Remarks by
ANDREW C. HOVE, Jr.
Acting Chairman
Federal Deposit Insurance Corporation

Before the Conference:
The New Regulatory Climate for Banks and Thrifts:
Understanding the Impact of December 19th

Washington, D.C.
January 25, 1993

I especially want to congratulate Ross Delston on the clever way he managed to avoid using FDICIA in the title of this conference. Of course, timing aided him there. When this conference was being planned several months ago, there were dire reports that the earth would tremble from the regulatory-induced collapse of banks in the days following December 19th. At the very least, some observers charged, the effective date of so many of FDICIA's provisions should lead to some catastrophic event. Surprise, surprise, surprise -- nothing of the sort happened. Circumstances conspired against disaster.

December 19th -- and every day since then -- passed in relative peace. But that shouldn't blind anyone to the momentous changes that FDICIA has brought -- is bringing -- and will continue to bring the banking industry.

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However, when the news that Congress had approved the Federal Deposit Insurance Corporation Improvement Act swept through banking, the reaction couldn't have been clearer. The bankers were outraged.

For example, soon after passage, I asked a community banker from the South how he thought bankers felt about the law. He thought for a moment and then said: "It feels something like the way a friend of mine must have felt when he returned to town from a long business trip abroad. He saw his brother waiting for him as he walked out the gate at the airport and he knew something was wrong. He asked his brother what the bad new was.

"'Well,' said his brother, "'your dog died.'

"'My dog died? Old Blue? Mercy, how did it happen?

"'It must have been the burnt horseflesh that killed him,'" his brother said.

"'Burnt horseflesh," my friend said, "'how did he get into that?"

His brother replied: "'When your barn burned down. Actually, the fire started in your house, then sparks flew over and caught the barn, trapped the horses. The dog ate some horse meat . . .'"

My friend broke in: "'My house burned down. How did that happen?"

His brother said: "'I think it was one of the candles. It must have tilted over during the funeral and set the curtains on fire.'"

"F-f-funeral?" my friend's voice quavered. "At my house? Who died?"

"'Dad,'" said his brother, "'You see, when your son ran off after leaving the note that he was investigating alternative lifestyles and he wouldn't be back, it broke Dad's heart and he died. We had a funeral service at the house, and that's when the candles by the coffin caught the curtains on fire, then the house and the barn, and in it the poor horses that Old Blue ate and died.'"

That, said the Southern banker, is how FDICIA feels.

From what I have heard and read: As a result of FDICIA, a large number of bankers believe the Federal government will soon micromanage the nation's banks. That is to say, by imposing detailed rules, the federal government will be the silent partner in every significant decision a banker makes. Some bankers believe that we are at that point already. And some look at the government's increasing demands as more and more of the same: A burden of cost and effort, most of which is a waste. For many bankers, FDICIA is a horror.

But, after the experience of living with the law for a year, I don't think the Apocalyptic view is justified. And remember, I am an Acting Chairman of the FDIC who spent 30 years as a community banker. So I'm not about to rattle off a party line.

True, FDICIA has its flaws -- some serious flaws. In some respects, it places an undue burden on the banking industry -- and I don't want to understate that burden. At the same time, however, there is a great deal in FDICIA that is desirable.

The law specifically and significantly increased the responsibilities of the FDIC, from requiring the FDIC's approval for new national bank or Fed member bank charters to granting us back-up enforcement authority over national banks to many other areas. In and of itself, this expansion is no bad thing. If one of the purposes of banking regulation is to protect the insurance fund, the insurer must have the regulatory tools to do so. And the idea that one of the purposes of banking regulation is to protect the insurance fund is not new. The earliest expression of it I've heard about was an article written by the FDIC's chief economist -- more than 50 years ago.

The FDICIA clearly represents this idea's triumph in the intellectual marketplace -- where it joins the prevention of bank failures and the prevention of banking concentration as one of the guiding principles of banking regulation.

In addition, much of the expanded authorities the law grants us merely allows us to fine-tune our current operations.

Did the law make the FDIC a "super-regulator," as is so often charged?

No, it stops short of that.

We don't call the shots in bank supervision. We still must work -- cooperatively -- with our colleagues -- and I stress "colleagues" -- in bank supervision at the OCC and the Fed.

Now one might say with some accuracy that FDICIA makes the FDIC accountable for any problem slipping through the web of Federal banking regulation. Congress made clear that it will no longer tolerate such slippage. But that accountability is a far cry from being a super-regulator.

