The OCC and FHLBB conduct their training both in field offices and at headquarters.

The majority of the Council training courses are administered in the Washington, D.C., area. Examiner attendees will incur travel, per diem, lodging, and miscellaneous expenses, as well as Council tuition fees, when attending a Council course. Agencies with a centralized training program that normally send their examiners to the Washington, D.C., area for training will incur little additional expense to send examiners to the Council school. However, some agencies with decentralized training would incur additional expenses for travel, per diem, lodging, tuition, and miscellaneous expenses when sending examiners to a centralized location.

Regulators express mixed support for the examiner education program

The success or failure of the Council's examiner education program can best be measured by how regulatory officials feel about how beneficial it has been to their examiners and how it has fulfilled their agencies' needs.

One FHLBB official stated that the only good thing about the Council is its school. He felt that the staff responsible for examiner education is doing a competent job. Because of the nature of its examinations, however, the FHLBB has never been a heavy user of the Council school. Now that recent legislation has given savings and loan associations additional powers formerly unique to banks, the FHLBB has a greater need for current and planned Council courses.

Some OCC officials expressed dissatisfaction with the Council's program. They are dissatisfied with the overall quality of the training. They also feel they have lost control over the content and quality of the training their examiners receive. Moreover, the OCC has a decentralized examiner training program and incurs the additional expenses of travel and per diem when OCC examiners attend a Council course in Washington, D.C. Even with these additional expenditures, OCC examiners represented almost 40 percent of the total number of students attending the Council school in 1982.

In our questionnaire to agency staff who had Council experience, we asked how they rated the training provided by the Council. The respondents indicated that even though there was some need for training, the quality of training provided was adequate at best. Nearly 44 percent of the Council participants who responded indicated that the overall quality of training was less than adequate, and only 9 percent of the respondents indicated that the training was more than adequate. About 37 percent of those responding indicated that there was a great or very great need for Council training, while 43 percent indicated there was only some or little need for Council training.

CONCLUSIONS

Our review showed that the Council has had only minimal success in developing and administering uniform examination training for examiners and assistant examiners. However, the Council has had some success at providing training courses in general business subjects and in banking specialties. The Council obtained facilities for a school, retained permanent and full-time staff, and made arrangements for examiners to have access to reasonably priced lodgings near the Council school.

Also, the Council's school has become a forum for the exchange of information on examining financial institutions at a staff level that would not have existed without interagency training.

The Council's lack of success in providing training in the commercial examination area is largely attributed to the inability of the Council to develop and adopt uniform principles and standards for the examination of financial institutions. This lack of uniformity has also impeded the development of other courses such as white collar crime that we believe could be included in a uniform examiner education program.

We concluded that a variety of issues are also of concern in the development of uniform examiner education. Issues such as the need for and use of training, the overall cost of training to the agencies, and the support of the program by the agencies greatly affect the success or failure of the Council's uniform examiner education program. These issues are not easily resolvable because the agencies comprising the Council have similar examination functions but differing approaches and philosophies to these functions. Until the Council resolves some of these differences in these areas and adopts uniform principles and standards, the Council school will be unable to develop the meaningful, uniform examiner education program originally envisioned.

CHAPTER 6

AGENCIES HAVE BEEN

GENERALLY RESPONSIVE IN

IMPLEMENTING COUNCIL ACTIONS

The Council has no authority to enforce its actions which require member agency implementation or which member agencies agree to implement. Therefore, agency compliance with both required and recommended Council actions has been the responsibility of the individual agencies. Some Council principals believe that Council enforcement authority should be strengthened. Other principals and agency officials feel that the Council should function as a policy setting agency but not have monitoring or enforcement authority.

We examined all agency headquarters directives to implement Council actions and conducted a limited review of regional agency operations to determine if member agencies had adopted and implemented approved Council actions. We found that member agencies generally supported proposed Council actions and largely implemented approved Council actions. However, our review revealed cases where member agencies did not adopt some proposed Council actions and have not implemented (as of June 15, 1983) some approved Council actions which they had agreed to adopt. For example, some Council actions have gone unimplemented by member agencies for periods ranging from approximately 3 months to over 3 years.

COUNCIL LACKS THE AUTHORITY TO ENFORCE ITS ACTIONS

The Council's enabling legislation does not provide the Council with any authority to enforce its actions. Specifically, Title X is silent on (1) what authority the Council has to enforce required member agency actions, (2) what actions the Council may take against member agencies which do not participate in Council decisions, or (3) what actions the Council may take if member agencies do not implement Council recommendations which they have agreed to adopt. Furthermore, the Council's Executive Secretary does not consider the enforcement of Council actions to be an appropriate Council role. As a result, agency implementation of approved Council actions has been the responsibility of the individual agencies.

Council principals have divergent views on the need for greater Council enforcement authority. Two Council principals believe that the Council's authority to mandate agency actions needs to be strengthened. They believe that without this

enforcement authority the Council lacks clout. Both have said they are unhappy with the present Council environment because too often the five different agency heads get together and come up with compromises which are less than satisfactory. One Council principal said that the Council cannot really require anything. Although section 1006(a) can technically be used for required agency actions, this principal said that its use is interpreted so narrowly by the Council that it is not effective. On the other hand, another Council principal believes that the Council should function informally to achieve the best results. Such an arrangement, he said, facilitates better cooperation among banking regulators and thrift regulators. Otherwise, he said, since banking regulators outnumber thrift regulators on the Council, banking regulators might be more likely to dominate the Council.

Notwithstanding the arguments surrounding the need for greater Council enforcement authority, member agencies, not the Council, are responsible for implementing Council actions. Therefore, we examined the record of agency adoption and implementation of past Council actions published in the Council's annual reports which required or recommended agency implementation.

AGENCIES HAVE ADOPTED AND IMPLEMENTED MOST COUNCIL ACTIONS

On the basis of our examination of Council voting records and agency directives implementing 44 out of the 91 approved Council actions which required or recommended agency implementation, we found that all five Council agencies generally supported and largely implemented the applicable actions. We selected these actions from the Council's 1979 through 1982 Annual Reports. They represent all actions published in the Council's own "Record of Actions of the Council" which required or recommended member agency implementation. We used the "Record of Actions of the Council" because, according to the Annual Report, it is a chronological record of the official actions taken by the Council pursuant to sections 1006 and 1007 of FIRA, Title X, and section 340 of P.L. 96-399 (Housing and Community Development Act of 1980) for each calendar year.

We examined the implementation of Council actions for two reasons. First, we wanted to determine the extent to which member agencies adopted these Council actions, i.e., agreed to implement them. Second, we wanted to ascertain whether or not headquarters management of member agencies had directed implementation of both required Council actions and Council recommendations which the agencies had agreed to adopt. The following chart shows the results of our review through June 15, 1983.

