

United States General Accounting Office
Washington, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 10 a.m., EST
Wednesday, February 5, 1976

Thursday



STATEMENT OF
ELMER B. STAATS
COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND
URBAN AFFAIRS
UNITED STATES SENATE
ON
PROPOSED GAO STUDY OF BANK REGULATORY
FUNCTIONS

We are here at your invitation to discuss a proposed GAO study of the bank regulatory functions of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation as described in your Committee's staff memorandum of January 26, 1976. The specific guidelines for this study, as proposed by your staff, are appended to my statement (Attachment 1).

We have had preliminary discussions with members of the Committee staff as to a possible GAO study of this nature. These discussions were in terms of a review only of the

U5 1652

activities of the Comptroller of the Currency in relation to several problem banks suggested by the Committee staff. The written proposal on which you have asked for our comments of course goes much further than these discussions. The scope of the proposed study has been extended beyond the Comptroller of the Currency to include in addition the regulatory and supervisory activities of the Federal Reserve Board and the FDIC. The proposed study would cover a representative sample of problem banks leading to our evaluation of the effectiveness of the agencies in carrying out their responsibilities rather than a limited number of case studies.

We have several comments on the proposed guidelines:

1. They provide that we would not be permitted to copy examination reports and work papers but that we could take notes. We do not believe in making such a study that we should be precluded from making copies of whatever documents we consider necessary to have for study, evaluation and support of our conclusions. In accordance with our regular audit practice, we would want to make copies of pertinent parts of examination reports and related work papers in addition to notes about them so that we can properly make our evaluations and use such materials in our follow-up

discussions with agency officials. This is our practice in connection with our annual audits of the Federal Savings and Loan Insurance Corporation where, as discussed later, we have access to the examination reports of the insured savings and loan associations. All of our work papers on these audits including whatever information we copy are kept in locked cabinets at our audit site in the agency's office and are not removed from the premises.

2. The guidelines state that we would prepare a report setting forth our conclusions on how effective the agencies have been in carrying out their supervisory responsibilities. We believe that this calls for too comprehensive a conclusion based on the somewhat limited examination we would be expected to make as we understand it. In the first place, we would not be going behind the examination reports and our sample of examination reports that we would review would be limited to a few of those on problem banks. To reach a general conclusion on the effectiveness of supervisory responsibilities, we would have to examine a much greater sample including not only examination

reports and actions on problem banks but also on non-problem banks.

3. The guidelines state that our report would remain confidential with the Committee to be released only pursuant to a Committee vote. As I will discuss later, we also have a request from a House subcommittee for an audit of bank regulatory activities. In addition, another House subcommittee is conducting a separate investigation of these activities. For these reasons, we believe that any report we prepare on any study we make of these functions should be made available to all committees who are actively involved.
4. The guidelines specify that any questions as to the scope and methods of our study would be determined by the Committee staff. If we are to make the study for the Committee, we believe that any questions that come up should be worked out on a cooperative basis as to what is practicable, rather than placing our office in the position of being directed by the Committee staff. This relates to the need for us to remain sufficiently independent to do "an objective and nonpartisan job" as the Committee staff memorandum says.

As the written proposal points out, the key to this kind of a study is full access to the bank examination reports and related files and records of the regulatory agencies. GAO has been authorized to audit the financial transactions of the FDIC for many years in accordance with the principles and procedures applicable to commercial corporate transactions.

As you know, this Corporation provides deposit insurance for commercial banks. However, in making our audits, we have never been given access to the bank examination reports except those relating to closed banks and therefore we have been able only to make a very limited audit each year. I have described this situation at some length in my letter addressed to the Chairman of this Committee on January 22, 1976, and a copy is attached to my statement (Attachment 2).

Also, as you know, except for the authority to audit the cancellation and destruction of U.S. currency unfit for circulation as provided in the act of May 20, 1966, we do not have any authority to audit the activities of the Federal Reserve Board or the banks and other facilities of the Federal Reserve System. Bills are pending in both the House and Senate to provide this authority and both bills, as presently drafted, provide that we would have access to bank examination reports from whatever source in making our audits.

