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September 28, 2004
Report No. 04-040

Division of Supervision and Consumer Protection's Regional Office Structure

AUDIT REPORT

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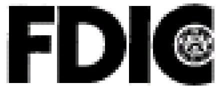


Federal Deposit Insurance Corporation
801 17th Street NW, Washington, DC 20434

Office of Audits
Office of Inspector General

DATE: September 28, 2004

MEMORANDUM TO: Michael J. Zamorski, Director
Division of Supervision and Consumer Protection

FROM: Russell A. Rau [Electronically produced version; original signed by Russell A. Rau]
Assistant Inspector General for Audits

SUBJECT: *Division of Supervision and Consumer Protection's Regional Office Structure*
(Audit Report 04-040)

This audit report discusses the results of our audit of the Division of Supervision and Consumer Protection's (DSC) regional office structure. DSC currently maintains six regional offices located in New York, Atlanta, Chicago, Kansas City, Dallas, and San Francisco. In addition, DSC operates two area offices[1]- -one in Boston and one in Memphis. DSC's regional office structure has remained essentially unchanged since 1987.

The objective of the audit was to assess DSC's regional office structure in light of changes that have occurred at the Federal Deposit Insurance Corporation (FDIC) and in the banking industry since the 1980's. To accomplish our objective, we reviewed DSC's staffing and office structure; policies, procedures, and programs for supervising institutions; and industry history and trends. Appendix I of this report discusses our objective, scope, and methodology in detail.

BACKGROUND

The FDIC helps to promote confidence and stability in the Nation's financial system by insuring deposits and examining and supervising financial institutions.[2] Much of the day-to-day performance of these functions occurs at the FDIC's 8 regional/area offices and 85 field offices around the country (see Appendix II). The primary responsibilities of the regional offices involve assessing risk to the deposit insurance funds and directing appropriate supervisory efforts to manage such risk. The regions are also responsible for ensuring compliance by

[1] The two area offices each report to a regional office; however, each office has maintained most of the functional responsibilities of a regional office.

[2] The FDIC is the primary federal regulator for state-chartered banks that are not members of the Federal Reserve System. The Office of the Comptroller of the Currency (OCC) is the primary federal regulator for all national banks. The Board of Governors of the Federal Reserve System (FRB) is the primary federal regulator for state-chartered banks that are members of the Federal Reserve System. The Office of Thrift Supervision (OTS) is the primary federal regulator for federal and state-chartered savings associations. Under the Federal Deposit Insurance Act, the FDIC may perform special examinations of any insured depository institution when deemed necessary for insurance purposes.

FDIC-supervised institutions with various consumer protection-related requirements. The field offices, which report to the regional offices, are responsible for conducting various institution examinations.

Generally, regional office personnel are responsible for ensuring that the supervisory strategies for institutions within their geographic boundaries are appropriate and revised as needed. This process requires ongoing coordination with DSC field office supervisors and state and federal regulatory agencies and effective use of off-site monitoring tools. In addition, the regional offices are responsible for performing activities related to the review, analysis, and processing of reports of examination and applications,[3] and for preparing miscellaneous correspondence directed to the Washington Office, state regulatory authorities, other federal regulatory agencies, and financial institutions.

In addition to supporting the performance of safety and soundness examinations as required by law, the regional offices provide specialists to help examiners address certain risks pertaining to information systems, trusts, accounting, and capital markets. The regional offices also provide technical guidance to field examiners and case managers for special situations, examinations, and investigations and provide feedback to field examiners on the quality and content of reports of examination.

Since the FDIC implemented its current regional office structure, the banking industry has been marked by tremendous changes:

- Consolidation has been a trend since 1985, when there were over 14,000 community banks,[4] compared to just over 7,000 today.

- In the mid-1980's, the top 10 banking organizations held 16 percent of industry deposits, while today, these organizations hold over 40 percent of deposits.

- During the 1980's, there was virtually no growth in total earnings for the commercial banking industry – earnings hovered at about $15 billion. By contrast, during the 1990's, annual earnings grew almost fivefold to just over $70 billion by the late 1990's.

- Banks continue to thrive, earning a record of nearly $120.6 billion in 2003. The return on assets (ROA) for 2003 was 1.38 percent, surpassing the previous all-time high of 1.30 percent in 2002.

According to some FDIC studies, the consolidation trend in banking suggests that the largest institutions may grow even larger, and the number of community banks could continue to decline to half as many as there are today. Much of the positive growth related to earnings has occurred

[3] Banks are required to submit applications to their primary federal regulator for certain activities that include, among other things, opening or relocating branch offices, changing control of the bank, and merging with or acquiring another financial institution.
[4] A community bank is a small local bank that serves the needs of one community or a series of communities in a close geographic area. Typically, these banks have assets totaling under $1 billion.

at the larger institutions, thus reinforcing the consolidation trend. The consolidation trend will ultimately pose significant challenges for the FDIC in its role as insurer and supervisor of financial institutions.

In addition to the quantitative changes in the banking industry, there have been significant changes in information technology and laws and regulations impacting the institutions' operations. Institutions have increasingly made banking services and data available to customers through information technology such as automated teller machines and transactional Web sites. In accordance with the Bank Secrecy Act (BSA), institutions must file reports for cash transactions exceeding $10,000 with the Internal Revenue Service.[5] Title III of the United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act) places considerable responsibilities on insured depository institutions to monitor foreign entities and individuals and cooperate with law enforcement officials in a timely manner. The DSC regions also direct examination efforts related to institutions' compliance with BSA and the USA PATRIOT Act.

The FDIC has been continuously downsizing since 1992, due, in large part, to the precipitous decline in bank failures and the continuing trend of consolidation within the banking industry. Total FDIC employment (including the former Resolution Trust Corporation[6]) has declined 75 percent from approximately 23,000 in 1992 to about 5,300 at the end of 2003.

RESULTS OF AUDIT

The DSC has not made a significant change to its regional office structure since 1987, even though the industry DSC supervises and its supervisory approach have experienced significant changes. Some examples of changes that have taken place include the following:

- FDIC-insured institutions have decreased from 17,345 in 1987 to 9,182 as of December 31, 2003 – a 47 percent decline even with over 2,000 newly chartered institutions during that time period.

- FDIC-supervised institutions have decreased from 8,450 in 1987 to 5,318 as of December 31, 2003 – a 37 percent decline.

- Failures of banks and savings associations have declined from a peak of 534 in 1989 to 3 during 2003.[7]

---

[5] Bank Secrecy Act, Title II, *Reports of Currency and Foreign Transactions*, requires a financial institution to file a Currency Transaction Report with the Internal Revenue Service for each cash transaction over $10,000 or multiple cash transactions by an individual in 1 business day, aggregating over $10,000.
[6] The Resolution Trust Corporation, or RTC, was a federal agency created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to oversee the liquidation of assets of insolvent savings and loan associations.
[7] As of the date of this report, four FDIC-insured banks had failed in 2004.

- The number of insured problem financial institutions[8] has decreased from 2,081 in 1987 to 106 in 2003 – a 95 percent decline. As of March 31, 2004, there were 114 FDIC-insured problem institutions with total assets of $30 billion.

- Total assets at FDIC-insured institutions have increased from about $3.0 trillion in 1987 to over $7.6 trillion at the end of 2003 – a 153 percent increase.

- The average ROA for FDIC-insured commercial banks has increased from 0.10 percent in 1990 to1.38 percent (an all-time high) as of December 31, 2003.

- The average equity capital ratio for FDIC-insured commercial banks has increased from 6.02 percent in 1987 to 9.1 percent as of December 31, 2003.

- The use of information technology has increased dramatically, particularly through transactional Web sites.

- The FDIC has implemented risk-focused examinations and has delegated many responsibilities from its regional offices to its field offices.

- Efforts to combat terrorist financing have increased since September 11, 2001.

The banking industry is financially stronger and significantly more consolidated today than it was in 1987. The ongoing consolidation of the banking industry has led to a few very large institutions holding an increasingly significant share of banking assets. Currently, the combined assets of the 18 largest insured banking organizations account for more than half of the assets of insured banking companies in the United States. The FDIC is the primary federal regulator for 2 of the 18 largest institutions as of March 31, 2004.

To keep abreast of industry changes, DSC has performed a number of studies (process redesigns) that have changed DSC's approach to examinations and supervision. Most notable was the implementation of a risk-focused examination process that has streamlined examination procedures at banks with low-risk profiles. In addition, DSC field offices now perform many functions that historically have been performed by regional offices such as examination review and processing, review of other regulators' reports, processing of applications, and serving as the contact point for bankers. Additionally, DSC is testing a "relationship manager" program that could delegate even more responsibility to the field offices. We estimated that the supervisory responsibilities for about 70 percent of the FDIC-supervised institutions could ultimately be performed at the field office level.

Recognizing the need for changes, the OCC and the OTS realigned their district (regional) office structures in 2002 and 2003, respectively, in response to continuing consolidation in the banking system and to take advantage of advances in technology and changes in the way these regulators managed their nationwide network of examiners and field offices. The OCC reorganized its field operations to eliminate a layer of management by delegating more authority to the agency's field offices, which are closer to the banks it supervises. As part of the OCC's reorganization, it

[8] The FDIC defines a problem financial institution as any insured institution that has been assigned a composite rating of "4" or "5" under the Uniform Financial Institution Rating System by its primary federal regulator or by the FDIC if it disagrees with the primary federal regulator's rating.

reduced the number of its district offices from six to four. The OTS restructured its regional offices (1) to achieve greater operating efficiencies by realigning its regional structure into four supervisory regions (down from five), consolidating its administrative functions in Washington, and reducing staff to meet reduced workload demands and (2) to achieve a balanced budget.

Industry, technology, and security changes and the changes in DSC's approach to its supervisory responsibilities could alter the future role of the regional offices and warrant reconsideration of the current geographic and organizational structure of the regional offices. DSC should reassess its current regional and area office structure to determine whether it is the most optimal alignment of resources for accomplishing its mission. An independent comprehensive review of regional office activities to ensure their relevance and fit for the 21st century and their relative priority is needed. While enhanced effectiveness and efficiency would be the primary considerations in assessing restructuring alternatives, economies could likely be achieved through the process.

CHANGES IN DSC's SUPERVISORY APPROACH AND IN THE BANKING INDUSTRY SINCE THE 1980's

The significant changes in the banking industry over the past 2 decades raise some questions about whether the FDIC's current regional office structure is appropriate. The changes have resulted in fewer FDIC-insured and FDIC-supervised banks and a precipitous decline in the number of problem and failed institutions as shown in Table 1.