<u>Agency</u>	<u>Council actions</u>	<u>Actions not adopted by agency</u>	<u>Actions adopted but not implemented</u>
FDIC	44	1	1
FRS	44	1	0
OCC	44	0	1
FHLBB	<u>a/</u> 21	4	5
NCUA	<u>a/</u> 19	0	0

a/Includes only those Council actions which are relevant to these agencies.

The above chart shows that the three banking agencies adopted nearly all of the 44 approved Council actions. The FDIC did not adopt the action concerning the supervisory policy on the enforcement of the Equal Credit Opportunity and Fair Housing Acts. Although not reported in the Council's 1981 Annual Report, thus not reflected in the above chart, the FDIC also did not adopt another Council action which recommended a uniform definition of capital for use by the three banking agencies. The FDIC and OCC did not implement a Council action they had agreed to adopt which would have required constituent banks to maintain their books on an accrual accounting basis rather than a cash accounting basis. The FRS did not adopt this Council recommendation.

The chart also shows that the FHLBB has not adopted or implemented 9 out of 21 applicable actions. Four actions were not adopted by the FHLBB, as was their option under the law. The FHLBB, citing insufficient staff following an internal reorganization, has not implemented three Council recommendations that they agreed to adopt--uniform interagency examination procedures for determining institution compliance with Federal Reserve Regulation Z (Truth in Lending Act), the Fair Debt Collection Practices Act, and Federal Reserve Regulation C (Home Mortgage Disclosure Act). Also, the FHLBB has not implemented Council approved uniform examination objectives for safety and soundness examinations. An FHLBB official said that these objectives were so general that they were not useful in the 30 functional examination areas they cover. Finally, the FHLBB has not implemented a Council approved supervisory policy on the purchase and sale of U.S. Government guaranteed loans which it adopted in November 1979. Since May 5, 1980, this action has remained in a proposal stage for FHLBB consideration.

REGIONAL AGENCY OPERATIONS
GENERALLY IN COMPLIANCE WITH
APPROVED COUNCIL ACTIONS

We found the Federal financial institutions regulatory agencies in compliance with seven out of eight Council approved actions sampled during a limited regional implementation review.

Results of regional survey
indicates agency implementation

We performed work at the regulatory agencies' headquarters offices and visited three Federal regions to speak with agency officials and review documentation regarding regional implementation of the following Council actions:

- Policy Statement on Coordination of Bank Holding Company Inspections and Subsidiary Lead Bank Examinations (FDIC, FRS, OCC).
- Policy Statement on Coordination of Formal Actions by the Federal Bank Regulators (FDIC, FRS, OCC).
- Uniform Supervisory Policy for Classification of Delinquent Consumer Installment Loans at Commercial Banks (FDIC, FRS, OCC).
- Standardized Examination Policies and Procedures for Examining Institutions Participating in the Clearing House Interbank Payment System (New York City only) (FDIC, FRS, OCC).
- Standard Interagency Examination Procedures for Determining Institution Compliance with Federal Reserve Regulation E (all five agencies).
- Interagency Supervision Policy Regarding the Assessment of Civil Money Penalties (all five agencies).
- Supervision Policy on Enforcement of Equal Credit Opportunity Act (FRS, OCC, NCUA).
- Definition of Bank Capital to be Used in Determining Capital Adequacy (FRS, OCC).

Except for one FHLBB region's treatment of standard interagency examination procedures for determining institution compliance with Federal Reserve Regulation E, our review showed that all five agencies appeared to be in compliance with the Council actions they had agreed to implement. Standard Regulation E examination procedures were approved by the Council for

agency implementation in July 1980. However, as late as November 1982, some FHLBB examiners in the Southeast were not using these standard examination procedures to review an association's compliance with Regulation E at each regular examination.

CONCLUSIONS

The Council's member agencies generally adopted and implemented applicable Council actions. There were, however, a number of instances where the depository institution regulators did not fully implement the Council's actions. We believe that in the latter cases, the depository institution regulators should have informed the Council that they were having difficulty implementing an action so that the Council could have considered whether the action needed revision.

CHAPTER 7

SHOULD THE PRESENT COUNCIL

CONCEPT BE CONTINUED?

The preceding chapters establish that the Council has not made significant progress in establishing uniform examination principles, standards, and report forms or in conducting schools for examiners of the Federal financial institutions regulatory agencies. The Council has promoted some uniformity in the Federal supervision of financial institutions, primarily in areas where there have been recent legislative mandates which affect all types of financial institutions or in areas where there were no major differences in opinions or philosophies about how institutions should be examined or supervised. Additionally, Council actions have led to improved reporting systems for federally supervised financial institutions. Concerns have been expressed by Council principals, however, about the extensive cost and effort that have been devoted to Council activities in relation to the relatively small benefits that have resulted. Also, top agency officials have expressed concern about the Council's bureaucracy and the length of time that it takes to complete Council projects.

Although the reasons for the Council's ineffectiveness were frequently difficult to determine, our review showed that there were numerous barriers to accomplishing the Council's objectives. In some cases the member agencies differed on how best to examine or supervise financial institutions. Member agency officials believed that the agencies were doing a reasonably good job and that the cost to implement new, uniform procedures was not justified. Some officials believed that because the member agencies' missions and institutions that they regulate were different, uniformity in examination and supervision was not always feasible.

To overcome the many barriers facing the Council in accomplishing its objectives, the Council must have the commitment of top-level member agency executives, adequate administrative support, and appropriate financing. Our review indicates, however, that member agencies are reluctant to fully support common programs in which they relinquish some control.

In many cases, institutions that the member agencies regulate compete with one another or are interrelated. As a result, the need for uniformity in regulation is as great, if not greater, than when the Council was established. During many of our past reviews of regulatory activities, we have identified inconsistent regulation by the member agencies.

There is no simple solution to the problem of how best to coordinate the Federal supervision of financial institutions. Two important factors to consider in any restructuring of the present system, however, are the questions of how significant the differences are in the agencies' examination and supervision of financial institutions and how great a concern this is to the Congress. If the differences are significant, and we believe they are, the only practical solution may be to consolidate the agencies.

To further compound the problem of how best to coordinate the Federal supervision of financial institutions, questions are surfacing as a result of recent changes in the financial services industry. For example, many types of institutions and the products which they offer are becoming more similar and are coming into increasingly direct competition with one another. This blurring of distinctions among the institutions raises a question as to how best to regulate them. The establishment of the Council centered on uniform supervision of depository institutions. If institutions are operating similarly, offering similar products, and competing with one another, the Congress may have to consider how best to promote uniformity in the Federal regulation of all activities of financial institutions.