We do not have any statutory authority to audit the Office of the Comptroller of the Currency. The expenses of the Comptroller of the Currency are paid from assessments levied against regulated banks and the law specifically provides that these funds are not to be construed as Government funds or appropriated monies. For this reason, our general audit authority over Government agencies does not include the Office of the Comptroller of the Currency and we have never been given specific authority to audit its activities.

Because of our lack of audit authority over the Comptroller of the Currency and the Federal Reserve System and the limitations placed by the FDIC on our audit of its activities, we could only make the study proposed by the Committee staff if the Committee makes satisfactory arrangements for our access to the pertinent bank examination reports and related files and records including those pertaining to management actions on the reports. To make a satisfactory study, we would also need the full cooperation of agency officials to discuss the management's use of the bank examination reports once they are completed and the nature of the actions taken on the findings and recommendations of the examiners. Without appropriate access to the necessary reports and records and the cooperation

of agency officials, we could not make the study contemplated in the Committee staff proposal.

As far as staff and other resources that would be required to make a satisfactory study are concerned, at this time we have no way of estimating how many staff members would be required, how much travel would be involved, or how long such a study would take. These requirements would depend on the number, size and complexity of the problem banks selected for study, satisfactory resolution of the access to records problem, and the cooperation of agency officials and employees.

Because of the restrictions on our audit authority, our experience in working with bank examination reports is limited. As stated earlier, we do have access to them in our work at the FDIC for banks that have been closed (see Attachment 3). However, we have never been able to persuade Corporation officials to permit us to examine other bank examination reports or obtain information about them except under conditions that would exclude all identifying data and we felt these conditions were too restrictive to be useful.

Our staff has had experience in reviewing the examination reports on savings and loan associations insured by the Federal Savings and Loan Insurance Corporation. We have never had

any problem with obtaining access to those reports in connection with our annual audits of that Corporation. By reviewing examination reports for a selected number of problem and non-problem associations, we are able to evaluate the impact of problem or potential problem associations on the financial condition of the Corporation (see Attachment 4). For this reason, we can make more satisfactory audits than in the case of the FDIC. In the latter case, we have repeatedly recommended in our audit reports that the Congress amend the FDIC Act to clarify our authority, but this has not been done.

In 1968, the House Committee on Banking and Currency held hearings on our recommendation. In our testimony, we discussed at length our continuing problem with respect to bank examination reports on insured banks. However, no change in the law was made as a result of these hearings.

I believe you are aware that the Chairman of the Domestic Monetary Policy Subcommittee of the House Committee on Banking, Currency and Housing is also very much interested in the subject of the bank regulatory activities of the three agencies. On January 24, he addressed a formal written request to us that we "conduct a full-scale audit of the bank regulatory functions of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Reserve System over the past five years."

This request of course calls for a more farreaching study than that contemplated in your staff's proposal although I believe that the objectives are the same. In any event, if you wish to have us make a study, it seems to me that its nature and scope ought to be worked out so that it will be satisfactory for the needs of both your Committee and the House Committee.

The Chairman of the House Subcommittee has written also to the heads of the three regulatory agencies requesting that they voluntarily allow our auditors to review and evaluate their supervisory responsibilities relating to the banks under their jurisdiction and that they make available to us all of the records, books and documents, and other material relating to their bank examination and supervisory functions. We have inquired of these agencies as to what arrangements will be made to make available to us the necessary reports, records, and files which we will need to examine in order to carry out the Subcommittee's request. At this time, we do not know what decisions have been made by the three agencies on the Subcommittee's request.