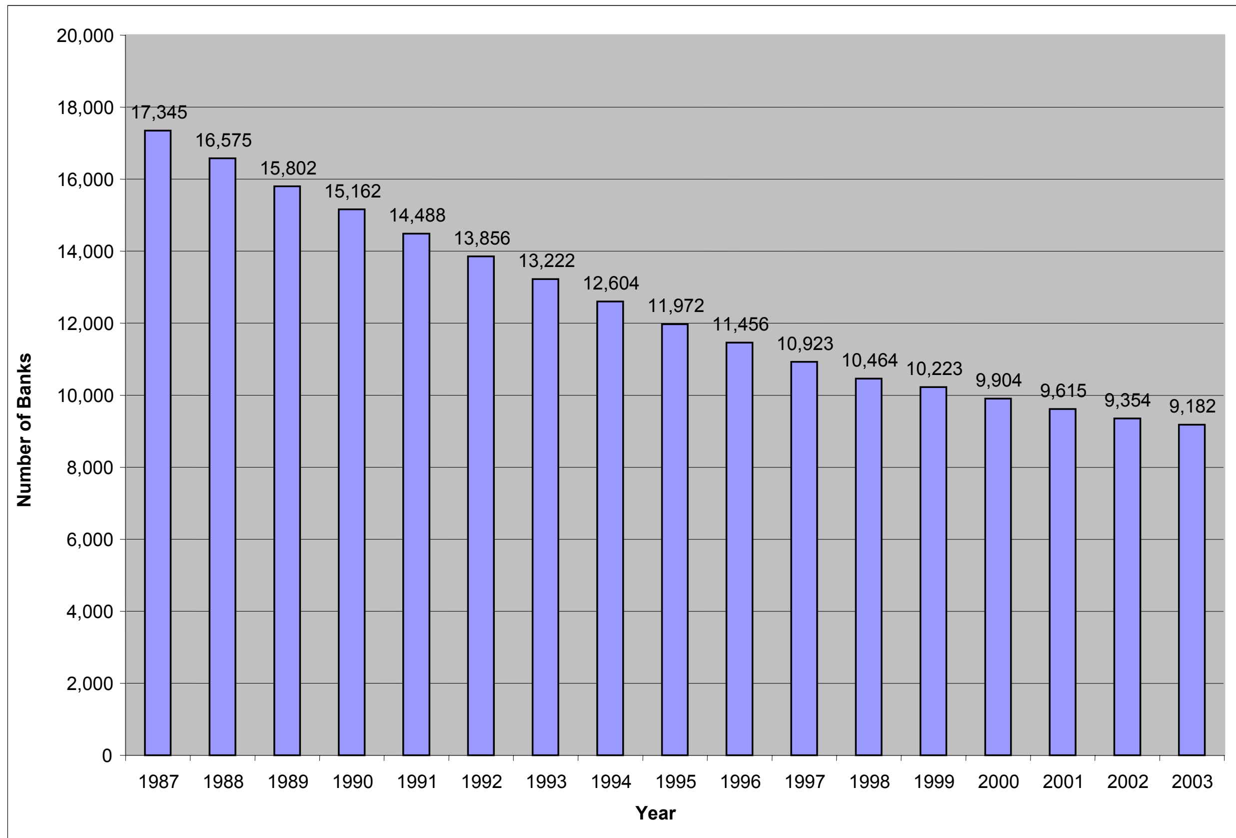
Table 1: Number of FDIC-Insured and -Supervised Institutions, Problem Institutions, and Failed Institutions for Selected Years Since 1987

Number of Institutions	1987	1989	1990	2003	Percent of Decline from 1987 to 2003
Insured *	17,345	15,802	15,162	9,182	47%
Supervised *	8,450	7,969	7,811	5,318	37%
Problem	2,081	1,632	1,492	106	95%
Failed	262	534	382	3	99%

Source: The FDIC's *Historical Statistics on Banking*, Commercial and Savings Institutions Bank Reports.
*The FDIC-insured and -supervised banks include institutions insured by the Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF).

During the late 1980's, a spate of bank failures contributed to the decline in FDIC-insured financial institutions. During the 1990's, a number of mergers and acquisitions also contributed to the decline in the number of FDIC-insured financial institutions. In fact, the number of FDIC-insured financial institutions has declined each year since 1987 as depicted in Figure 1 on the next page (see Appendix II for a state-by-state analysis) and, on average, each region is supervising 46 percent fewer institutions now in comparison to 1987.

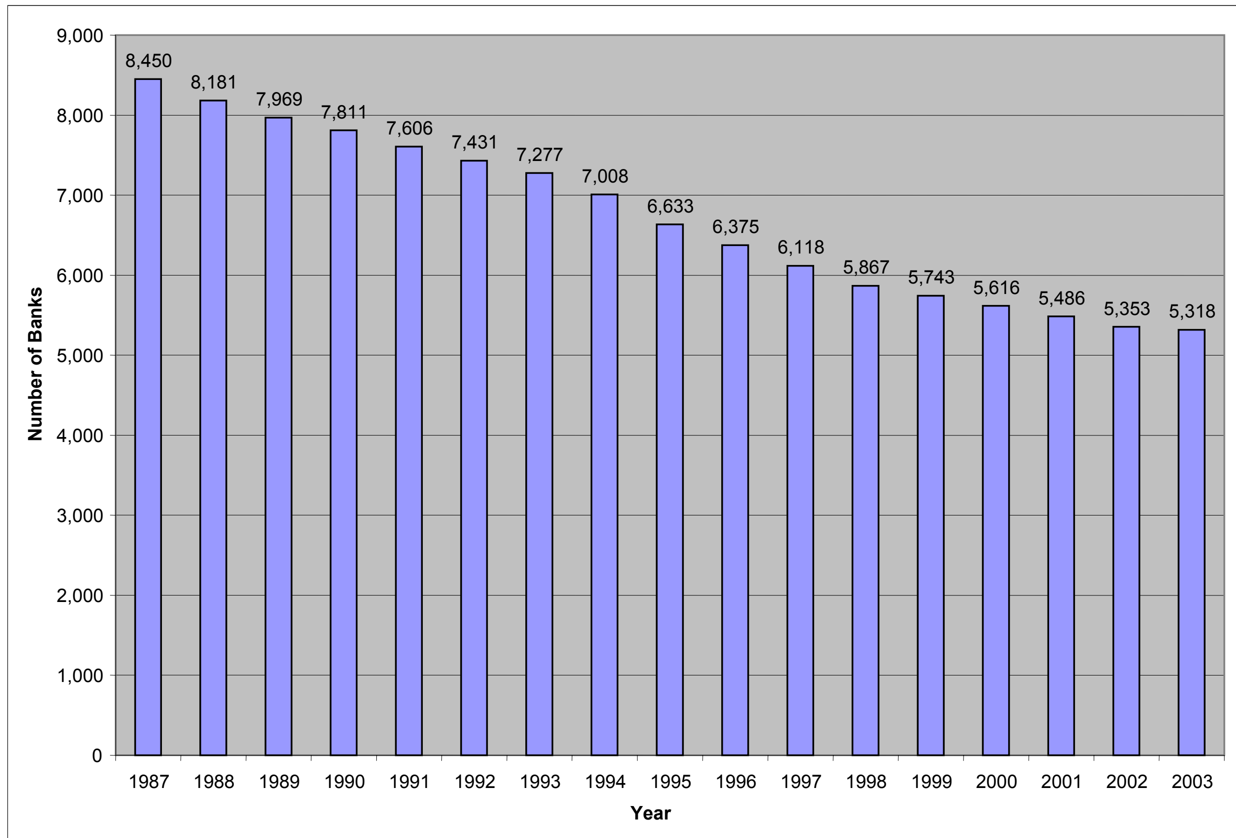
Figure 1: Total Number of FDIC-Insured Institutions From 1987 to 2003



Source: The FDIC's *Historical Statistics on Banking*, Commercial and Savings Institutions Bank Reports.

Additionally, the number of FDIC-supervised institutions has declined by over 3,100 (40 percent) since 1987, as shown in Figure 2 on the next page.

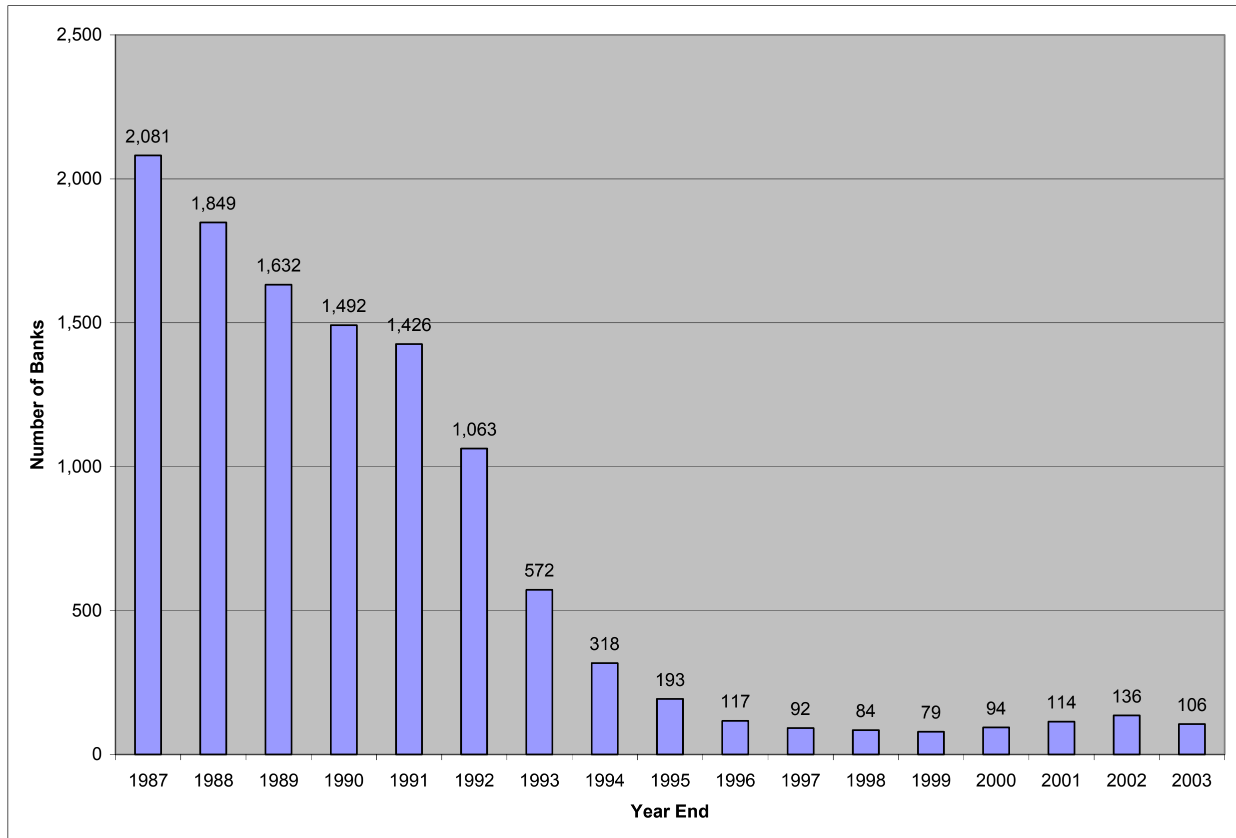
Figure 2: FDIC-Supervised Institutions From 1987 to 2003



Source: The FDIC's *Historical Statistics on Banking*, Commercial and Savings Institutions Bank Reports.