RESISTANCE TO COUNCIL ACTIONS

For the Council to be an effective mechanism for improving the regulators' examination and supervision programs, the participating agencies need to view the Council in a positive manner and fully support its activities. We do not believe that the agencies have supported the Council in this manner. To illustrate, the project to develop uniform examination principles and standards (discussed in ch. 3) was eventually terminated primarily because the member agencies believed that uniform examination principles and standards would be costly to implement and would not significantly improve the quality of the examination process. The project team, however, made no effort to estimate either the costs or benefits of uniform examinations.

In efforts to revise institutional operations, there is often both employee and organizational resistance that present very real barriers which must be overcome. For this reason, management must exert maximum effort to establish the objectivity and credibility of its actions. We believe that the project staff missed an opportunity to successfully complete its mission by not attempting to objectively evaluate the effectiveness of procedures used by the five agencies and select the most effective procedures from each agency as applicable.

Although top agency officials recognize that each agency may have different procedures and techniques for performing a

particular examination function, the agencies believe that their present examination programs are satisfactorily identifying problem institutions and find them effective for the institutions they regulate. In this regard, we issued a report ^{1/} in 1981 on the Federal examination of financial institutions which discussed variances in the agencies' examination practices. We pointed out that the Federal regulators had not determined the optimal examination effort needed to effectively supervise financial institutions while minimizing supervision costs. The report pointed out several areas where the burden of examinations could be reduced. We believe the Council should have required the project staff to assess the effectiveness and efficiency of the various agencies' practices to identify which procedures were superior.

Regulators have different views and philosophies

The Federal regulatory system for depository institutions is very complex. This system of law and regulation was developed over many years and reflects a complicated structure with many different purposes and objectives. As a result, each of the five depository institution regulators represented on the Council has developed its own constituency and method of supervision.

After safety and soundness, each agency has in some way a unique mission of its own. For example, the FRS has a major interest in establishing monetary policy for the nation; the FDIC is concerned with maintenance of its insurance fund; and the OCC is the national charterer of banks. In addition, over the years, the FDIC has developed a constituency which is primarily composed of small banks while the OCC regulates the larger banks in the nation's banking system. The thrift institution regulators are responsible for "promoting" the development of the savings and loan and credit union industries. The FHLBB, however, has constituents who primarily make mortgage loans while NCUA's constituents concentrate their efforts mostly on consumer loans. As a result of the above characteristics, each agency considers its own objectives when it develops an examination approach.

The depository institution regulators each prefer to use their own method of examination when carrying out their missions. The agencies, as a result, have developed different sets of policies and procedures which they believe best conform to

^{1/}"Federal Examinations Of Financial Institutions: Issues That Need To Be Resolved" (GGD-81-12, Jan. 6, 1981).

their needs. These differences in examination policies and procedures among the regulators were documented by the Council's TFS. In evaluating the possibilities of establishing uniform examination principles and standards, the TFS identified characteristics which influence and differentiate examination policies and procedures among the depository institution regulators. These were: (1) inherent agency characteristics, (2) broad policy directives, (3) examination planning and control, (4) use of sampling in the examination, (5) structure and use of examination workpapers, and (6) policies and procedures by functional areas. These differences and likenesses among the agencies in their examinations were discussed in detail in chapter 3.

In our questionnaire to member agency staff who worked on Council projects, we asked their opinions on how the existing philosophies of member agencies hinder or facilitate the Council's ability to establish uniform examination principles, standards, and report forms. Of those responding to the questionnaire, over 89 percent felt that the existing philosophies of member agencies either somewhat hindered (35 percent) or greatly hindered (54.4 percent) the Council's ability in this area. Only 4.3 percent felt that the members' philosophies somewhat or greatly facilitated the Council's ability in this area.

Structure and organization hamper Council effectiveness

The Council's ability to resolve uniformity issues has been greatly hindered by the Council's own structure and organization. We identified several problems which are inherent in the Council itself and hamper its ability to deal effectively with uniformity issues. These problems centered around the belief that the backgrounds and influence of member agencies tend to affect the ability of Council working groups to reach agreements.

The legislative history of the law which established the Council indicates an expectation that the agencies would (1) participate in Council activities, (2) cooperate with each other in developing uniformity, and (3) follow mutually agreed upon recommendations. However, our review showed that the agencies are reluctant to compromise on issues relating to established agency positions.

Differing agency responsibilities have hindered problem solving. When agency responsibilities differ, agencies tend to vote their own interest and compromise becomes harder or not possible. An example where a compromise was not able to be reached involved the TFS's attempt to develop uniform examination principles and standards.

In our questionnaire to Council staff members, we asked whether the Council's ability to establish uniform examination principles, standards, and report forms had been hindered by the inability of staff members to compromise their agencies' position. Of those responding, 73 percent stated that the amount of compromise agency staff are willing to make has somewhat hindered (44.7 percent) or greatly hindered (28.3 percent) the Council's ability. Only 12.5 percent felt that the willingness to compromise had greatly or somewhat facilitated the Council's ability in this area.

NEED FOR UNIFORMITY IN
EXAMINATION AND SUPERVISION
OF FINANCIAL INSTITUTIONS

The fact that the Council has had considerable difficulty in developing uniform examination procedures and report forms indicates that sufficient uniformity does not now exist. It is difficult, however, to precisely measure the significance of the differences in agency approaches. We have reviewed specific activities of the member agencies and have identified problems resulting from the lack of uniformity among the agencies. For example, in a previous report ^{2/} we identified significant differences in examination concepts, approaches, scope, and frequency of the five member agencies.

In another report ^{3/} we identified a need for uniform standards concerning the criteria used by the Federal bank regulatory agencies to assess bank merger applications. We found that the regulators defined the relevant market to be used in evaluating competitive effects of proposed mergers in different ways and lacked uniform criteria in applying the line of commerce and potential competition concepts. This resulted in conflicting decisions by Federal regulators and encouraged "agency shopping", a practice whereby parties to a merger seek out the Federal bank regulator possessing the most lenient standards for assessing mergers.

Due to increasingly rapid marketplace innovations, questions have been raised concerning some of the most fundamental issues of banking which, we believe, further demonstrate the significance of problems created by a fragmented regulatory framework. Such a question is the basic definition of a bank. It may be appropriate to define a bank in different ways. How

^{2/}"Federal Examinations Of Financial Institutions: Issues That Need To Be Resolved" (GGD-81-12, Jan. 6, 1981).