You have asked for our views on the necessity for a study of bank regulatory activities. We believe that there are these alternatives:

1. Since we lack statutory authority to make audits of the Comptroller of the Currency and the Federal Reserve System and since we have had a long-standing disagreement with the FDIC on the extent of our audit of its activities, we believe that we could best serve the Committee if the study proposed by the Committee staff were made by the Committee itself. We would be willing to assist in such a study by assigning members of our staff to the Committee to help carry it out. Under the circumstances, we would prefer this course of action at this time.
2. If the Committee wishes such a study to be made and that we should do it for the Committee, we would do our best to carry it out in accordance with the Committee's wishes, assuming that satisfactory arrangements could be made with the three regulatory agencies for access to the necessary records. In this case, the scope of the study could be confined to selected case studies of problem banks which is what we understand would be the intent of the Committee staff

proposal. A second possibility would be to limit the case studies to closed banks, tracing the history of actions over a period of time, possibly beginning from the time the banks were placed in a classified category.

However, a more comprehensive study might be made by examining a statistically drawn sample of problem banks of the three agencies and examining what is done about the findings and recommendations of the examiners in the cases reviewed.

3. Another approach would be for the Committee to arrange for us to make a survey of these activities as we normally do in auditing other Government programs and activities and on the basis of such survey reach preliminary conclusions as to what should be examined in more depth.

If this course of action were followed, we could advise the Committee later of our preliminary findings and recommendations about the kind of audit or study that we believe could be helpful to the Committee in its oversight work.

One reason for suggesting this alternative is the fact that the Comptroller of the Currency engaged the public accounting firm of Haskins & Sells to make a major study of his agency and to propose recommendations that would enable it to achieve its objectives more efficiently and effectively. The accounting firm submitted a comprehensive report in May 1975 which contained numerous recommendations and we understand that many of these recommendations are now being placed into effect.

For this reason, there is some question as to whether a review of the handling of examination reports on problem banks in the past will lead to observations or conclusions that are relevant in the light of changing procedures in the Office of the Comptroller of the Currency. A preliminary survey of current operations including changes in procedures would be helpful in making decisions as to what further studies would be helpful to the Committee.

It is our view that an independent review of how bank regulatory functions are carried out would be desirable as a means of assisting the Congress in carrying out its oversight responsibilities. Under present arrangements, there is no

provision for such independent review. To depend on unofficial investigations by the press and disclosures in the press of information used by the regulatory agencies to carry out their functions is not, in my judgment, a satisfactory situation. Public confidence in the commercial banking industry is important in our society and the effectiveness of Government supervision and regulation has much to do with that confidence. However, as with all Governmental activities, I think there should be provision for an independent review of how important responsibilities are carried out and I think in this area there is a serious gap.

I think the best solution is for the Congress to give us statutory authority to make audits of the activities of the bank supervisory and regulatory agencies in the same way that we do for almost all other Governmental programs and activities. The fact that the information that we would be working with is highly sensitive should not in itself be an overriding reason why our office, as a part of the legislative branch, should be barred from making such audits.

In devising our work plans and programs where we have statutory audit authority, it is our continuing policy to keep abreast of the interests of the congressional committees so as to enable us to concentrate our work on matters that will be as helpful as possible to them.

Guidelines for the GAO Study

If the Committee determines to request a GAO study of the bank regulatory process, the following guidelines are suggested:

1. The GAO study would begin by reviewing the examination reports and associated working papers for a representative sample of problem banks. The reports examined would go back far enough in time to the point where difficulties first began to be noted.

2. All examination reports and working papers would be reviewed in the offices of the respective regulatory agencies. GAO would not be permitted to remove these documents or to copy them. GAO auditors would, however, be permitted to take notes to assist them in their subsequent follow up interviews with agency officials.

3. After reviewing the examination reports and working papers, the GAO would interview officials in the three agencies to determine what action was taken by the agencies with respect to problems noted in the examination report. These examination reports and working papers would be taken as given. GAO would not be permitted to challenge the accuracy of an examiner's findings by conducting a separate examination of the bank involved. Instead, the focus of the GAO study would be on what actions were taken or not taken by the agency on the examiner's findings.