Further, in the late 1980's there were over 1,500 problem banks in the country. However, the number of problem banks has dropped to below 140 every year since 1996, as shown in Figure 3 on the next page.

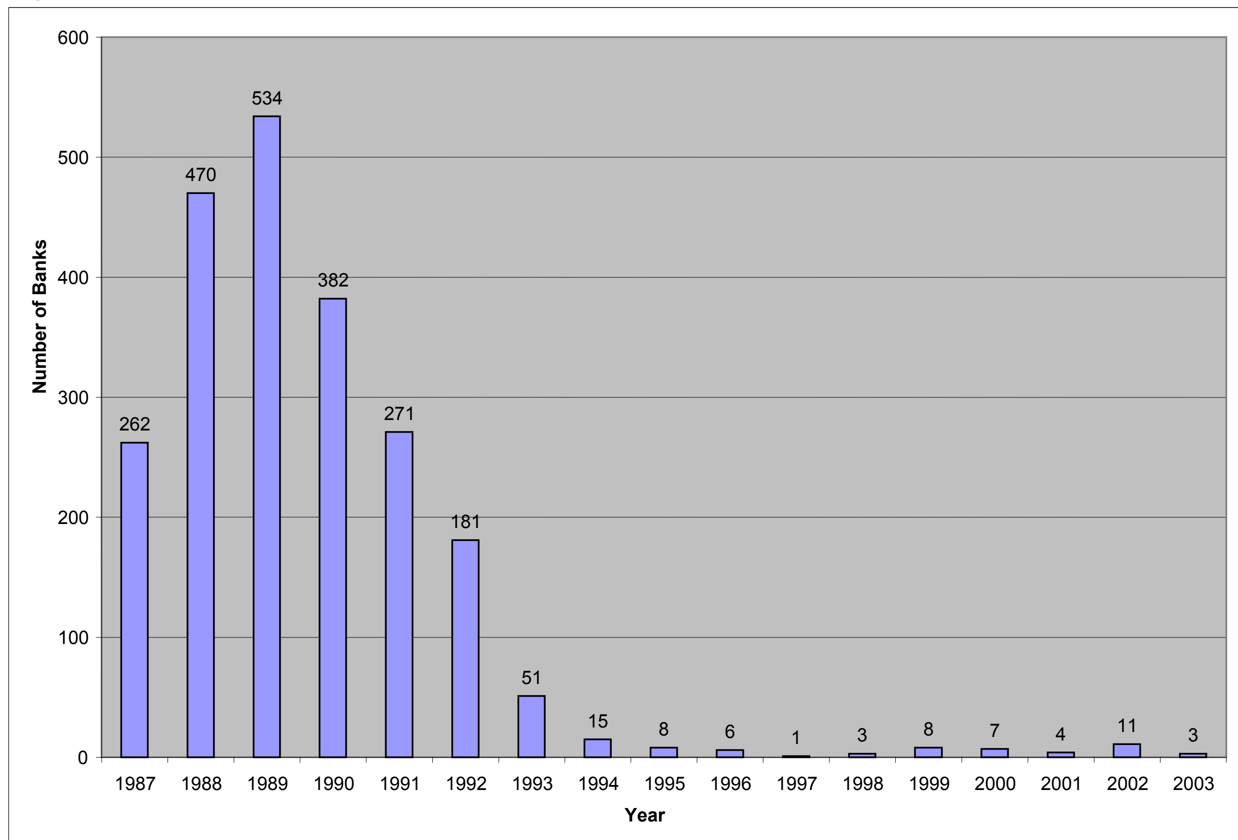
Figure 3: Total Number of Problem Institutions From 1987 to 2003



Source: The FDIC's *Historical Statistics on Banking*, Commercial and Savings Institutions Bank Reports.

Following the trend of declining problem institutions, institution failures are at historical lows not seen since 1940 through 1975 when bank failures averaged less than 7 per year. It has been close to 10 years since the banking industry experienced more than 15 failures in 1 year, as shown in Figure 4, which follows.

Figure 4: Number of Failed Institutions From 1987 to 2003



Source: The FDIC's *Historical Statistics on Banking*, Commercial and Savings Institutions Bank Reports.

Processing reports of examination and handling matters that deal with problem and failing institutions requires additional regulatory scrutiny, ultimately to preserve the BIF and SAIF. DSC regional office personnel typically become heavily involved in problem and failing institutions as a result of enforcement actions. The personnel also prepare summary comments and problem bank memorandums, necessitating increased communication with DSC Washington Office personnel.

The decline in the aggregate number of financial institutions is largely attributed to consolidation within the industry. Many institutions have been absorbed through mergers and acquisitions even though over 2,000 newly chartered institutions have been established since 1990. The FDIC reports that, through consolidation, a financially stronger and generally healthier industry has developed. Since 1990, the banking industry has reported stronger earnings and capital levels.

Table 2 on the next page depicts the improvement in the banking industry using earnings and equity capital as indicators for measuring financial wellness.

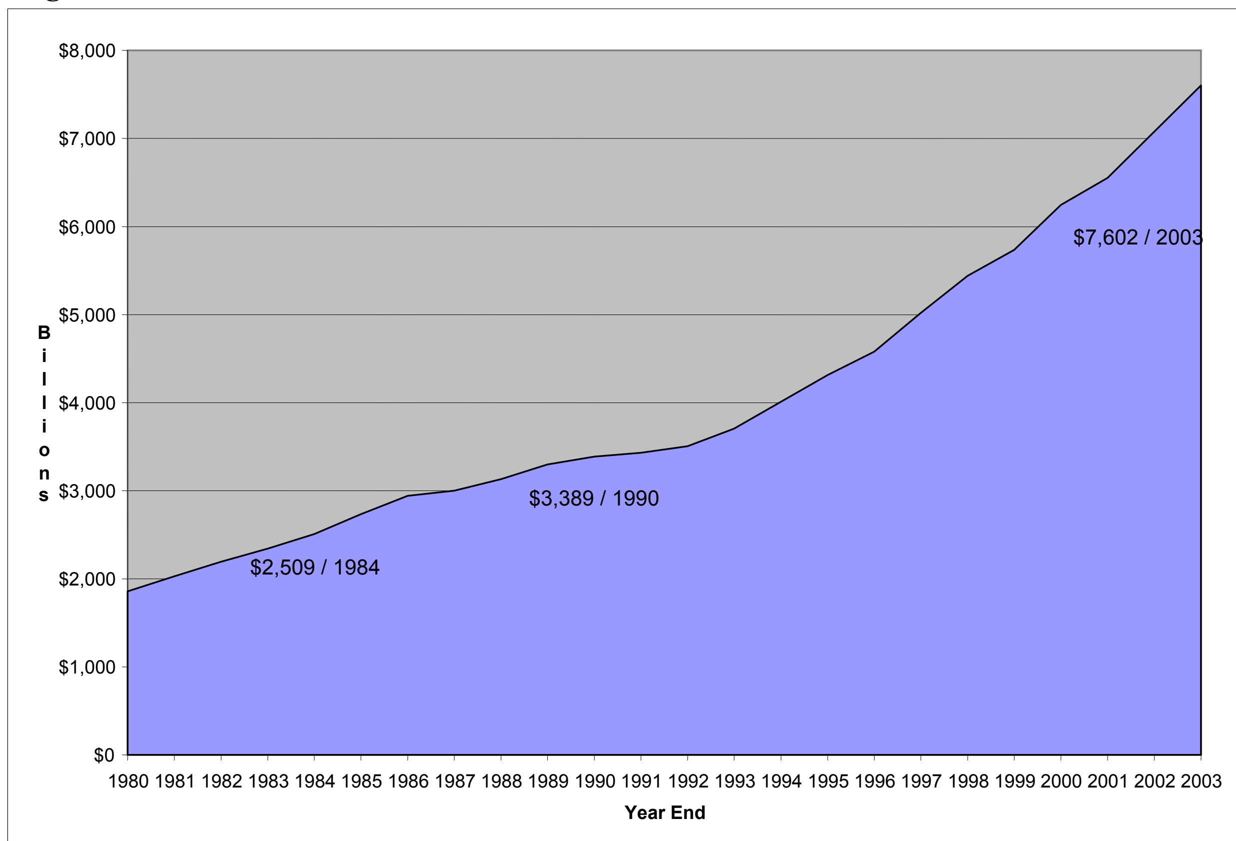
Table 2: Comparative Earnings and Equity Capital Ratios for Selected Years Since 1987

Percentage	1987	1990	1995	2000	2003
Return on Assets	0.10%	0.48%	1.17%	1.18%	1.38%
Return on Equity	1.50%	7.50%	14.70%	13.99%	15.32%
Equity Capital Ratio	6.02%	6.45%	8.11%	8.49%	9.10%

Sources: The *FDIC Quarterly Banking Profile* for Returns on Assets and Equity and the FDIC's *Historical Statistics on Banking* for equity capital ratios.

Banks have not only become more profitable but have also experienced significant growth in assets in the past 2 decades, while the number of banks has declined. Industry assets have more than tripled since 1984, and at the end of 2003, FDIC-insured commercial banks had combined assets in excess of $7.6 trillion, as illustrated in Figure 5 below.

Figure 5: Assets of FDIC-Insured Commercial Banks from 1980 to 2003



Source: The FDIC's *Historical Statistics on Banking*.

The examination processes for monitoring and evaluating information technology (IT) risks, consumer protection, and compliance with the BSA and USA PATRIOT Act have also changed significantly. Changes in these processes have required a shift in the skill sets needed to evaluate and monitor risk within these areas.