^{3/}"Bank Merger Process Should Be Modernized And Simplified" (GAO/GGD-82-53, Aug. 16, 1982).

an agency chooses to define a bank may raise for debate major issues which could affect the future structure of the financial institution industry.

This question of the definition of a bank has already been much debated. The issue surfaced recently when OCC granted, over the objection of the FRS, national bank charters to financial institutions. The OCC granted the charters on the premise that the newly chartered institutions would not have full bank status because they would either not make commercial loans or would not accept demand deposits. However, the FRS believed the charters should have been denied because it felt that the financial institutions were using a technicality to prevent themselves from coming under the jurisdiction of the Bank Holding Company Act and thus avoiding FRS regulation. In response to this controversy, in April 1983 the Comptroller of the Currency ordered a moratorium on the approval of this type of national bank charter until the Congress could deliberate on the issue. While the moratorium may solve the immediate problem, this type of conflict demonstrates the problems that can surface because of the fragmented Federal regulatory structure.

CHANGES IN THE FINANCIAL SERVICES INDUSTRY

Because of intense competitive pressures and because of changing regulatory attitudes and laws, the role of each type of institution, once clear, is becoming increasingly blurred. In many cases different types of financial institutions are more directly competing with one another. It has been pointed out in studies that significant regulatory differences exist in the approaches that Federal, State, and self-regulatory organizations take in dealing with different types of financial intermediaries. The different regulatory treatment of many types of institutions offering similar products and directly competing with one another raises several issues from the Council point of view.

Legislation to establish the Council was considered by the Congress during the 1970s. The legislation focused on the lack of uniformity in the supervision of depository institutions. The many changes which have taken place in the financial services industry since enactment of legislation establishing the Council suggest that future consideration of the desired uniformity in Federal supervision may need to be in a broader context than just that of depository institutions. The question of what type of financial industry this country should have, how it should be regulated, and what structure would be the most effective to regulate that industry will require much study and deliberation.

Changes in the depository institution structure

During the past several years, sweeping changes have taken place within the depository institution structure. Many factors, including increased competition and fluctuating interest rates, helped bring about changes in the laws and regulations separating financial institutions, thereby eroding many of the previous barriers which differentiated them.

This erosion of distinctions in types of financial institutions is evident when the recent changes in powers granted thrift and banking institutions are noted. Thrift institutions have recently been given powers that previously were exclusive to banks to make commercial loans, issue credit cards, offer checking accounts, and establish trust departments. Banks, on the other hand, have become more active in the residential mortgage market. Both types of institutions now offer variable rate money market funds to compete with money market funds in the securities industry. In addition, existing interest rate ceilings which provide thrifts with an advantage in offering certain rates will soon be phased out, thus providing more equality and competition between the two types of institutions.

Also, the regulation of the present system has become increasingly more complex. As deregulation and interstate banking activities increase the number of mergers and holding company acquisitions, the ability of State and Federal regulators to effectively monitor and examine these entities will become more difficult. For example, over two-thirds of the multibank holding companies contain at least one bank which is federally chartered and at least one bank which is State chartered. Furthermore, it is not uncommon for a holding company system to include national, State member, and State nonmember banks, sometimes in several States.

The possibilities for regulatory confusion, inconsistency, and duplication are real concerns. Also, this complicated structure provides for potential gaps to occur in the examination process which could have safety and soundness implications. To overcome such problems under the present structure requires a high level of interagency coordination, not only at the Federal level, but also with responsible State regulators. Admittedly, some steps have been taken to bring about coordination, such as the agreement to coordinate examinations of all bank holding companies and their subsidiary banks whose consolidated assets exceed \$1 billion. However, as the depository institution structure continues to increase in complexity, we believe that the efforts to coordinate bank holding company supervision will become more difficult and also more necessary.

Major issues surface in the financial industry

Factors that have brought about recent changes in the depository institution industry have also resulted in changes in the financial services industry as a whole. As a result, the barriers which once separated the depository institution industry from the rest of the financial services industry are eroding. This erosion can be illustrated by examining recent changes in the application of laws separating banking and commerce.

For example, the Glass-Steagall Act, the common name given to the Banking Act of 1933, is the Federal law which has long separated the two industries. Provisions of this law, enacted over 50 years ago, prohibited the payments of interest on demand deposits, authorized the FRS to impose maximum rates for time deposits, and excluded depository institutions from underwriting and dealing in securities. However, during the last few years, these industries have crossed over the line which had long separated them. Now either through the marketing of like services or through holding company subsidiaries, these industries have been brought into direct competition.

This interindustry activity has taken several forms and includes:

- Financial institutions, securities firms, and insurance companies all offering money market fund-like instruments.
- Banks and savings and loans offering brokerage services to their customers.
- Holding companies providing depository institution, brokerage, and insurance services, as well as other commercial products.
- Financial institutions being owned by commercial companies, such as a steel mill, furniture store, and mutual fund.

The above examples are but a few of the new and growing combinations which are developing from previously separated industries. Many feel that one-stop financial supermarkets are not far away. Further changes in the rules guiding these combinations are still being considered. What lies beyond and what type of regulatory structure will exist has now become an issue of great importance.

REORGANIZATION OF THE FEDERAL
FINANCIAL REGULATORY AGENCIES
IS BEING STUDIED

Many studies ^{4/} on the Federal regulatory structure have been made over the years. Some of these studies have provided recommendations for realigning or consolidating the responsibilities of the regulatory agencies. However, these studies have not resulted in any significant changes. Nevertheless, we believe that the major changes in the financial industry discussed earlier in this chapter have necessitated a renewed assessment of the present regulatory structure.

An important step in studying the financial industry was taken in the fall of 1982 when the Task Group on Regulation of Financial Services, headed by Vice President Bush, was charged to undertake a study of the problems in the existing system of Federal regulation of financial institutions and services. The task group has a plan to consider ways of reorganizing the "flock" of Federal agencies that regulates financial institutions and report its findings and any desirable changes to the President. To be included in the study is an examination of questions regarding the scope and nature of regulatory consolidation and reorganization.

Among those issues which the task force is exploring are the following areas which they consider to be problems with the current regulatory structure:

- The differential treatment of like products by different regulators.
- Excessive regulatory controls in some areas where costs of regulation may far exceed the public benefits.
- Overlap and duplication in some jurisdictional areas of regulatory agencies.
- The possibility of significant delays in obtaining regulatory approval for otherwise permissible transactions or activities.
- Potential difficulties in management of shared responsibilities where several agencies are required to cooperate when addressing certain financial institution issues.

^{4/}"The Debate On The Structure of Federal Regulation of Banks" (OGC-77-2, April 14, 1977). This report summarizes the results of studies of the regulatory structure.