4. After completing their interviews with agency officials, the GAO would prepare a report for the Committee setting forth its conclusions as to how effective the agency has been in carrying out its supervisory responsibilities. In preparing its report, the GAO would not discuss the condition of any individual bank included in its sample unless the bank has already failed or merged with another institution and such discussion would not impair public confidence in the solvency of the successor institution. An advance copy of the report would be made available to the head of each agency before it is delivered to the Committee. Each agency would be afforded an adequate opportunity to comment on the GAO's conclusions as an addendum to the report.

- 2 -

5. The report would remain confidential with the Committee and would be released only pursuant to a vote of the Committee.

6. At all times throughout the study, the GAO would work closely with the Committee staff. Any questions as to the scope and method of the study would be determined by the Committee staff in accordance with the policies of the Committee.

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

January 22, 1976

B- 114831

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

Dear Mr. Chairman:

Recent stories in the press raising questions about the financial condition of two large New York banks based on apparently unauthorized access to bank examination reports of the Comptroller of the Currency prompts me to write to you about the recurring problem faced by the General Accounting Office in its required audits of the FDIC.

The Federal Deposit Insurance Act requires us to audit the financial transactions of the corporation in accordance with the principles and procedures applicable to commercial corporate transactions and under such rules and regulations as may be prescribed by the Comptroller General.

That law also specifically provides that we shall have access to all books, accounts, records, reports, files, and all other papers, things, or property belonging to or in use by the Corporation pertaining to its financial transactions and necessary to facilitate the audit.

Despite the specific provisions of this law, for many years the Corporation has refused to give our auditors access to the reports of examinations of banks which are insured by the Corporation, except those pertaining to closed banks. Corporation officials have in effect taken the position that these records involve matters beyond the scope of audit intended by the Congress when it specified that our audit would be of financial transactions of the Corporation. Corporation officials do not regard their function of examining banks or their use of reports of bank examinations performed by examiners of the Comptroller of the Currency and the Federal Reserve Board as coming within the meaning of the term financial transactions.

We have contended from the start, however, that the intended audit, which is to be in accordance with the principles and procedures applicable to commercial corporate transactions, of necessity covers the regulatory activities including the bank examination work.

This difference of opinion has existed for many years. Although we have repeatedly recommended in our audit reports on the FDIC that the Congress amend the law to specifically provide for our access to the examination reports and related records pertaining to insured banks, no action has been taken to do so. As a result, our annual audits of the Corporation are limited in nature and we have so stated in our reports.

A bill (S. 2268) now pending in the Congress to revise and restate certain functions of our Office includes a provision which would give the Comptroller General the means of enforcing our existing right of access to information needed for audit purposes. This provision would authorize us to institute court action to compel the production of documents in cases where an executive department or establishment fails to comply with a request for information, books, documents, papers, or records.

GAO can be more helpful to the Congress in carrying out its legislative and oversight responsibilities in the field of bank insurance and regulation if our authority to have access to bank examination reports prepared by Federal agencies is clarified in the law.

The FDIC Act also specifies what kind of an audit report shall be submitted by the Comptroller General to the Congress. One of the specific requirements is that these reports include such comments and information as may be deemed necessary to inform the Congress of the financial operations and condition of the Corporation. Because of the importance of the conduct of bank examinations to the insurance process and the use of the resulting reports, the auditors must have unrestricted access to those reports and related working papers if they are to obtain the understanding of all of the important factors affecting the Corporation's financial operations and condition as necessary to enable them to prepare the kind of reports contemplated by the law.

The examination reports contain facts, opinions, and recommendations of vital importance to the conduct of the Corporation's affairs. Without access to these reports and the related supporting files and records, the auditors cannot evaluate the financial operations and condition of the Corporation, which is inseparably linked with that of the banks it insures.