According to the FDIC, no area of banking has changed as significantly during the past 10 years as the IT area.[9] Insured institutions offer their banking services to customers through automated teller machines and electronic Web sites for transactional activities. The FDIC's primary concern about the financial industry's use of IT is the potential risk of loss to the insurance funds from high-cost bank failures if risks are not adequately managed and controlled.[10] In its efforts to evaluate risks in the IT environment due to increased and complex data systems and delivery channels, the FDIC conducts IT examinations designed to assess an institution's IT risks. Also, DSC conducts examinations of nonbank service providers that develop and support e-banking applications.

The FDIC is legislatively mandated to enforce various statutes and regulations regarding consumer protection and civil rights with respect to state-chartered, nonmember banks and to encourage community investment initiatives by these institutions. Some of the more prominent laws related to this area include the Truth in Lending Act, Fair Credit Reporting Act, Real Estate Settlement Procedures Act, Fair Housing Act, Home Mortgage Disclosure Act, Equal Credit Opportunity Act, Community Reinvestment Act (CRA) of 1977, and Gramm-Leach-Bliley Act. The Corporation accomplishes its mission related to these laws by conducting compliance and CRA examinations and taking enforcement actions to address compliance violations. In 2003, the FDIC revised its approach to examining institutions for compliance with consumer protection laws and regulations. Under the new approach, FDIC compliance examinations combine a risk-based examination process with an in-depth evaluation of an institution's compliance management system, resulting in a top-down, risk-focused approach to these examinations. The new examination approach recognizes that the banking industry's compliance responsibilities continue to grow and become more complex with changes in financial products and services.

The BSA and the USA PATRIOT Act have significantly affected insured institutions' operations by requiring institutions to be vigilant in the prevention, detection, and prosecution of international money laundering and the financing of terrorism. In accordance with BSA Title II, an institution must file a Currency Transaction Report with the Internal Revenue Service for each cash transaction over $10,000 or multiple cash transactions by an individual in one business day, aggregating over $10,000. The BSA also requires an institution to file a Suspicious Activity Report with the Treasury Department when suspected money-laundering activity or BSA violations occur. USA PATRIOT Act, Title III, provisions include requirements related to special due diligence, correspondent accounts, concentration accounts, verification of customer identification, and information sharing. Further, Title III places considerable responsibilities on insured depository institutions to monitor foreign entities and individuals and to cooperate with law enforcement officials in a timely manner. The FDIC and other financial institution regulatory agencies work together with the Treasury Department's Financial Crimes Enforcement Network (FinCEN) to issue guidance implementing these statutory requirements. The FDIC is responsible for monitoring compliance with the BSA and USA PATRIOT Act by the financial institutions that it supervises.[11]

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[9] *FDIC Outlook*, fall 2003 edition, Chicago Regional Perspectives, *Improved Security is Vital as Information Technology Grows More Complex*. *FDIC Outlook* is published quarterly by the FDIC's Division of Insurance and Research as an information resource on banking and economic issues for insured financial institutions and financial institution regulators.

[10] Office of Inspector General, Audit Report No. 04-022, *FDIC's Information Technology Examination Program*, June 15, 2004.

[11] Office of Inspector General, Audit Report No. 03-037, *The FDIC's Implementation of the USA PATRIOT Act*, September 5, 2003.

Process Redesign Programs Change DSC's Approach to Bank Supervision

The FDIC has redesigned its approach to bank supervision, particularly since 2000 (see Appendix III for organizational and procedural changes since 1992). During 2000, DSC recognized the need to adjust to a changing banking industry and began a series of process redesign efforts to evaluate its own organization and processes. The Process Redesign program was divided into several phases, focusing on strategic changes in examination processes and economies in personnel and infrastructure.

In July 2001, the Process Redesign Infrastructure Work Group (work group) issued a report on its study of DSC's field office infrastructure. The work group consisted of only DSC personnel. The study resulted in minimal changes to DSC's structure and a recommendation to consolidate field offices that were co-located either in the same building or metropolitan area. Also, DSC executives conducted an infrastructure review of DSC's field offices. The executives' conclusions were similar, with recommendations for closing 6 of the 90 offices by consolidating 8 field offices into 4 offices and closing 2 satellite offices. In addition, the FDIC's internal reorganization order, effective June 30, 2002, designated the Boston and Memphis Regional Offices as area offices reporting to the New York and Dallas Regional Offices, respectively.

In 2001, Process Redesign I made recommendations to streamline the pre-examination, supervision, and applications processes. Some of the changes included: streamlining the pre-examination process and loan reviews, revising the report of examination format, using software packages to speed up and standardize routine examination processes, training examiners to review large and complex data service providers and vendors, and developing a comprehensive contingency plan for major technology problems. DSC estimated that these changes saved resources equivalent to the work of about 95 examiners.

Process redesign changes also affected the examination process, including:

- implementation of the Maximum Efficiency Risk-focused Institution-Targeted (MERIT) Guidelines examination program (discussed below),
- delegations of authority from regional offices to field offices, and
- a pilot test of a Relationship Manager Program (discussed later in the report).

MERIT Examination Guidelines

During Process Redesign II, the MERIT Guidelines were developed for safety and soundness examinations. (Similar risk-based approaches have been implemented for IT and trust examinations to promote the efficient use of examination resources and have been considered for compliance examinations.) The MERIT Guidelines reduced the time and effort spent on institutions with low-risk profiles that did not need much oversight so that examination efforts could be spent on institutions that needed more attention. Effective for examinations after March 31, 2002, the FDIC implemented the MERIT Guidelines for "1" or "2" rated, "Well-Capitalized" banks with total assets of $250 million or less (the threshold was subsequently increased to $1 billion in January 2004) that also met certain other criteria. One of DSC's Corporate Performance Objectives for 2002 was to reduce, by 20 percent, the average time spent conducting safety and soundness examinations of banks with "1" and "2" ratings and with under

$250 million in assets.[12] As of December 31, 2003, approximately 3,600 (68 percent) of the FDIC's supervised institutions were potentially eligible for the MERIT examination program.

Beginning in 2003, as a result of Process Redesign III, DSC delegated various work products for certain low-risk institutions to field office supervisors and supervisory examiners. The work products were previously processed at DSC regional and area offices. These duties included examination report processing, general correspondence, and certain applications for these institutions and off-site reviews. Regional and area offices still handle more complex banks or banks with high-risk profiles, enforcement actions, and certain applications. Further, DSC changes in the bank supervisory process have included a Dedicated Examiner Program[13] and the decision to test a Relationship Manager Program.

Delegations of Authority from Regional Offices to Field Offices

DSC's delegation of certain risk management functions to the field level in 2003 was consistent with the FDIC's goal of more effectively supervising and serving a rapidly changing banking industry. DSC concluded that, within well-defined parameters, the field-level has both the capability and the capacity to process various work products previously processed at the regional/area office level. The result was a realignment of responsibilities and streamlining of many of DSC's core risk management functions, placing greater authority and responsibility on lower levels within the organization while preserving a high degree of responsiveness to the industry and maintaining appropriate attention to risk. According to DSC transmittal number 02-049:

> Field Supervisors and Supervisory Examiners will assume many of the duties transitioned, including the review, processing, and signature of Reports of Examination (ROE); the processing and approval of certain applications; the processing of general correspondence; and the conducting of offsite reviews. Regional/Area Office Case Managers/Specialist will continue to have primary responsibility for the various risk management functions relating to more complex or higher-risk profile banks, including review and processing of ROEs (including separate cover specialty ROEs), enforcement actions, and more complex applications.

The transmittal memorandum further stated:

> All banks meeting MERIT criteria that are not part of organizations transcending the geographic boundaries of Regional/Area Offices and that do not have total assets exceeding the $1 billion and $10 billion signing authority for CG-14 and CG-15 Field Supervisors, respectively, will have the following risk management functions performed at the Field-level:
>
> - Reviewing and processing of ROEs prepared by the FDIC or State Authority.
> - Reviewing and processing of certain ROEs prepared by other Federal regulators.

[12] Division of Supervision Memorandum, Transmittal Number 2002-017, March 27, 2002.
[13] The FDIC dedicated eight examiners to the largest insured depository institutions in September 2002. The examiners work closely with the resident examination staff of primary supervisors and the institutions' personnel. They have access to information about the risk and trends in these institutions.

- Processing branch-related applications (new branches and relocation of branch/main offices).
- Processing correspondence relating to any relationship assigned to the Field. Conducting offsite reviews for any bank that is part of a relationship assigned to the Field.
- Reviewing and processing Holding Company Inspection Reports prepared by the Federal Reserve or State Authority pertaining to a relationship assigned to the Field.
- Functioning as a point of contact.
- Performing Banker Outreach activities on assigned institutions.

As part of these changes, greater responsibility for bank supervision was delegated to the field offices. To see how these changes may be impacting the activities of the field office supervisors and regional office case managers, we obtained from DSC application and examination data for the year 2003 to June 30, 2004. The processing of applications and ROEs continues to shift from the regional offices to the field offices as a result of the delegations. The percentages for processing ROEs and applications increased in the field offices and decreased in the regional offices as shown in Tables 3 and 4.

Table 3: Examinations Processed at Regional and Field Offices

	Field Office		**Regional Office**	
Year	**Total Exams**	**Percentage**	**Total Exams**	**Percentage**
2003	1,927	31.89%	4,116	68.11%
2004 (as of 6/30)	1,023	38.10%	1,662	61.90%

Source: DSC's schedule of examinations.

Table 4: Applications Processed at Regional and Field Offices

	Field Office		**Regional Office**	
Year	**Total Applications**	**Percentage**	**Total Applications**	**Percentage**
2003	621	20.93%	2,346	79.07%
2004 (as of 6/30)	434	25.44%	1,272	74.56%

Source: DSC's schedule of applications.

We obtained staffing data from DSC to see the effects that delegating work could have on the regional office structure. We found that overall regional office staffing has decreased by 25 percent from year-end 2000 levels as shown in Table 5 on the next page.

Table 5: Total Regional Office Staffing

REGION	2000	2001	2002	2003
Atlanta	80	76	61	62
Boston	53	52	31	38
Chicago	91	88	77	71
Dallas	75	71	63	59
Kansas City	108	106	90	86
Memphis	70	51	39	43
New York	90	86	73	68
San Francisco	93	90	74	66
Total Employees	**660**	**620**	**508**	**493**

Source: DSC's staffing schedules at year end for 2000 through 2003.

Further, we reviewed Case Manager and Assistant Regional Director staffing nationwide, as shown in Table 6.

Table 6: Assistant Regional Directors and Case Managers per Year

Category	1990	2000	2001	2002	2003
Assistant Regional Directors	30	35	36	27	28
Case Managers (Risk Management)	NA	206	197	152	159

Source: DSC's staffing schedules for years 2000 through 2003. Staffing tables for 1990 and earlier were not available. The numbers from 1990 were based on information we obtained from FDIC publications.

