

## FDIC to Undo Limits on Examiner Discretion

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By Joe Adler

WASHINGTON — Federal Deposit Insurance Corp. Chairman Sheila Bair plans to scrap a program designed to streamline safety and soundness examinations after agency employees complained it was not working.

The Merit program was created in 2002 under then-Chairman Don Powell to reduce the amount of time examiners spent in small, well-managed banks. It originally applied to banks with assets of less than \$250 million, but the threshold was later raised to \$1 billion.

Two-thirds of examiners surveyed, however, said the program did not allow enough time to conduct a proper review, so the agency plans to make changes that would give examiners more discretion.

In a Dec. 21 memo e-mailed to agency staff and obtained by American Banker, Ms. Bair outlined a series of upcoming changes "meant to increase ... [examiners'] flexibility in establishing examination plans."

"We pay examiners and their supervisors to exercise sound judgment, and we value and trust that judgment," Ms. Bair wrote.

An independent review started in April by the agency's division of supervision and consumer protection — and reinforced by the employee survey — found that current examiner guidelines were too rigid, and examiners were already making the appropriate schedule adjustments independent of the Merit program.

"The Merit instructions are unnecessarily prescriptive at this point," said Doreen Eberley, the division's New York regional director.

Ms. Eberley said the division recommended doing away with the program "in light of the changing economic environment," including the industry's far-reaching mortgage problems, so that examiners could respond promptly to problems without worrying about complying with the Merit guidelines.

"There won't be any impediment ... for examiners in terms of conducting the examination activities that they think are appropriate for any given institution," Ms. Eberley said.

Under Merit — for Maximum Efficiency, Risk-Focused, Institution Targeted Examinations — examiners were to spend less time inspecting individual loan transactions at institutions with Camels ratings of 1 or 2 and to put more emphasis on off-site analysis and a broader look at a bank's risk management process. Its aim was to focus agency resources on known trouble spots in the industry.

In response to low employee morale, the FDIC hired Hay Group, a human resources consulting firm based in Philadelphia, to survey agency employees.

The results, compiled Nov. 20, showed that 54% of respondents were unsatisfied with the way examiner issues were handled at the agency; 45% singled out the time allotted for bank examinations, and 49% said Merit had a negative impact on job satisfaction.

Though a more comprehensive agency response to the employee survey is expected soon, Ms. Bair said in the memo that she was taking "immediate action" to address examiner concerns "that surfaced in the survey results."

In the Dec. 21 memo Ms. Bair outlined other coming changes to the exam process. Relationship managers will still be the FDIC's point of contact for bankers, she said, but these employees will no longer prepare the supervisory plans. Also, the report of examination will become the principal document of record and rules associated with the report of examination will be eliminated, she wrote.

Ms. Bair also said in the memo that she planned early this year to negotiate a new program for awarding pay packages to employees based on individual performance. The agency's pay-for-performance system was criticized extensively in the surveys, and employees have expressed frustration at subjective measures that managers use to determine pay allotments. Ms. Bair said that, though the surveys show general agreement with the system's concept, she is discussing possible improvements with the National Treasury Employees Union that would take effect in 2008.

Nicholas Ketcha Jr., a former FDIC director of supervision, said the industry would likely have mixed reactions to the Merit program's elimination.

"There will be some criticism by banks that this will be an additional intrusion," Mr. Ketcha said. "It will be welcomed by some banks, who say, 'Hey, I welcome examiners coming in. It gives me that independent look that maybe I hadn't had before.' "

Mr. Ketcha said examiners had complained that Merit reflected a "bean-counter" approach at the agency, under which 1- and 2-rated institutions were automatically treated with softer gloves. "They were being asked to go in and do these quickie exams, and they didn't really have the time to look through everything," he said. "Examiners

were saying they needed flexibility to make an on-site judgment that if there were problems in an institution, they" could go "deeper."

Efforts to reach Mr. Powell were unsuccessful Wednesday.