Without access to these reports, the auditors cannot evaluate:

- whether bank examinations were of sufficient scope and could be relied upon to identify all banks that should have been classified as problem banks,
- whether the management of the Corporation has taken effective followup action on findings disclosed by bank examiners, and
- the significance of possible adverse effect of problem banks on the Corporation's financial position.

A further basis of need is the fact that the employees of the Corporation's examination division, who make the examinations of State banks that are not members of the Federal Reserve System, constitute about three-fourths of the total personnel of the Corporation. A very substantial part of the salaries and related benefits paid by the Corporation are therefore applicable to this function. Therefore, it is essential from an audit standpoint that the auditors have an opportunity to examine the products of their efforts in order to evaluate the effectiveness of their work and how good a job is being done.

The question is sometimes raised that bank examination reports contain much confidential information relating to the financial condition and operations of banks and that this information is so sensitive that it should not be entrusted or otherwise made available to the auditors for the Congress. It should be borne in mind in connection with any discussion of this question that in our audit operations throughout the Government we have access to the most sensitive information including that which is given the highest national security classification. We have strict procedures for safeguarding such information from unauthorized disclosure and there is no reason to believe that any confidential information contained in bank examination reports would be treated with any less care.

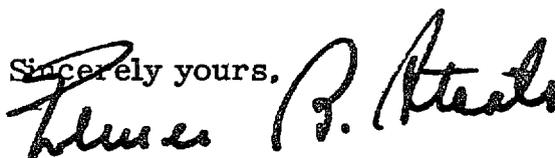
It should also be pointed out that it is not our intention to include in our audit reports specific information of an adverse nature on specific banks drawn from these reports if the disclosure of such information is regarded by the Corporation or other responsible officials as being contrary to the public interest because of its confidentiality or sensitivity. Our concerns are with how well the system of supervision and regulation works, including the important element of bank examinations, and its impact on financial operations and condition of the Corporation.

In making annual audits of the Federal Savings and Loan Insurance Corporation as required by the Government Corporation Control Act, we consider it an important part of our audit procedure to review the reports by the Office of Examination and Supervision of the Federal Home Loan Bank Board on its examinations of individual savings and loan associations. In these audits we have been given full access to the examination reports as well as to supporting working papers and related correspondence and other files. Access to these records by our auditors has never caused any problems to the Federal agencies concerned or to the savings and loan associations and, to our knowledge, such access has not jeopardized the relationships that exist between the agencies and the associations with which they deal.

Legislation now being considered in the Congress providing for an independent audit of the Federal Reserve System by GAO provides for access to bank examination reports irrespective of the source of those reports. This is a very important provision and one which we wholeheartedly endorse. A satisfactory audit simply cannot be made if the agency under audit is permitted to withhold from examination any important documents and records that bear on their operations.

In the case of the FDIC, we know of no satisfactory reason why our capacity to assist the Congress in its legislative and oversight work relating to the broad field of Federal bank insurance and regulation should be obstructed because of the refusal of the FDIC to give our auditors access to bank examination reports. We believe it to be highly desirable that the Congress assist us in this long-standing problem by clarifying the law as recommended in our periodic audit reports.

Sincerely yours,



Comptroller General
of the United States

FEDERAL DEPOSIT INSURANCE CORPORATION
GAO REVIEW OF EXAMINATION REPORTS ON CLOSED BANKS

Since the early 1950's GAO has made various requests to the Chairman of the Board of Directors, Federal Deposit Insurance Corporation, for complete and unrestricted access to all of the corporation's records deemed necessary to carry out GAO's audit responsibility. The Chairman of the Board has refused these requests. The Corporation has taken the position that GAO's right to access of its records is limited to those administrative or housekeeping records pertaining to its financial transactions. The position of GAO and the Corporation on this matter are set forth in detail in our report to the Congress, "Audit of the Federal Deposit Insurance Corporation, Year Ended June 30, 1964" (B-114831, February 28, 1966).