--The possibility of overlap and conflict between State and Federal requirements because of the dual system for chartering and supervising depository institutions.

In addition, a Federal Bank Commission bill, S. 559, has been introduced in the Senate. The bill was introduced, in part, because of the belief that the developments in the marketplace have outpaced the present financial institution regulatory structure. The bill has two key objectives: to streamline the Federal Government's role in regulating financial institutions and to make the regulatory system cheaper and more effective. Included in the bill are specific provisions to (1) abolish the OCC and transfer its functions to a newly established commission, (2) continue FDIC as an insurance and financial entity, but relocate it under the new commission, and (3) transfer out of the FRS all its supervisory and regulatory powers to the new commission, thus enabling the FRS to concentrate its efforts on monetary policy.

CONCLUSIONS AND ALTERNATIVES TO THE PRESENT COUNCIL

The current need for uniformity in the Federal examination and supervision of financial institutions is as great or greater than when the Council was established in March 1979. The Council in its present form has not taken a leadership role in providing the needed uniformity. There are many barriers to achieving uniformity, such as the reluctance of participating agencies to reach compromises and coordinate the use of their powers in managing their programs.

During our review, we discussed several alternatives to the present Council with members of the Council, bankers, and members of nationally recognized banking associations. These alternatives ranged from total consolidation of the five financial institution regulators to amending the rules under which the present Council works. The following is a brief discussion of some of these options and some of the positive and negative considerations which relate to implementing them.

Modifying the present Council

We discussed a number of changes to the present Council to make it more effective. These changes included requiring that Council policies be adopted by member agencies, establishing deadlines for the Council to implement mandated actions, and providing the Council with permanent staff.

The idea of making the implementation of all Council actions mandatory by expanding the coverage of section 1006(a)

of the act has been discussed as a possible solution to uniformity. This approach is based on the assumption that there is a reluctance by the member agencies to adopt Council policy. We found that the Council members have so narrowly defined the application of section 1006(a) that the agencies have been required to implement only 11 actions under this mandatory compliance provision. Arguments against this approach might include the feeling that (1) the Council might pass even fewer total actions than they do now, (2) the agencies might view the Council in a more negative fashion than they do now, or (3) the actions passed would be vaguely stated and result in only limited uniformity. An example of the latter problem can be illustrated by the present interagency bank rating system. This system provides for a composite rating, ranging from 1 to 5, to describe the condition of a bank. However, we noted that the criteria established provided only general guidance and required substantive subjective judgment in determining a bank's rating.

The Council was, on at least one occasion, given a legislative mandate to complete certain tasks by an established date. The Home Mortgage Disclosure Act Amendments mandated the Council to complete certain actions by a specified date and the Council generally met the requirements of this act. Congressionally specified actions with completion dates, therefore, might better define the requirements of a particular Council action. On the other hand, specifying completion dates might, if set unrealistically, result in vague policies and unsatisfactory actions. Unrealistically established completion dates could disrupt agency activities by placing inordinate burdens on an agency's staff resources, thus weakening the agency's ability to deal with other significant financial institution problems.

Another alternative to strengthening the present Council is the idea of providing it with permanent staff. The positive aspects of such an alternative could be a more independent Council, Council staff could carry out their functions more objectively, and Council projects could be better and more systematically staffed. The negative aspects of such a proposal could include the added cost of additional staff, agency staff and top officials may feel more threatened by an independent Council staff, highly qualified agency staff may be hired by the Council thereby weakening the quality of agency staffs, and independent Council staff could make the process of developing and adopting uniform actions more bureaucratic.

Consolidation of the financial institution regulatory agencies

The idea of consolidating the financial institution regulatory agencies has taken many forms in recent discussions.

Various approaches have included consolidation of the three bank regulators, consolidation of the three bank regulators and the FHLBB, and consolidation of all five financial institution regulators. Also discussed is the consolidation of these agencies along functional lines. This alternative generally includes such approaches as consolidating just the insurance funds of the FDIC, FHLBB, and NCUA; consolidating all the regulatory functions of the five regulators into a single agency; and leave the FRS with monetary policy. We issued a report ^{5/} on April 14, 1977, in which we briefly summarized many of the studies and proposals that had been made on restructuring the Federal bank regulatory agencies.

In May 1983, the President's Private Sector Survey on Cost Control in the Federal Government issued a report recommending that a new agency, the Federal Banking Commission, be established to encompass the bank regulation and insurance functions that are currently conducted separately by the OCC, FRS, and FDIC. The task group led by Vice President George Bush, as discussed earlier, is also studying the problems of the existing system of Federal regulation of financial institutions and plans to make recommendations to the Congress in the fall of 1983. In addition, a bill has been introduced in the Senate that would consolidate the bank regulatory agencies into a Federal Bank Commission.

The concept of consolidation, no matter what form it takes, has a variety of arguments for and against. Arguments for consolidation include simplification of administration, economy and efficiency of operation, elimination of actual or potential policy conflicts, improvement in the handling of failing bank situations, and the ability to better adjust to a rapidly changing environment. Arguments against consolidation include fear of the concentration of banking powers, the elimination of regulatory choice; benefits of diversity, disruption of the Federal/State relationship, and the opinion that the present system has worked well so why change it.

Establishing a common examination force

A solution which has been mentioned to overcome some of the inefficiencies of the five depository institution regulators has been the establishment of a common examination force. Proposals for this force have ranged from combining the existing examination offices into a single force to replacing the

^{5/}"The Debate On The Structure Of Federal Regulation of Banks" (OCG-77-2, April 14, 1977).

current group of examiners with a professional quasi-governmental group which could be directly responsible to the Congress. In a 1981 report 6/ to the Congress, we recommended that the Council study the feasibility of consolidating the Federal regulatory agencies' examiner forces as a reasonable solution to overcome the inherent problems of each agency maintaining separate networks of examiners.

The benefits of such a force could include more economic and efficient use of examiners, more easily managed workloads, less long distance travel for some examiners, and greater uniformity in the application of procedures. Some of the drawbacks might include initial organization turmoil, lack of accountability of examiners to the primary supervisory authority, disruption of established relationships with financial institutions, and possible adverse effects on examiner morale and quality of examinations.

High-level officials
see need for alternative
to Council

During our review of the Council, we discussed several of the above options with the heads of the agencies which make up the Council as well as many other top agency officials. Generally, these individuals were not optimistic about the Council's ability to fulfill its congressional mandate. They felt that even if changes were made to the law giving the Council additional authority to mandate actions or if mandatory time schedules were imposed, the Council would still not be an effective means of bringing uniformity to the Federal financial institution regulators. However, the option of some form of consolidation has often been offered as a solution to the present structure.