By delegating tasks from the regional and area offices to the field offices, DSC provided its regional and area office staff opportunities for more efficient use of their time. Yet, the number of assistant regional directors (ARD) has not declined significantly. Also, the number of ARDs remained steady after the delegation of tasks to the field offices in 2003. DSC noted that it had 30 ARDs in 1990 with 7,811 FDIC-supervised institutions, while in 2003, DSC had 28 ARDs with 5,318 FDIC-supervised financial institutions. Although the number of case managers in the area and regional offices decreased 26 percent from 2000 to 2002, the number of case managers increased from 152 in 2002 to 159 by October 2003.

<u>Conversion of Boston and Memphis Regional Offices</u>

The FDIC internal reorganization order, dated June 30, 2002 redesignated the Boston and Memphis Regional Offices as area offices reporting to the New York and Dallas Regional Offices, respectively. Based on the staffing records for these offices, there were no related changes in office duties and responsibilities other than the elimination of the regional director positions. The position of Area Director was created essentially to replace the deputy regional director position.

We obtained staffing records for the two area offices for 2002 and 2003, as shown in Table 7 below.

Table 7: Staffing at Boston and Memphis Area Offices

	Boston		Memphis	
Category	**2002**	**2003**	**2002**	**2003**
Area Director	1	1	1	1
ARD	2	2	2	2
Senior Case Manager	0	1	0	0
Case Manager	9	11	12	12
Community Affairs/Specialists	6	9	11	13
Financial Analyst Examiners	2	2	2	3
Assistants	11	12	11	12
Total	**31**	**38**	**39**	**43**

Source: DSC's Staffing by Category for 2002 and 2003.

The records show that total staffing actually increased at the area offices between 2002 and 2003 despite the fact that the offices lost the designation of "regional office" and that responsibility for most MERIT examinations had been delegated to the field offices. In our opinion, opportunities likely exist to increase the efficiency and effectiveness of the regional structure because each of the regional/area offices have very similar operations, including functions for risk management, compliance, and administration.

Pilot Testing a Relationship Manager Program

On April 5, 2004, DSC implemented a 6-month pilot Relationship Manager Program for selected state nonmember banks. This program tests "a flexible, risk-focused and risk-based approach for supervisory activities to be conducted over a period of time, based on resources commensurate with the perceived risks. [DSC designates] a relationship manager within a field or territory office. Under the oversight of the … field supervisors, the relationship manager serves as the designated point-of-contact for the respective banks in their portfolios."[14] Prior to 2003, this function was handled by case managers at the regional offices. Full implementation of the Relationship Manager Program would result in further delegations of regional and area office tasks to the field offices.

Increased Use of Technology Affects the Examination Process

Significant changes in technology since 1987 have also had a major effect on the bank examination process. In the 1990's, DSC implemented several software applications to automate the examination process for greater efficiency and accuracy, including:

- Automated Loan Examination Review Tool (ALERT) – a computer application designed to automate part of the loan review function and replace manual methods used for over 60 years.

[14] Division of Supervision and Consumer Protection, Memorandum System, Transmittal No. 04-013, *Relationship Manager Pilot Program*, April 2, 2004.

- General Examination System (GENESYS) – which records financial institution data and creates the report of examination.
- Examination Documentation (ED) – an automated tool designed to facilitate a risk-focused examination by providing a means to organize and sort written comments on examination analysis and decision making.

Technology has also made it possible for DSC employees anywhere in the country to access bank financial data and information by means of the Virtual Supervisory Information On the Net (ViSION). ViSION is a single, module-based, integrated information system mounted on the World Wide Web (Web-based system), which greatly improves and speeds up a user's ability to meet changing needs. ViSION includes access to a variety of supervisory and regulatory data sources and systems via the Information Workstation module, which allows access to viewing Call Report [15]data, Uniform Bank Performance Reports (UBPR), off-site monitoring systems, examination and enforcement action reports, economic data, and the OCC's examination database.

Other technological advances have been made in off-site monitoring processes. Off-site monitoring focuses on evaluating the financial condition and potential risks of insured depository institutions through data collection, analysis, and review. During 1998, the FDIC implemented a new off-site rating tool, SCOR (Statistical CAMELS[16] Off-site Rating), to more effectively and efficiently monitor risk to the banking and thrift systems. SCOR is an off-site monitoring tool that displays statistical and qualitative information. SCOR uses quarterly Reports of Condition and Income (Call Reports) to identify institutions that could receive a downgrade in their CAMELS ratings at their next safety and soundness examination. To do this, SCOR uses statistical techniques to estimate the relationship between Call Report data and the results of the latest examination and estimates the probability of an institution being downgraded at the next examination. Case managers use the SCOR analysis to identify the reasons for the deterioration in any components identified by SCOR and recommend an appropriate follow-up response. FDIC examiners review SCOR data as part of their pre-examination planning.

In 2003, the FDIC implemented FDIC*connect*, a secure business channel that provides the FDIC with the capability to electronically exchange sensitive information with insured financial institutions. The benefits of electronic transactions include increased efficiency, reduced transaction costs, and greater customer satisfaction. For example, members of the financial community are able to file branch applications electronically. Also, bank insiders required to disclose changes in their stock ownership may use FDIC*connect* to record the changes. Banks filing the annual "summary of deposits" survey, which contains deposit information on a branch-by-branch basis, can also choose the electronic route. As of March 9, 2004, a total of 626 institutions had registered to use FDIC*connect.*

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[15] Call Reports are sworn statements of a bank's financial condition that are submitted to supervisory agencies quarterly in accordance with federal regulatory requirements. Call Reports consist of a balance sheet and income statement and provide detailed analyses of balances and related activity.

[16] Financial institution regulators use the Uniform Financial Institutions Rating System to evaluate a bank's performance. Six areas of performance are evaluated and given a numerical rating of "1" through "5," with "1" representing the least degree of concern and "5" the greatest degree of concern. The six performance areas identified by the CAMELS acronym are: Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk.

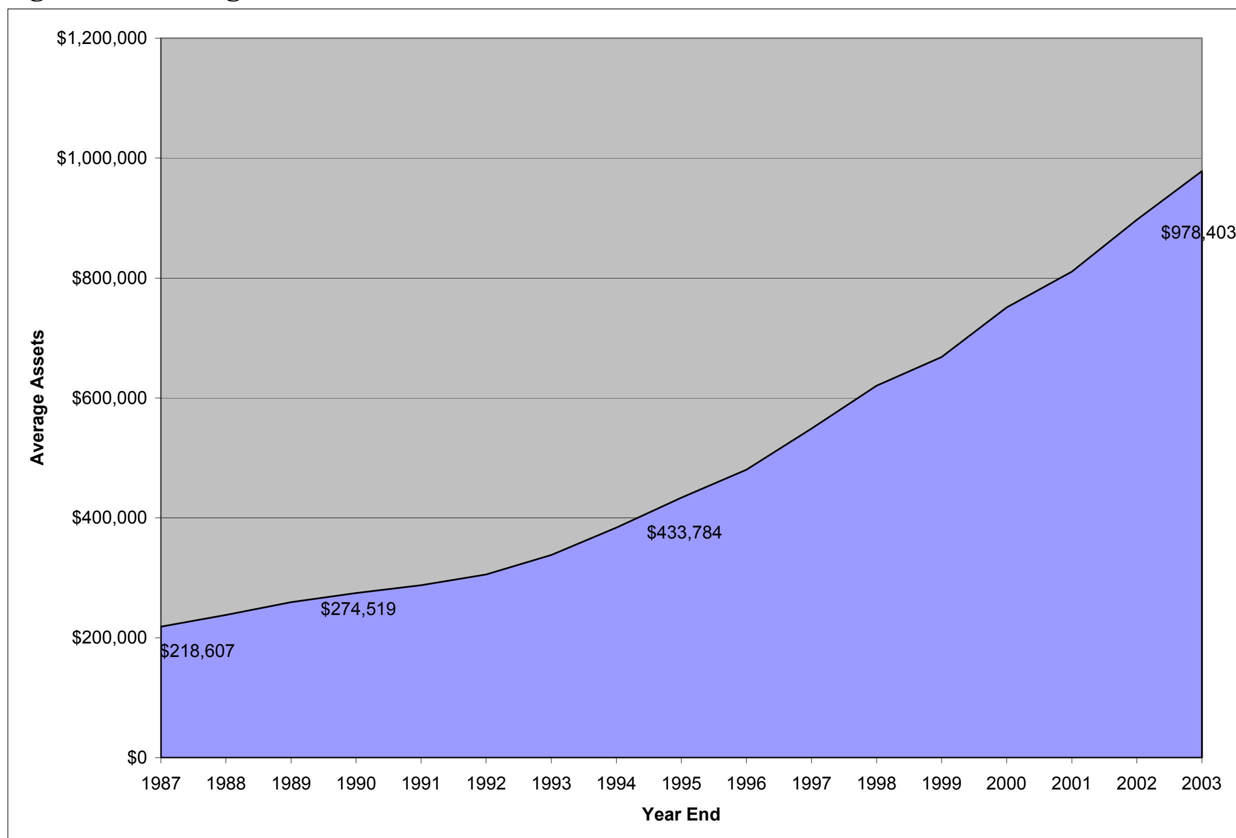
In addition, the FDIC has begun developing a system in which institutions will be able to submit Call Reports directly to their respective primary federal regulator through secure Internet connections. Online submission will enable DSC staff to promptly review the reports and resolve any questions, deficiencies, and inconsistencies with the institutions.

As discussed later in this report, a study performed by the OCC in 2002 determined that the increased use of technology had transformed the relationship between its district (regional) offices and its field offices. The reorganization of its district offices was dictated in large part by dramatic changes in technology. According to the FDIC's Deputy to the Chairman and Chief Operating Officer, the FDIC believes that the use of technology will continue to improve operational efficiency within both the banking industry and the FDIC. In that regard, DSC's business processes and the related number, location, and type of personnel needed to efficiently and effectively carry them out should keep pace with technological issues and advances.

Effects of Consolidation on the FDIC

We recognize that, although there are fewer FDIC-insured and -supervised institutions, consolidation in the industry has added a new dimension of risk. The average asset size of FDIC-insured commercial banks has increased almost fivefold between 1987 and 2003 as shown below.