Although GAO has been denied unrestricted access to the Corporation's examination reports, we have been provided access to the records of closed banks. As a part of our annual audit of the Corporation's financial statements, we review the examination files on the banks closed during and subsequent to the audit period. These files contain examination reports and related correspondence. In our review, the reasons for the bank closing are identified and the need for a loss reserve is determined.

- 2 -

In identifying the reasons for the bank closing, we review correspondence among the regulatory agencies and between these agencies and the bank officials. The identified reasons are discussed with Corporation officials and substantiated with information in the examination reports.

The information in the examination reports also is used to substantiate the expenses incurred by the Corporation for bank closings and to evaluate the adequacy of the Corporation's reserves for bank losses. The Corporation computes these costs based on actual expenditures and their valuation of the acquired assets and obligations.

As a part of our review of the records on closed banks, we also attempt to analyze the examination procedures which have been employed in past examinations by the Corporation or the Federal Reserve. In particular, we attempt to determine that (1) the Corporation's examination guidelines were followed, (2) the examiners' suggestions were acted upon, (3) examination intervals were proper, and (4) examiners performing the review were rotated periodically. We cannot, however, make an overall evaluation of the Corporation's bank examination process based on this limited assessment. Such an evaluation would require that GAO have unlimited access to all examination reports, files, and other records of the Corporation, the Federal Reserve Banks, and the Comptroller of the Currency.

- 3 -

<u>Fiscal Year</u>	<u>Number of Insured Banks Which Failed</u>			
	<u>State</u>		<u>National</u>	<u>Total</u>
	<u>Nonmember</u>	<u>Member</u>		
1970	5	-	2	7
1971	7	-	1	8
1972	2	-	1	3
1973	2	-	1	3
1974	1	-	2	3
1975	7	1	2	10
July 1-Dec. 31, 1975	<u>5</u>	<u>1</u>	<u>1</u>	<u>7</u>
Total	<u>29</u>	<u>2</u>	<u>10</u>	<u>41</u>

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION
GAO REVIEW OF EXAMINATION REPORTS OF SAVINGS AND LOAN ASSOCIATIONS

The Federal Savings and Loan Insurance Corporation, a wholly owned Government corporation, insures withdrawable share and deposit accounts up to \$40,000 for each insured member in all Federally chartered savings and loan associations and similar institutions upon their request and upon approval by the Federal Home Loan Bank Board. The Board, an independent supervisory and regulatory agency, carries out certain functions of the Corporation such as processing insurance applications and examining insured institutions.

The Government Corporation Control Act requires GAO to make an examination of the Corporation's financial statements. An important part of our audit is a review of the Federal Home Loan Bank Board's Office of Examinations and Supervision's reports on the results of its examinations of individual savings and loan associations. The Office of Examination and Supervision is responsible through its examination process for protecting the Corporation's assets against losses caused by the financial failure of any insured savings and loan association.

During the audit we have been given unlimited access to examination reports and supporting working papers, classified and unclassified correspondence files, minutes of Board meetings and related data on all savings and loan associations including those institutions the Board has classified as "problem" cases. In making our

- 2 -

audit, we examine selected "problem" cases to ascertain the basis for their classification and the reasonableness of the Board's allowance for estimated losses.

We also review on a sample basis the Board's examination reports on "non-problem" associations to determine the reasonableness of these classifications and the adequacy of the Corporation's primary and secondary reserves. This work includes an evaluation of the Board's procedures for identifying problem institutions and the effectiveness of follow-up action taken on examiner findings.

On occasion, we have questioned the classification of a particular savings and loan association or the amount of allowance or reserve established. We have always been able to resolve these questions informally with officials of the Corporation.

We have experienced no difficulty in obtaining access to records in the audits of the Federal Savings and Loan Insurance Corporation and the Federal Home Loan Bank Board. Access to these records by our auditors has never caused the Federal agencies concerned or the savings and loan associations any problems and, to our knowledge, such access has not jeopardized the relationships that exist between the agencies and the associations with which they deal.