The idea of consolidation was discussed by a former Comptroller of the Currency in April of 1981 before the Senate Committee on Banking, Housing and Urban Affairs. In this testimony he stated that:

"* * * despite the progress the Examination Council has made, we are convinced that it is an inefficient tool for coordinating the activities of independent regulatory agencies. Therefore, the time has come to move beyond the Examination Council."

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6/"The Federal Structure for Examining Financial Institutions Can Be Improved" (GGD-81-21, April 24, 1981).

"I believe that the banking regulatory structure ought to be consolidated into an independent banking commission."

He suggested that this commission ought to be given responsibility for the present supervisory and regulatory responsibilities of the FDIC, FRS, OCC, FHLBB, and NCUA.

The present Comptroller of the Currency, in his recommendations to the Vice Presidential Task Group on Regulation of Financial Services, rejected the idea of creating one "super agency" to handle all aspects of bank and thrift regulation and insurance at the Federal level. Instead he recommended combining the licensing, examination, and supervision functions of the FRS, OCC, FDIC, and FHLBB into one agency. The FDIC's deposit insurance activities and the FHLBB's insurance fund would be consolidated into a second agency. Under this plan, the Federal Reserve would continue to handle monetary policy and act as the Nation's central banker and lender of the last resort.

The present Chairman of the FDIC, in a March 1983 speech to the Independent Bankers Association of America, stated that:

"* * * the various financial agencies at the federal level should be consolidated and all regulation should be organized along functional lines. To be specific, the regulatory functions of the Federal Home Loan Bank Board, the Federal Reserve and the Comptroller of the Currency should be consolidated into an independent agency headed by a board."

* * * * *

"* * * the FDIC would remain as a separate independent agency with insurance responsibilities for all state- and federally-chartered banks and S&Ls. It would have the right to examine and take enforcement actions against any insured institution or its affiliates."

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Our review has shown that the present Council system has not accomplished the objectives laid out for it by the Congress. Furthermore, we have described the inherent problems within the Council which, we believe, will prevent it from achieving its congressional mandate of uniformity. Finally, in view of our discussions with agency officials, and the significant need for uniformity because of the rapid changes both within the depository institution industry as well as the financial

industry as a whole, we believe that some form of consolidation of the agencies or their functions may be needed to effectively deal with policy differences among the agencies involving such areas as the establishment of examination priorities, determination of examination scope, and timing and communication of examination results.

Regardless of the course the Congress may take in dealing with the current structure of the depository institution industry, we believe there are certain issues which are important when the reform of the current regulatory structure is considered. These issues include the

- relationship between the Federal depository institution regulators and other agencies, such as the Securities and Exchange Commission and State regulatory agencies;
- justification for maintaining different regulatory mechanisms for regulating depository and nondepository institutions which offer similar and directly competitive products; and
- need for maintaining three separate Federal depository insurance programs for financial institutions.

MATTERS FOR CONSIDERATION BY THE CONGRESS

Decisions about the future structure for regulating financial institutions must take into consideration many factors which are not quantifiable. The decisions require judgments about important issues, such as what type of financial industry this country should have, how it should be regulated, what role States should play in the regulation, the justification for maintaining different regulatory institutions which offer similar and directly competitive products, and the need for maintaining three separate depository insurance programs. In the final analysis the Congress must decide these issues.

As previously stated there are a number of proposals being considered to reorganize the Federal structure for regulating financial institutions. In making its judgments on these proposals, the Congress should consider that a coordinating mechanism such as the Council has not been effective in dealing with major policy differences in the examination process.

AGENCY COMMENTS AND OUR EVALUATION

Although the Council did not comment on our conclusions regarding its overall ineffectiveness, the member agencies, except for NCUA, generally agreed that the Council was not

effectively accomplishing its legislative objectives. Although FHLBB agreed with our conclusions, it did state that uniformity for uniformity's sake is not always justified and that any development of uniform examination policies and procedures should be subject to a cost/benefit test and result in an improved examination process. We fully concur with FHLBB. While the Comptroller of the Currency agreed with the observations and contents of the report, he did point out that significant differences remain among the member agencies and their respective supervised institutions which make identical examination policies and procedures inappropriate or even impossible. While we recognize that there could be situations where identical examination policies and procedures may be inappropriate, we believe that these situations would likely occur less today than when the Council was established because changes in the industry have increased institutions' similarity.

NCUA stated that there is no evidence in our report or in regulatory studies that uniformity improves supervisory effectiveness. NCUA stated that "We don't believe there is one unique, uniform, or superior way to conduct an exam or to supervise an unsound institution, let alone the diverse players in the financial services industry." NCUA believes the Council's role should be

"* * * a forum for federal and state regulators to share common concerns and to learn from each other's experiences what alternatives and options can be employed to respond to supervisory and examination issues - newly emerging, as well as traditional ones."

The Congress established the Council as a mechanism for achieving uniformity in the Federal examination and supervision of financial institutions. Our review was primarily directed at examining the progress that the Council has made in meeting its legislatively established objectives. We did not attempt to substantiate the benefits of uniform examination and supervision in this review, but we did identify problems that prohibited the Council from accomplishing its objectives. While there may be instances where Council recommendations are not applicable to all member agencies, we do not believe this factor fully explains or justifies the ineffectiveness of the Council to promote greater uniformity in the Federal examination and supervision process. For example, Council records indicate that the Council's Chairman, in considering further efforts to develop examination uniformity, concluded that the difficulties experienced in that effort may have resulted in part from "bureaucratic turf problems, lack of cooperation and a failure to communicate."

With regard to the alternative that some form of consolidation of the present regulatory structure is needed, the Council and FRS deferred comment pending the issuance of recommendations by Vice President Bush's Task Group on Regulation of Financial Services. The OCC and FDIC, however, favor some form of consolidation of the regulatory structure. The FHLBB believes that any move towards uniformity or consolidation of the agencies should begin with the three bank regulatory agencies. NCUA stated that our conclusion that some form of consolidation may be necessary is without any factual or theoretical support. NCUA appears to base its observations on the assumption that there is no evidence in this report or regulatory studies that uniformity increases supervisory effectiveness and thus there is no justification for strengthening the Council or restructuring the regulatory system. It was not an objective of this study to assess the need for uniform examination and supervision. The Congress determined that the Council was the proper mechanism for facilitating uniformity. The objective of our current review was to determine how well the Council was carrying out its legislative mandate.