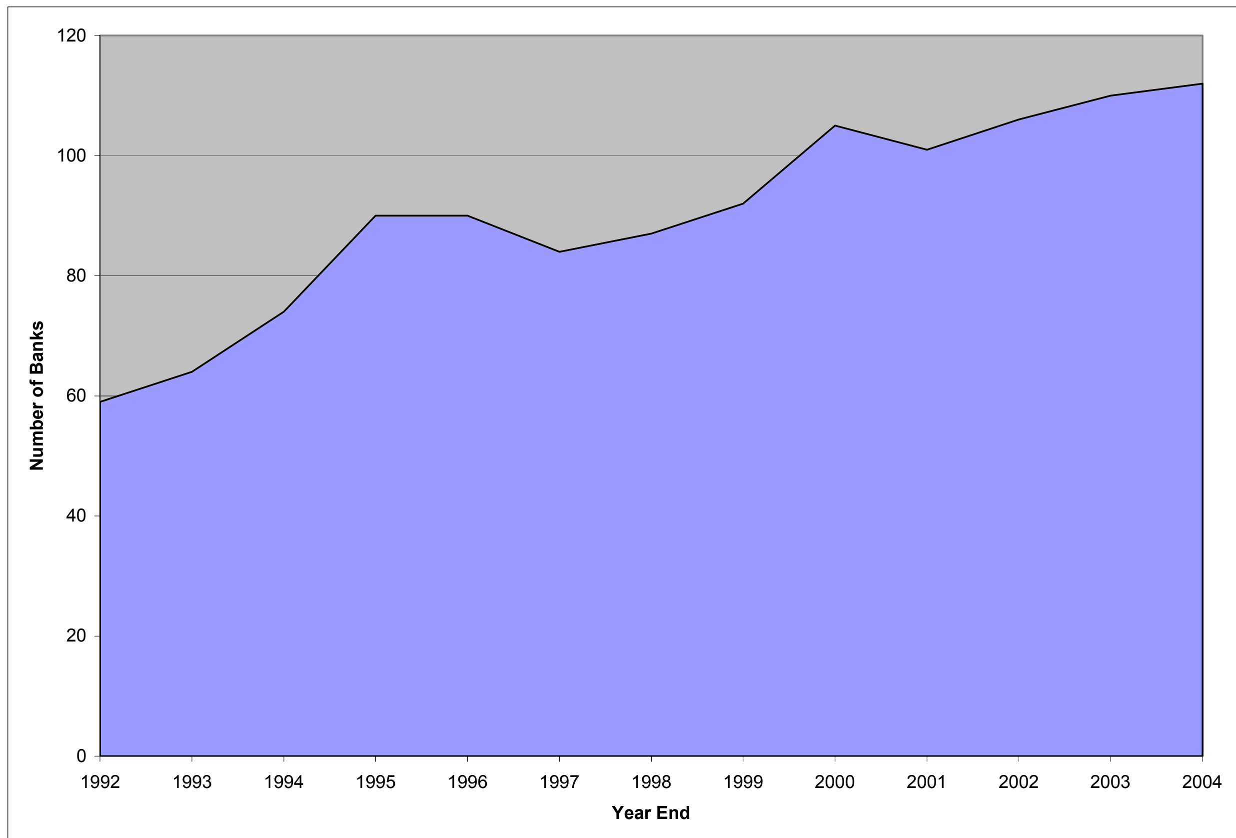
Figure 6: Average Assets of FDIC-Insured Commercial Banks



Source: The FDIC's *Historical Statistics on Banking*.

In addition, the number of banks with assets in excess of $10 billion has increased. As shown in the following chart, there were 59 such banks in 1992, and in 2004, that number had increased to 112, representing a 90 percent increase.

Figure 7: Number of FDIC-Insured Banks With Total Assets Exceeding $10 Billion



Source: FDIC's Institutional Directory of commercial banks and savings and thrifts.

Although consolidation can sometimes decrease risk through diversification, the failure of larger size institutions can pose increased risks of loss to the FDIC's deposit insurance funds.

Changes in Other Federal Agencies' Regional Office Structures

In 2002 and 2003, the OCC and OTS, respectively, announced plans to realign their regional and district office structure in response to continuing consolidation in the banking system and to take advantage of advances in technology and changes in the way they manage their nationwide network of examiners and field offices.

OTS realigned its regional structure into four supervisory regions, consolidating its administrative functions in Washington, D.C., and cutting staff to meet reduced workload demands and to achieve a balanced budget. OTS realigned its regional supervisory structure by eliminating its central region and apportioning supervisory responsibilities for the institutions in that region to the other regions.

Under the OCC realignment, the San Francisco and Kansas City District Offices were merged into a new office in Denver, while the Atlanta and Dallas District Offices were consolidated in

Dallas. After the reorganization, the OCC had four district offices in New York, Chicago, Dallas and Denver.

We interviewed OCC officials to obtain an understanding of the process they used in assessing their district (regional) office organization. The process included asking a cross-section of OCC employees to participate in a working group to assess OCC needs and develop options to meet those needs, both today and strategically in the future. The objective of the working group was to gather information to help the OCC evaluate whether its district office functions and locations were best aligned with the OCC's long-term supervisory strategy. The OCC's structure had not changed since 1983.

The reorganization of the OCC's district offices was dictated in large part by dramatic changes in technology and in the OCC's approach to managing its nationwide network of examiners.
In 1997, the OCC reorganized its field operations to reduce a layer of management and delegate more authority to the Assistant Deputy Comptrollers who manage the agency's field offices. Much of the day-to-day decision-making authority in the supervisory process was transferred from district offices to field offices, at a closer level to the community banks supervised by the OCC.

Also driving the realignment was the fact that national bankers told OCC in interviews that they almost always contacted their local field office, rather than the district office, when they had questions or issues. According to OCC officials, the realignment has not had any negative impact on OCC's supervision of national banks.

Further, technology had transformed the relationship between the district offices and the field offices. The OCC is now on a common computer network that facilitates document and message sharing. The OCC's "Examiner View" system provides data and analytical tools to examiners while they are working in the field. The OCC has also developed an online training system.

The OCC estimated that realignment is expected to save at least $23 million in operating costs over the next 5 years.

CONCLUSION AND RECOMMENDATION

DSC's regional office structure, both geographically and organizationally, has remained essentially unchanged since 1987. Yet, DSC's approach to supervision and the industry it regulates have changed dramatically over the past 2 decades. According to senior DSC officials, there are no current plans for restructuring the regional and area offices.

In a memorandum to FDIC employees on August 6, 2004, the Deputy to the Chairman and Chief Operating Officer of the FDIC noted that the "rapid pace of industry change requires that the FDIC periodically modify its business practices in order to continue to effectively carry out its mission." The memorandum further noted, among other things, that:

- industry consolidation will continue to decrease the aggregate number of insured, depository institutions for which the FDIC is the primary federal supervisor;

- concentration of risk to the insurance funds in the largest banking organizations (largely supervised by other regulators) will grow more pronounced over time;

- a two-tiered banking system (mega/large vs. small/community) appears likely to emerge which may have operational implications for all of the FDIC's business lines;

- growing complexities within the industry will require a more integrated, corporate approach to risk assessment and risk mitigation; and

- the use of technology will continue to improve operational efficiency within both the banking industry and the FDIC.

These changes will focus increased attention on DSC workforce planning, including staffing and workload analyses. However, DSC's current regional office structure leaves some unanswered questions about the location and organizational roles and responsibilities of the current regional/area offices. Accordingly, DSC should reassess its current regional/area office structure to determine whether it is the most optimal alignment for accomplishing its mission in the 21st century. Although cost reductions may not be the primary consideration in restructuring, economies would likely be achieved as a result of consolidating and streamlining offices and functions.

Recommendation

The Director, DSC, should initiate an independent analysis of the DSC's regional structure to determine the optimal means to effectively manage the division's organizational structure and its resources. This analysis should be performed in conjunction with staffing and workload analyses that may be performed in support of workforce planning for the future.

CORPORATION COMMENTS AND OIG EVALUATION

On September 21, 2004, the DSC Director provided a written response to the draft report. The response is presented, in its entirety, as Appendix IV to this report. DSC generally agreed with the intent of our recommendation but stated that an independent study of DSC's regional office structure would not be advisable at this time. However, as an alternative action, the Director agreed to evaluate DSC's regional structure as part of DSC's annual workforce planning and budgeting efforts. Also, the Director noted that DSC will continue to regularly review projected workload assumptions and address any resulting imbalances and will continue to analyze staffing requirements and necessary skill sets. We consider the Director's comments responsive to our recommendation. The recommendation is resolved but will remain undispositioned and open until we have determined that agreed-to corrective actions have been completed and are effective. DSC's response indicates that this process will continue with each budget cycle; however, to provide disposition and eventual closure to the recommendation, we will assess actions taken by DSC as they relate to DSC's 2006 budget cycle. Accordingly, the completion date for implementation of this recommendation will be December 31, 2005.

In addition to responding to the report's recommendation, DSC provided comments on certain parts of the report. Those comments follow along with the OIG's evaluation of the comments.

- Regional Office Structure Changes

DSC disagreed with the report comment that DSC had not made a significant change to its regional office structure since 1987. As evidence, DSC noted that: (1) the case manager program was instituted in 1997; (2) Specialists had been designated in the areas of IT, Capital Markets, Accounting, Trust, and Special Activities, including fraud and BSA; and (3) the former regions of Memphis and Boston have been designated as area offices of Dallas and New York, respectively.

Our report distinguishes between changes in supervisory approach, such as establishment of the case manager program, and regional office structure changes. The central theme of this report is that DSC's regional office structure, both geographically and organizationally, has remained essentially unchanged since 1987, while DSC's approach to supervision has changed significantly over the past 2 decades. We also point out that the organizational hierarchy, including roles and responsibilities of regional offices, has changed little since the 1980's. Regarding the Boston and Memphis area offices, with the exception of the elimination of the regional director positions, these offices appear to be staffed similar to and perform essentially the same functions as the other regional offices. Thus, we do not consider these designations of area offices as significant structure changes.

- More Delegations to the Field Offices

DSC agreed that it has been delegating more processes and responsibilities to the field offices. However, DSC disagreed that the Relationship Manager Program, if implemented, would result in even more work delegated to the field offices.

Our comment was based on a Regional Director Memorandum, dated April 2, 2004, which implemented a 6-month pilot of the Relationship Manager Program. The pilot Relationship Manager Program expanded the number of bank cases that could be delegated to the field by including cases with a safety and soundness component rating of "3"as long as the composite rating remained a "1" or a "2." Prior to implementing the pilot Relationship Manager Program, cases with component "3" ratings were administered out of the regional offices.

- Other Regulatory Agency Regional Changes

DSC stated that the report seems to focus on the regional office structure changes at both the OCC and the OTS. The Director noted that the average FDIC regional office has responsibility for more banks than the average OCC or OTS regional office. Also, the Director noted that due to the nature of the FDIC's backup insurance role and relationship with state agencies, the FDIC needs to be structured to meet its responsibilities rather than to parallel the structure of other agencies.

