Remarks by
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before
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Thank you.

This the first time I've talked to a group of bankers since I became Acting Chairman of the FDIC less than two weeks ago. Since then, I've felt like the young man who joined the Navy to see the world only to be assigned to the Pentagon: It's not what I planned on -- I wouldn't have asked for it -- but there is a job to be done and I have been handed it.

In my case, that job is to finish what Bill Taylor began.

Bill Taylor was a dedicated public servant, a strong leader and a person of principles. He headed the FDIC for 10 months, not very long by any measure. But it was long enough to create a legacy for the Corporation. What did Bill Taylor leave? His deep concern for the solvency and integrity of the insurance fund. His deep concern for the integrity -- the safety and soundness -- of the banking system. His deep concern for integrity -- period.

To be sure, these concerns are not original. But while these concerns may not have been original, no one felt them stronger than Bill Taylor. They were his constant companions. He took them personally. But he didn't keep them to himself -- he shared them with his colleagues on the FDIC Board and with the FDIC staff. So what does that mean for the future? No great changes from the course set over the last 10 months, that is to say: restoring the solvency of the insurance fund and reinforcing the safety and soundness of the banking system.

First the fund. Your fund -- bankers contribute to it and, directly and indirectly, benefit from it. On September 15, the FDIC Board will consider the issue of raising insurance premiums. We were going to consider it tomorrow, but we postponed the scheduled vote on the request of Acting Comptroller of the Currency Stephen Steinbrink and Office of Thrift Supervision Director Timothy Ryan.

They wanted more time to think about it.

Well, two weeks isn't forever and inconvenience is sometimes the price of collegial courtesy. A two-week delay is a small price to pay if it assures a decision will be forthcoming on September 15 -- as I expect it to be.

It will not be an easy decision to make. A college professor once told me that 95 percent of the decisions I would make in a financial career could be made by any reasonably intelligent eighth-grader. I would earn my money for making the other five percent. For the members of the FDIC Board, replenishing the insurance fund falls into that five percent category.

And, like choosing between being tried by a judge or tried by a jury, there are only varying degrees of downside to consider.

Further, mixed signals about the current and future condition of the banking system make a decision about a premium increase a judgment call.

The first half of this year was a great one for the banking industry as a whole -- record earnings in the first quarter, and the strong likelihood of record earnings in the second.

What gave the industry such a healthy glow in the first half? Many factors. The most important: low interest rates. Profits went up. Some banks that were heading for failure appear stabilized. And some banks that would have failed by now received a reprieve -- not a pardon -- a temporary reprieve.

Things are better. Progress was made. But when I look at the numbers I'm like the farmer standing in his drought-stricken fields during a rainstorm -- I just have to ask: Is good news moving in for a while or just passing through?

A number of serious problems remain. Resolving them will require sizeable expense to the insurance fund. Low interest rates will not be around forever. When rates rise, the weight of the past that many banks carry with them will become heavier. Inevitably.

And that is sobering in light of the fact that the number of banks on the problem list continues at a high level -- over 1,000 -- and in light of the fact that the total assets of these troubled institutions approach $600 billion. Moreover, bank exposure to weakened real estate markets remains substantial.

How substantial? Commercial banks nationwide hold almost $400 billion in loans for commercial real estate. That is almost four times the total assets of all the banks in Ohio and more than the total assets of all the banks in California. Many of these commercial real estate loans will require restructuring and refinancing in the coming months as original terms cannot be met. In short, banking's exposure -- its big exposure -- to commercial real estate is not much better today than it was a year ago.

Further, some banks are beyond help -- despite low interest rates. As of today -- eight months through the year -- failed bank assets have totalled a bit more than $22 billion. By any standard, $22 billion is a lot of money. In fact, only three times have total failed bank assets <u>for an entire year</u> been higher than $22 billion.

Now, some people look at the income numbers for the first half and say that banks are almost completely out of the woods. Others are more cautious -- feeling that there continue to be a number of worrisome problems that will need to be dealt with. And still others subscribe to the conspiracy theory that says bank closings are being delayed by the regulators. They talk of a December surprise.

Well, failures have been delayed -- and perhaps a few avoided -- by low interest rates and other developments. But not by the regulators. There has been no effort to delay the closing of insolvent banks. State and federal regulators are closing insolvent banks as quickly as the law permits.

At the same time, some fault us for not having more failures. They say that the supervisors are ignoring the condition of many banks.

In fact, we have taken the opposite approach. The FDIC has anticipated -- and publicly accounted for -- what we believe is to come. We have released 1991 financial results for the Bank Insurance Fund. In those figures, we pre-booked an estimated loss of more than $15 billion for banks we thought likely to close after 1991. We booked these losses to display the exposure publicly, even though it meant a deficit of $7 billion.