The Council, FDIC, and FRS said that the report did not sufficiently reflect several of the Council's achievements. They said that the development of a Uniform Bank Performance Report was a noteworthy Council accomplishment. We agree, but the original objective of this project was to develop a common surveillance system which would replace the various systems that each agency has independently developed and maintained. A uniform data document such as the bank performance report was one of the three parts of the surveillance systems. The other segments of the system included a screen with which the data would be analyzed and an action system which would provide for a uniform response to potential problems disclosed by the screen. The project has not progressed beyond the first stage of developing the data collection instrument--the Uniform Bank Performance Report.

The report is largely identical to a bank performance report that OCC was using when the project was undertaken. The OCC told us that they now use the Uniform Bank Performance Report the same as their previous performance report had been used. The FDIC and FRS, the other two regulators that the report was to benefit, told us that the report is used as an analytical tool when their monitoring system identifies a potential problem situation. The report is also used by their examiners in planning and, to some extent, conducting examinations. We believe that the agreement on a Uniform Bank Performance Report is an important first step towards developing a uniform surveillance system and, to that extent, the project was successful.

The Council also believed that we did not sufficiently recognize the development of the uniform Reports of Condition and Income for banks as noteworthy Council accomplishments. While our draft report contained extensive discussion on the development of the uniform Reports of Condition and Income, it also included comments by agency officials which suggested that a uniform report could have been accomplished without the Council. Because we did not intend unduly to minimize the accomplishments of the Council, we have deleted these comments from our report.

The FRS commented that our report suggests that a uniform bank holding company performance report does not exist. It noted that FRS developed a bank holding company performance report several years ago. We agree that FRS has had such a report. However, the Council project we discuss was an effort to develop a report which would be acceptable to all three banking agencies. This Council project was not successful in achieving uniformity.

The Council and FRS also believe that the Council's training in international banking is a noteworthy accomplishment. We did not include a discussion of international banking courses in our report because international banking is only one part of the commercial examination. Moreover, the students attending these courses as well as the Council's manager of examiner education generally did not rate these courses as high as other courses. For example, the report on the quality of examiner training in 1982 by the Council's manager for examiner education stated that:

"International banking has become critically important to the regulatory agencies in recent years. Unfortunately, our international schools remain weak and are not as effective as they should be."

The Council's 1982 report discusses various problems with the two courses conducted on international banking and concluded that on the basis of the attendee ratings, the courses were considered inadequate.

Federal Financial Institutions **Examination Council**, Washington, DC 20219



August 18, 1983

Mr. William J. Anderson
Director
United States General
Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

On behalf of the Examination Council, I am pleased to respond to the General Accounting Office's Draft Report, "The Federal Financial Institutions Examination Council Has Not Brought Uniformity to the Federal Examination and Supervision of Financial Institutions."

In general, the Council believes that the report does not provide a balanced perspective of the Council's achievements since its inception. It emphasizes areas where success was not forthcoming, such as examination uniformity, the Uniform Bank Holding Company Performance Report, and a uniform definition of bank capital. The report, however, gives little or no credit for several noteworthy accomplishments, such as development of the Uniform Bank Performance Report, the uniform Reports of Condition and Income for commercial banks, and a complete program of examiner training in international banking.

The Report also discusses issues related to the organizational structure for the Federal supervision and regulation of depository institutions and notes that the Task Group on Regulation of Financial Services, chaired by Vice President Bush, is addressing these issues. The Council prefers to defer to the recommendations of the Task Group regarding agency reorganization.

We appreciate the opportunity to provide comments on the GAO Draft Report.

Sincerely,

Robert J. Lawrence
Executive Secretary



Comptroller of the Currency
Administrator of National Banks

Washington, D C 20219

August 19, 1983

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

Dear Mr. Anderson:

We appreciate the opportunity to respond to GAO's draft report entitled "The Federal Financial Institutions Examination Council Has Not Brought Uniformity to the Federal Examination and Supervision of Financial Institutions". The draft report discusses various additional actions that could be taken to promote uniformity in the Federal supervision of financial institutions, including some form of consolidation of the five member agencies. The Office of the Comptroller of the Currency (OCC) offers the following general comments for GAO's consideration.

We are in agreement with the observations and contents of the report, however, we feel that there are some statements that could be subject to misinterpretation due to the use of generalizations when discussing agencies' performance. Significant differences remain among the five member agencies and their respective supervised institutions which make identical examination policies and procedures inappropriate or even impossible.

With regard to your recommendation to Congress on the issue of agency consolidation, the OCC remains in favor of some form of consolidation. However, we feel that detailed discussions of this topic at this time are premature pending the results of the Task Group on Regulation of Financial Services, headed by Vice President Bush.

Sincerely,

C. T. Conover
Comptroller of the Currency

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

EDWIN J. GRAY
 CHAIRMAN

AUG 31 1983

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

Dear Mr. Anderson:

This is in response to your request for my views on the GAO Draft Report on the FFIEC.

Based upon my limited contact with the FFIEC, it appears that the GAO has for the most part, reached a valid set of conclusions. I hesitate however, in accepting your conclusion on the need for uniformity. I do not believe that uniformity for uniformity's sake is always justified. I prefer the view expressed by the member agencies, that any development of uniform examination policies and procedures should first be subject to a cost/benefit test and result in an improved examination process.

I do believe any move toward uniformity or consolidating the agencies should begin with the three banking regulatory agencies. Their overlapping jurisdiction and the fact that they all regulate the same industry suggest that they would have the best chance at success. The various functions of the Bank Board, on the other hand, give it a unique role, different from that of banking regulatory agencies. The National Credit Union Administration can also claim substantial differences in philosophies and functions. It is my opinion that if uniformity cannot first be accomplished within the banking agencies, there is little expectation that it can be achieved for all five member agencies.

I do agree with the GAO's final conclusion that Congress must first address a number of issues before any more decisions are made about the future structure for regulating financial institutions.

Sincerely,

Edwin J. Gray



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington D C 20429

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

August 12, 1983

Honorable William J. Anderson
Director, U.S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

This is in response to your letter of July 21, 1983, requesting our comments on the draft GAO report entitled "The Federal Financial Institutions Examination Council Has Not Brought Uniformity To The Federal Examination And Supervision Of Financial Institutions."

Needless to say, we agree with the statement in the title and indeed, with the essence of the draft report as a whole. We agree that the Council has had limited success in establishing uniform examination principles, standards and reports and that what has been accomplished was achieved at very considerable cost. In our view, the Council has simply added another bureaucratic layer to interagency cooperation that could be achieved more expeditiously and at less cost through more informal mechanisms. Overall, we agree that the Council has not been effective in achieving its statutory objectives and, in our view, should be abolished in favor of a consolidation and restructuring of the regulatory agencies along the lines indicated in our deposit insurance study^{1/} and our report to Vice President Bush's Task Group on Regulation of Financial Services.^{2/}

1/ "Deposit Insurance in a Changing Environment," a study of the current system of deposit insurance pursuant to section 712 of the Garn-St Germain Depository Institutions Act of 1982, submitted to the United States Congress by the Federal Deposit Insurance Corporation on April 15, 1983.