We agree that the FDIC's structure does not need to parallel other regulatory agencies. Including the examples of other regulators was intended to show that they deemed it necessary to reassess their office functions and locations in light of changes in the banking industry over the past 2 decades and to ensure the best alignment for effective and efficient supervision.

- Workload Implications from MERIT Examinations

The Director, DSC, stated that staffing comparisons associated with the decline in the number of institutions and the transfer of MERIT banks to the field should reflect that the report review, report processing, and the branch application workload associated with "small" 1- and 2-rated banks is relatively light. The more complex and problem institutions assigned to the regional office case managers require much more time-consuming, in-depth analysis. Therefore, it is not a simple transfer of the number of institutions from the regional offices to field offices that would equate to staffing requirements, but rather the complexity and interrelationships that the regional office staff deal with, that require significantly more hours and expertise.

We recognize that the allocation of resources is more complex than simply equating staffing requirements to the number of banks that have been shifted to the field office for case management. For that reason, we recommended that an independent analysis be conducted to determine the most optimal alignment of resources for accomplishing DSC's mission. DSC's agreed-to annual evaluation of its regional office structure should study the roles and responsibilities of the regional offices in light of significant changes in the industry and the FDIC's supervisory approach.

- Industry Assets

DSC stated that the "growth in industry assets increases the level of risk to the insurance fund. Consequently, any review of regional operations and efficiencies should give consideration to the value added by regional office staff expertise (i.e. monitoring and offsite reviews) that mitigate potential risk." The Director also noted that there has been an increase in the number and asset size of specialty institutions, such as credit card banks and that the industry trend is toward fewer, but more complex institutions.

We agree, and the report discusses the effects of consolidation in the industry. The report also notes that the average asset size of FDIC–insured commercial banks has increased almost fivefold since 1987, posing increased risks to the insurance funds.

- Problem Institutions

The Director stated that although the number of problem banks has declined since 1987, the complexity of the industry has increased significantly. Also, the Director indicated that from 1998 through 2003, the number of problem institutions and associated assets has been increasing. The more complex nature of problem institutions requires regional staff expertise for the ongoing monitoring of these institutions.

We agree that the industry has become more complex since the 1980's. Regarding the increase in problem banks from 1998 to 2003, the number increased from 92 in 1998 to 117 in 2003 – a relatively small increase in number. This increase still represents a precipitous decline from the late 1980's and early 1990's when the number of problem banks ranged from 1,000 to 2,000.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of the audit was to assess DSC's regional office structure in light of changes that have occurred in both the FDIC and the industry it regulates. We performed the audit field work in Washington, D.C., using information obtained from DSC and the FDIC's Division of Administration (DOA). We performed the audit from March through July 2004 in accordance with generally accepted government auditing standards.

Scope and Methodology

To achieve the audit objective, we:

- Obtained DSC staffing and budget information from year 2000 through 2003.
- Obtained the number of FDIC-insured and FDIC-regulated financial institutions, problem institutions, and failed financial institutions identified from 1987 through 2003.
- Obtained examination hours from Scheduling Hours and Reporting Package (SHARP) reports from years 2001 through 2003 for case managers, field office supervisors, and examiners.
- Obtained telework hours since the initiation of the telework program.
- Obtained leasing costs for years 2001 and 2003 and compared them for any reductions in square footage and rental costs.
- Compared staffing at the various locations before and after structure reorganization and evaluated the reduction and distribution of staff in accordance with banking activities within the regions.
- Obtained documentation pertaining to the FDIC's and DSC's strategic goals and DSC policies and procedures related to its workforce and office structure and functionality.
- Reviewed process redesign initiatives.
- Reviewed Regional Director Memoranda pertaining to the MERIT Guidelines, delegations of authority, and case manager delegations.
- Interviewed some of the team members who conducted the analysis of the OCC's infrastructure. Discussed the methodology and results of the analysis.
- Obtained the OCC infrastructure realignment report.

Government Performance and Results Act

In addressing the Government Performance and Results Act, we reviewed the FDIC's 2003 Annual Performance Plan pertaining to the FDIC's operational efficiency and effectiveness to accomplish its mission. To pursue increased operational efficiency and effectiveness, the FDIC seeks new ways to improve internal management and work processes and to reduce operational costs. To assess DSC's performance measures as they related to the FDIC's mission, we obtained and reviewed DSC's memoranda on examination processes, supervision programs, and management programs. We read *FDIC NEWS* for articles pertaining to interviews with the Director, DSC, on process redesign programs, such as MERIT. We also evaluated staffing in

regional offices. DSC's realignment of both the field offices and management structure was to increase operational efficiency and effectiveness in management and streamline work processes and to reduce operational costs.

Compliance with Laws and Regulations

There were no laws or regulations significant to our audit objective.

Fraud and Illegal Acts, Management Controls, and Reliance on Computer-Processed Data

The limited nature of the audit objective did not require that we assess the possibility of illegal acts or fraud or evaluate management controls. Also, for the purposes of this audit, we did not conduct tests to determine the reliability of computer-processed data obtained from the FDIC's various systems, but the reliability of these systems is subject to audit coverage by the FDIC OIG.

NUMBER OF FDIC-INSURED INSTITUTIONS IN 1987 AND 2003

Atlanta Region

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
Alabama	260	162	-37.69%
Florida	560	304	-45.71%
Georgia	427	345	-19.20%
North Carolina	205	104	-49.27%
South Carolina	123	97	-21.14%
Virginia	241	141	-41.49%
West Virginia	225	74	-67.11%
Total	**2,041**	**1,227**	**-39.88%**

Chicago Region

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
Illinois	1475	769	-47.86%
Indiana	461	206	-55.31%
Kentucky	397	243	-38.79%
Michigan	362	178	-50.83%
Ohio	527	304	-42.31%
Wisconsin	629	311	-50.56%
Total	**3,851**	**2,011**	**-47.78%**

Dallas Region

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
Colorado	498	180	-63.86%
New Mexico	119	60	-49.58%
Oklahoma	540	278	-48.52%
Texas	2051	698	-65.97%
Total	**3,208**	**1,216**	**-62.09%**

Memphis Area

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
Arkansas	294	170	-42.18%
Louisiana	367	170	-53.68%
Mississippi	170	103	-39.41%
Tennessee	345	208	-39.71%
Total	**1,176**	**651**	**-44.64%**

Kansas City Region

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
Iowa	647	422	-34.78%
Kansas	656	380	-42.07%
Minnesota	741	486	-34.41%
Missouri	677	377	-44.31%
Nebraska	451	270	-40.13%
North Dakota	180	104	-42.22%
South Dakota	149	94	-36.91%
Total	**3,501**	**2,133**	**-39.07%**

New York Region

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
Delaware	51	34	-33.33%
Maryland and D.C.	217	127	-41.47%
New Jersey	279	146	-47.67%
New York	362	206	-43.09%
Pennsylvania	473	270	-42.92%
Puerto Rico	25	11	-56.00%
Total	**1,407**	**794**	**-43.57%**

Boston Area

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
Connecticut	153	63	-58.82%
Maine	58	40	-31.03%
Massachusetts	373	209	-43.97%
New Hampshire	100	31	-69.00%
Rhode Island	20	15	-25.00%
Vermont	35	19	-45.71%
Total	**739**	**377**	**-48.99%**

San Francisco Region

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
Alaska	15	7	-53.33%
Arizona	62	50	-19.35%
California	691	318	-53.98%
Hawaii	28	8	-71.43%
Idaho	30	18	-40.00%
Montana	180	80	-55.56%
Nevada	23	37	60.87%
Oregon	71	38	-46.48%
Utah	68	64	-5.88%
Washington	135	100	-25.93%
Wyoming	113	46	-59.29%
Total	**1,416**	**766**	**-45.90%**

Other Areas

State	Number of Banks as of 12/1987	Number of Banks as of 12/2003	Change
American Samoa	1	1	0.00%
Federated States of Micronesia	1	1	0.00%
Guam	1	3	200.00%
Virgin Islands	1	2	100.00%
Total	**4**	**7**	**75.00%**

Grand Total

Number of Banks as of 12/1987	Number of Banks as of 12/2003	% Change
17,343*	**9,182**	**-47.06%**

Source: FDIC's *Historical Statistics on Banking*, Commercial and Savings Institutions Bank Reports.

*The number of banks listed here as of 1987 differs by two banks in comparison to the number shown in Figure 1 on page 6 of this report due to the compilation of statistics by the FDIC.

CHRONOLOGY OF SIGNIFICANT EVENTS

The following chronology describes significant events in DSC's history, including: risk-focused and compliance examinations, management structure, and technology consistent with the FDIC's corporate goal to more effectively supervise and serve the rapidly changing financial industry.

DATE	EVENT
December 1992	Implemented the Offsite Program for Large Insured Depository Institutions (LIDI) to introduce a program of integrating regular off-site monitoring into the FDIC's over-all supervisory effort.
April 1996	Automated Loan Examination Review Tool (ALERT) implemented. ALERT is a computer application designed to improve the loan review function in bank examinations. ALERT automated the loan selection and transcription process and replaced manual methods used for over 60 years.
April 1997	DSC implements the case manager program.
October 1, 1997	The FDIC, FRB, and Conference of State Bank Supervisors implement the Risk-Focused Examination Process. This approach assesses an institution's risk by evaluating its processes to identify, measure, evaluate, and control risk. The FDIC developed 10 examination modules to focus on risk management and to help establish the scope of the examination. The modules gave examiners a means to organize and sort written comments on examination analysis and decision making.
June 1998	The GENESYS Version 1.0 implementation and training plan began. GENESYS is an integrated software application for recording financial institution data and creating the ROE.
August 29, 2000	The Large State Nonmember Bank On-site Supervision Program was implemented.
November 2000	Senior Division of Supervision (DOS) managers from the regions and headquarters and the DOS Director initiated Process Redesign I to identify actions needed to proactively prepare for the future and to examine existing processes to improve efficiency. DOS conducted the detailed evaluation of its processes and procedures at its field and regional offices and headquarters.
March 31, 2002	Maximum Efficiency, Risk-Focused, Institution-Targeted (MERIT) Guidelines were issued. "Well-capitalized" banks with a "1" or "2" rating and total assets of $250 million or less were eligible for MERIT Guidelines.
June 30, 2002	The Division of Supervision and the Division of Compliance and Consumer Affairs were restructured into the current DSC. The Boston and Memphis regional offices were converted to area offices in accordance with the *Federal Register, Volume 67, Number 230*.