Now December will be -- or rather, is -- a significant month for future bank closings -- but anyone familiar with the Federal Deposit Insurance Corporation Improvement Act already knows that. It is no secret that on December 19th a change in the law will go into effect that will hasten the closing of banks. That is to say, banks on the road to failure will be closed earlier. As a result, we can expect a surge in bank failures sometime in 1993 or 1994.

Why?

Chartering authorities now close banks when the banks are out of equity capital. Beginning December 19th, FDICIA effectively requires the authorities to promptly close critically undercapitalized institutions -- defined by law as those with less than 2 percent tangible capital. And the FDIC is authorized to appoint itself a receiver for such banks, if the appropriate state authority fails, or is unable, to take the necessary action.

The law at present does not permit the early closure of failing banks. The law beginning December 19th virtually requires the early closure of failing banks. How early? Within 90 days -- though the deadline can be extended under certain circumstances.

How many critically under capitalized banks are there? As of the end of the first quarter, there were about 80, representing total assets of about 30 billion dollars. Today there are other institutions headed south for the 2 percent level -- and they might make it by that date in December.

What do the early closures mean to you, assuming that you don't find your bank among them, in which case the meaning is all too clear?

Logically, the move will lower the cost of bank failures to the Bank Insurance Fund in the long run. And I don't need to add that every dollar the BIF saves is a dollar that the banks save.

A lot of numbers that float through the public debate these days have little relation to reality. They remind me of the boy who arrived at his house breathless and told his father: "Dad, I ran home from school behind the bus and saved 50 cents."

The father then said: "Next time run home behind a taxi and save three dollars."

I cannot estimate how much the earlier closing of failed banks will save the BIF, but every dollar saved will be real and that's the important point -- especially when you are looking at the level of losses we are looking at.

Some people say that -- in the short run -- we should wait to find out how much damage there actually will be and then raise premiums to match losses. But that would risk coming up a day late and a dollar -- or millions or billions of dollars -- short. We cannot afford to add to the uncertainty in the banking system. The sooner the bank insurance fund shows that revenues again have exceeded expenses, the sooner the anxiety will fade that the public faces another large cost.

Others say that we should wait to raise premiums because the banks have been drained by too many problem loans. What, however, makes more sense: raising premiums now, when profitability is higher, or waiting until later, when profitability might be lower?

All these are powerful arguments in favor of deciding to raise insurance premiums.

Proposals to raise insurance premiums have dominated industry attention the last few months. Large amounts of money have a strong effect on people, whether they are bankers or not.

But if I were a banker -- again -- I would be giving much more attention to the regulatory restructuring now being developed as a result of FDICIA than I would be giving to the premium issue.

This regulation will have a far more significant effect on the banking business in the long run than the premium increase will.

In FDICIA, Congress sought to protect the deposit insurance funds by drawing clearer lines around what depository institutions can and cannot do -- and how they can do what they can do. The law emphasizes early intervention, capital, accountability, and regulatory oversight. Under FDICIA, the government will exercise greater control over the day-to-day operations of banks by issuing regulations for credit underwriting, asset growth and real estate loans, as well as loan documentation and interest rate exposure. Under FDICIA, banks will be examined more frequently and more thoroughly. Under FDICIA, we are required to limit state-chartered banks to the activities permitted national banks.

We -- the federal regulators -- have only limited discretion concerning these matters. They are the law. And the law contains capital-driven standards that will require federal regulators to begin a variety of enforcement proceedings against insured institutions that fall over capital level tripwires. Banks failing to meet minimum capital standards will be prohibited from soliciting brokered or high yield deposits. They will be restricted in borrowing from other banks. And they will be limited in borrowing from the Federal Reserve.

It is clear that the regulatory and supervisory agenda for all the federal bank regulatory agencies is now largely driven by FDICIA.

Just as it should be clear that the FDIC is committed to the spirit of the law. That commitment does not mean that we intend to write the most severe regulations conceivable to implement the law. The most severe regulations conceivable would be counterproductive: eroding, rather than reinforcing, the safety and soundness that is the goal.

No, we will go where the law directs us -- and it directs us explicitly and in detail -- but we will go no farther.

After college, I went into the Navy. I'll never forget the first time we sailed out of sight of land. I turned to a friend of mine who I knew was from the Midwest and had never seen the ocean and asked him: "Did you ever think there was this much water?"

"Not only that," he answered, awestruck, "we're only looking at the top."

The unknown can be intimidating. Over the last few years, we have lived through a banking crisis unlike anything seen in more than half a century, but now we know how extensive the problems were -- and are. Resolving those problems will take effort and money and time, but the problems are not limitless -- they can be resolved. They won't go away if we ignore them. But they will go away if we address them.

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