2/ FDIC Report on Regulation of Financial Services, April 25, 1983.

Honorable William J. Anderson

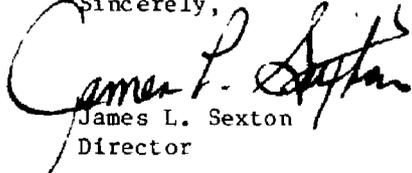
- 2 -

August 12, 1983

While generally agreeing with the draft report's conclusions, we might observe, in fairness to the Council and for the sake of balance, that scant mention is made in the report about the UBPR (Uniform Bank Performance Report), a notable Council success, while considerable attention is focused on the Council's failure to achieve a UBHCPR (Uniform Bank Holding Company Performance Report).

Similarly, the comment on page 32 of the report is not accurate in stating that most actions to achieve uniformity in examination procedures were in consumer areas where the underlying statutes required uniformity. In fact, the underlying statutes simply required enforcement and presented the opportunity for uniformity which was achieved through Council efforts. (Note 1.)

Finally, we must take exception to the statements on pages 73 and 74 to the effect that the agencies implementation of the Council's Truth in Lending enforcement policy guide showed that the FDIC "did not adequately inform" the Council that we were using enforcement criteria not specified in the policy guide. We dispute that conclusion for the reasons detailed in our comments in the GAO's report on that review. (Note 2.)

Sincerely,

James L. Sexton
Director

Note 1: Page number has been changed to correspond to the final report.

Note 2: These statements were deleted in view of FDIC's comments.



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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

August 18, 1983

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

Dear Mr. Anderson:

The Board of Governors of the Federal Reserve System appreciates the opportunity to review and comment on the GAO's draft report entitled, "The Federal Financial Institutions Examination Council Has Not Brought Uniformity To The Federal Examination and Supervision of Financial Institutions." The Board agrees with the GAO's conclusion that the Examination Council has had difficulty in achieving substantial uniformity in the federal regulation of depository institutions. The Board also concurs that the Council has been least successful in its efforts to establish uniform commercial examination principles, standards and report forms among the five agencies represented on the Council. As the GAO correctly notes, this inability to obtain substantial uniformity in the commercial examination area has made it infeasible for the Council to establish a comprehensive training program for commercial examiners of the five agencies. Such a program, to be effective, would require a relatively high degree of uniformity in commercial examination policies and procedures among the agencies.

While the Examination Council has had only limited success since its establishment in 1979, the Board believes that the Council has served, and can continue to serve, as a useful forum for the agencies to exchange supervisory experiences and to discuss common supervisory problems. This forum may become more valuable as the depository institutions supervised by the five agencies become more alike, and could, over time, help to achieve greater uniformity in supervisory approaches.

While concurring with the GAO's primary conclusions regarding the performance of the Examination Council, the Board believes that the GAO's draft report does not sufficiently reflect several of the Council's achievements. First, the draft report does not give adequate recognition of the development by the Council of a uniform bank performance report. This report, which is now widely used by examiners of the three banking agencies, has moved the agencies toward a common analytical framework and common set of financial ratios for evaluating the financial condition of individual banks.

Mr. William J. Anderson

-2-

Second, while the GAO report is correct in concluding that the Council has failed to develop a comprehensive examiner training program, the report gives virtually no recognition to the development of a series of interagency examiner training courses in international banking. At a time when international banking is a major source of concern, these successful international banking courses and seminars constitute more than a peripheral contribution to an examiner education program.

Third, the GAO's draft report does not seem to give sufficient recognition to the Council's achievements in the consumer compliance area. Particularly noteworthy accomplishments include the development of uniform examination procedures for enforcing many of the consumer protection statutes.

Finally, the GAO report seems to suggest that a uniform bank holding company performance report does not now exist. In fact, the Federal Reserve, which is the sole federal agency responsible for supervising bank holding companies, developed a bank holding company performance report several years ago. Since its development, this report has been made available to the other banking agencies. At present, the Federal Reserve is discussing with the other banking agencies possible changes in the existing bank holding company performance report and the underlying financial data that bank holding companies file periodically with the Federal Reserve.

At the conclusion of its draft report, the GAO recommends some form of consolidation of the present regulatory structure in order to achieve needed uniformity in the supervision and examination of depository institutions. The GAO also notes that the Task Group on Regulation of Financial Services, which is chaired by the Vice President, is now considering possible changes in existing agency structure, and will issue its report in several months. Pending the issuance of this report, the Board defers comment on the GAO's recommendation of some form of agency consolidation.

If the Board can be of any further service to the GAO in its evaluation of the performance of the Examination Council, please do not hesitate to contact me.

Sincerely,



William W. Wiles
Secretary of the Board



NATIONAL CREDIT UNION ADMINISTRATION

September 7, 1983

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

Dear Mr. Anderson:

We appreciate the chance to comment on the draft report entitled "The Federal Financial Institutions Examination Council has not brought Uniformity to the Federal Examination and Supervision of Financial Institutions."

The Report is a description of efforts where in, GAO's judgment, the Council has failed "to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions." GAO's explanation of why the alleged failures have occurred include "bureaucratic turf problems, lack of cooperation, failure to communicate, and the agencies inability to divert scarce and valuable resources given budget constraints and pressing financial industry problems" (page 24).

We believe the explanation is much simpler. Namely, there is no evidence anywhere in the Report or in regulatory studies that uniformity per se improves or causes an increase in supervisory effectiveness, or to use the criteria in the Report, "ensures progressive and vigilant supervision." All the cases listed which GAO interprets as a failure of the FFIEC to fulfill a Congressional prescription of uniformity are classical examples where a uniform approach would have reduced, in the judgment of the participants, supervisory responsiveness and effectiveness.

The GAO's conclusion from this review that "some form of consolidation of the present regulatory structure" is necessary is without any factual or theoretical support.

Regarding the FFIEC, we believe that its future effectiveness will be in its unique role as a forum for federal and state regulators to share common concerns and to learn from each other's experiences what alternatives and options can be employed to respond to supervisory and examination issues - newly emerging, as well as traditional ones. We don't believe there is one unique, uniform, or superior way to conduct an exam or to supervise an unsound institution, let alone the diverse players in the financial services industry.

Sincerely,

C. W. FILSON
Director, Office of Programs

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