July 2002	The FDIC created the Consumer Response Center (CRC), which is headquartered in the Kansas City Regional Office. CRC logs data of "3," "4," and "5" rated institutions for reports issued to the United States Congress, FDIC's Board of Directors, and other regulatory, state, and federal agencies. CRC specialists respond to consumer, financial institution, and advocate inquiries and complaints.
August 15, 2002	DSC announced 52 newly selected field supervisors and the closing of one satellite office and merged six field offices into three.
September 14, 2002	The Dallas Field Office moved to the Dallas Regional Office.
September 30, 2002	The Statesboro, Georgia, Satellite Office was closed. Its workload and jurisdiction were divided between the Norcross and Albany, Georgia, Field Offices.
October 2002	DSC launched the Dedicated Examiner Program and assigned eight DSC examiners to the country's largest banking organizations. The examiners monitored operations at the institutions to which they were assigned and worked with the federal financial regulators who were the primary supervisors of the institutions.
October 31, 2002	The Orlando, Florida, Field Office was closed.
November 29, 2002	The FDIC's June 30, 2002 internal reorganization rule was effective in the *Federal Register,* Volume 67, Number 230.
January 1, 2003	DSC realigned the responsibilities of risk management case managers in regional offices and field office supervisors. Field office supervisors and supervisory examiners assumed the following duties for certain low-risk institutions: reviewing and processing ROEs; processing and approving certain applications; processing general correspondence; and conducting off-site reviews. These delegations of authority were applicable for MERIT-classified banks that did not transcend geographic boundaries of regional offices and did not have assets exceeding the signing authority for field supervisors.
June 30, 2003	DSC revised compliance examination procedures to combine the risk-based examination process with an in-depth evaluation of an institution's compliance management system. Under this approach, examiners were able to devote more attention to institutions requiring additional regulatory scrutiny. Identification of the causes of compliance deficiencies and violations was intended to help institution management to improve their operations and be proactive in consumer compliance responsibilities.
December 8, 2003	The FDIC initiated the FDIC*connect* program.
January 14, 2004	The FDIC implemented the Fair Lending Examination Specialist Program to improve the quality of examinations; considerably reducing fair lending examination processing time; moving decision making authority to the field in keeping with corporate objectives; and reducing workload in the section. A specialist was appointed at each regional and area office.
January 31, 2004	The MERIT-eligible threshold was raised to include institutions with up to $1 billion in assets.
April 5, 2004	The FDIC began a pilot Relationship Manager Program for selected state nonmember banks. The pilot program continues through September 30, 2004, at which time it could be made permanent. The program explores alternatives

	to point-in-time examinations by testing a flexible, risk-focused and risk-based approach that allows for supervisory activities to be conducted over a period of time, based on allocation or resources commensurate with perceived risk. The program eliminates existing examination frequency schedules for other types of examinations such as compliance, IT, and trust examinations.
May 31, 2004	The Overland Park Field Offices were moved to the Kansas City Regional Office. The Manhattan and New York East Offices were merged.
August 31, 2004	The FDIC announced the date of the timeline implementation for institutions to submit Call Report data directly to the Federal Financial Institutions Examination Council (FFIEC) through secure Internet connection (the date was subsequently changed to sometime in 2005).

CORPORATION COMMENTS

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990 Division of Supervision and Consumer Protection

September 21, 2004

MEMORANDUM TO: Stephen M. Beard
Deputy Assistant Inspector General for Audits

FROM: Michael J. Zamorski, Director
Division of Supervision and Consumer Protection

SUBJECT: *Review of DSC's Regional Office Structure*
Draft Report, Assignment Number 2004-016

Thank you for the opportunity to respond to your draft audit report about DSC's regional office structure. In general, we agree with your recommendation for an independent analysis of DSC's regional structure. In fact, we have continuously been reviewing our structure and staffing levels. We believe an independent analysis is premature and offer the following comments:

Regional Office Structure Changes

We disagree with your statement on page 3 of the report that "the DSC has not made a significant change to its regional office structure since 1987, even though the industry it supervises and DSC's supervisory approach have experienced significant changes." We would argue that we have made several changes in response to industry transformation, namely:

- We instituted the Case Manager system in 1997 in response to the increasing complexity of DSC's supervised institutions.
- Similarly, in response to the increased complexity in the areas of IT, Capital Markets, Accounting, Trust and Special Activities including Fraud and Bank Secrecy Act, we designated specialists with expertise in these areas.
- In 2001, we designated the former regions of Memphis and Boston as area offices of Dallas and New York respectively.

More Delegations to the Field Offices

While we agree with your general comments that we have been delegating more processes and responsibilities to the field offices, we do not agree that the relationship manager (RM) program, if implemented, would result in even more work delegated to the field offices. The RM program's primary impact, as piloted, will be on the examination cycle (an open-examination cycle rather than a point in time examination) and provides examiners more flexibility in carrying out the FDIC's supervisory responsibilities. If implemented, the RM program would not materially impact delegated activities.

Other Regulatory Agency Regional Changes

The report seems to focus on the regional office structure changes at both the OCC and the OTS, each having reduced their number of regional offices from six to four in 2002 and 2003, respectively. For comparison purposes, as of March 31, 2004, there were 1,969 national banks and 1,404 thrifts. Assuming no banks or thrifts are supervised out of the Washington offices (which is not a correct assumption), each OCC District office is responsible for an average of 500 banks and each OTS region is responsible for an average of 400 thrifts. Each FDIC regional office, on the other hand, is responsible for an average of 900 FDIC-supervised institutions and nearly 600 additional insured institutions. Due to the nature of our backup insurance role and our relationship with state agencies, we feel FDIC needs to be structured to meet its responsibilities, rather than to parallel the structure of other agencies.

Workload Implications from MERIT examinations

Staffing comparisons associated with the decline in the number of institutions and the transfer of MERIT banks to the field should reflect the report review, report processing and the branch application workload associated with "small" 1- and 2-rated banks is relatively light. On the other hand, the more complex and problem institutions assigned to Case Managers require a much more time consuming depth analysis. Therefore, it is not a simple transfer of the number of institutions from the regional offices to field offices that would equate to staffing requirements, but rather the complexity and interrelationships that the regional office staff deal with that requires significantly more hours and expertise.

Similarly, the analysis of the number of Assistant Regional Directors should not be simplistically equated to the number of banks under their immediate supervision. Again, size and complexity of the workload need to factor into the equation. In addition to bank-specific workload, there are other duties the ARDs perform such as special projects, outreach meetings, Directors' Colleges, and many other functions.

Industry Assets

The chart below includes changes in the total number of banks by region and total assets associated with those banks.

FDIC Insured Institutions

Region		All	**ATL**	**CHI**	**DAL**	**KC**	**NY**	**SF**
No. Bks	1998	10,490	1,334	2,076	2,395	2,485	1,397	784
	2003	9,196	1,225	2,041	1,817	2,186	1,203	724
% of Chg		-12.3%	-8%	-1.7%	-24%	-12%	-14%	-8%
TA	1998	6,531,024M	1,430,427M	1,150,245M	443,992M	562,642M	2,318,503M	613,469M
	2003	9,076,005M	1,872,179M	1,548,654M	539,136M	526,643M	3,255,576M	1,333,815M
% of Chg		39%	31%	35%	21%	-6%	40%	117%

CORPORATION COMMENTS

The growth in industry assets increases the level of risk to the insurance fund. Consequently, any review of regional operations and efficiencies should give consideration to the value added by regional office staff expertise (i.e. monitoring and offsite reviews) that mitigate potential risk.

In addition, there has been an increase in the number and asset size of specialty institutions, such as credit card banks. Recently, the FDIC has been closely monitoring the activities of these institutions given the spike in consumer debt levels and payment delinquencies. We have previously indicated to the Office of Inspector General, we are also allocating more resources to the analysis of limited-charted institutions (i.e. Industrial Loan Companies) in cooperation with state regulatory authorities.

Given the contraction in the industry and the trends toward fewer, but more complex institutions, regional operations need to monitor these institutions closely. Also, regional staff provides a level of expertise and knowledge that is needed to better supervise and regulate these institutions.

Problem Institutions

The OIG report observes that the number of problem banks has declined since 1987; however, the complexity of the industry has increased significantly, making a comparison of the current industry to that of 1987 difficult.

Our analysis of the more complex industry from 1998 to 2003 reflects the number of problem institutions and associated assets are increasing. The more complex nature of the problem institutions currently requires regional staff expertise for the ongoing monitoring of these institutions.

All 4, 5- Rated Insured Institutions

Region / State		All	ATL	CHI	DAL	KC	NY	SF
Number of Bks	1998	92	18	11	30	8	8	17
	2003	117	18	29	27	16	11	16
% of Change		27%	-	163%	-10%	100%	37.5%	-5.88%
Total Assets	1998	11,901M	1,871M	734M	2,138M	547M	1,192M	5,416M
	2003	27,052M	1,541M	3,473M	1,688M	2,272M	16,279M	1,796M
% of Change		127%	-17%	373%	-21%	315%	*	-66%

* Material increase could be caused by one institution.

As stated previously, we are positioning our workforce to reflect the complexity and trends in the financial services sector and have recently implemented a plan to downsize through attrition and hiring restrictions. DSC continues to regularly review projected workload assumptions and address any resulting imbalances and continues to analyze staffing requirements and necessary skill sets. We appreciate your recommendation of an independent study of our regional office structure, but we have made the decision that such a study is not advisable at this time. Therefore, as an alternative action, we will continue, as part of our ongoing reassessment efforts, to evaluate our regional structure as part of our normal annual workforce planning and budgeting efforts.

MANAGEMENT RESPONSE TO RECOMMENDATIONS

This table presents the management response on the recommendation in our report and the status of the recommendation as of the date of report issuance.

Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved:[a] Yes or No	Dispositioned:[b] Yes or No	Open or Closed[c]
DSC will evaluate its regional structure as part of DSC's normal annual workforce planning and budgeting efforts. Also, DSC will continue to regularly review projected workload assumptions and address any resulting imbalances and will continue to analyze staffing requirements and necessary skill sets.	December 31, 2005	N/A	Yes	No	Open

[a] Resolved – (1) Management concurs with the recommendation, and the planned corrective action is consistent with the recommendation.
(2) Management does not concur with the recommendation, but planned alternative action is acceptable to the OIG.
(3) Management agrees to the OIG monetary benefits, or a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

[b] Dispositioned – The agreed-upon corrective action must be implemented, determined to be effective, and the actual amounts of monetary benefits achieved through implementation identified. The OIG is responsible for determining whether the documentation provided by management is adequate to disposition the recommendation.

[c] Once the OIG dispositions the recommendation, it can then be closed.