In short, FDICIA will result in a smaller, better capitalized and more managerially conservative banking industry. There results are not unintentional. They are the goals the lawmakers set out to achieve. And fostering a stronger banking industry -- whose managers act prudently -- is a legitimate goal of public policy.

But one unintended consequence of FDICIA has become clear to all of us -- its effect on banks -- and especially community banks -- in terms of the regulatory burden. There can be no doubt that FDICIA will impose significant reporting and paperwork burdens on the banking industry. And there can be no doubt that the smaller institutions will feel the regulatory burden more heavily. And the smallest, the most.

The regulators are quite aware of the problem and, within the limitations set by FDICIA, we are trying to write regulations that take the problem into account. But it is a problem.

Now, one provision of the law that must be implemented this year, in particular, brings together several of the general concerns that FDICIA has raised or spread. The regulators are, at present, drafting proposals to put that provision, Section 132 of the law, into effect. That provision requires each of the regulatory agencies to prescribe managerial and operational standards for the institutions it regulates.

Those standards must cover: Internal controls, information systems, and internal audit systems; loan documentation; credit underwriting; interest rate exposure; asset growth; compensation for employees and officers, though Congress subsequently cut back on this requirement; and anything else that we think is important. Final regulations must put this provision into effect no later than next December 1.

This provision was -- and is -- thought-provoking -- for the regulator as much as for the regulated. The law left us with pretty much of a free hand in developing the standards, but we didn't want our free hand to become a dead weight on the industry. So last July, we asked for public comment before we drafted regulatory proposals -- comment on the general direction in which we should go.

As we put it at the time, we were asking for direction on: "how to balance the objectives of the statute relating to safety and soundness standards with the important need to avoid establishing unrealistic and overly burdensome standards that unnecessarily raise costs within the regulated community.

"In light of the need to attract and retain capital and management talent in the banking and thrift industries, it is important that the standards not needlessly impose uncertainty or raise substantive issues with respect to their implementation by the agencies."

In other words, through the clear and bracing prose that federal agencies are known for, we were asking bankers whether the forthcoming regulations should: Be general or specific. Specify minimum or maximum standards. Define key words or phrases. Discriminate between size and/or financial condition of institutions. Provide for exceptions, and so on.

The FDIC alone received 335 comments on the provision. Many of them told us what to do with the standards -- in suggestive detail.

Seriously, though, concerns were clear.

Section 132 is one of those legislative mandates that can become counterproductive if not delicately handled. In fact, it is one of those mandates that can become counterproductive despite the intent and careful work of the regulators who write the rules. There are two schools of thought on how to address the regulations that will bring it into effect. The first is to be general -- establishing targets like "Love thy neighbor." The second is to be detailed and specific, in other words saying: "You will love thy neighbor in the following 142 ways by the tenth day after the first full moon following your birthday."

As no one knows better than all of you do, there are pluses and minuses in both approaches. The major plus for the first -- the general -- approach is that it leaves discretion to examiners. The major minus is that it leaves discretion to the examiners. The major plus for the second -- the detailed and specific -- approach is that it leaves far less to the examiner's judgment than the first. And being sharp people, you've no doubt figured out the major minus of a detailed and specific approach.

In a nutshell, the regulations implementing Section 132 cannot be perfect, so the question then become: "Which flaw is the most attractive?"

And further: Which has the least impact on banking's competitiveness? Which will have the least impact the attractiveness of serving on a bank's board of directors? Which adds to the regulatory burden the least -- and especially for the smaller banks, the banks affected the most by an increase in paperwork and in the compliance process?

These regulations don't exist in a vacuum -- how do they dovetail with the capital tripwires of prompt corrective action?

How do they dovetail with Section 112 of FDICIA -- the provisions that require managements of larger financial institutions to take many actions relating to auditing and internal controls, including establishing an independent audit committee?

And keep in mind that whenever an agency determines that an institution has failed to meet any of the safety and soundness standards, the institution must submit an acceptable plan to the agency describing how it will correct the deficiency.

Failure to do so -- or to implement the plan -- triggers remedial regulatory action.

The agency can then order the institution to correct the deficiency, and until it does correct it, the agency can prohibit or limit asset growth; impose interest rate restriction; or take other actions it considers necessary.

Now, Section 132 of FDICIA is not a blank check, nor is it a license to kill. Much of its thrust -- particularly on operational and managerial standards -- is generally reflected in regulatory policy already. But -- to a degree that we've yet to determine -- it will bring the presence of examiners further into managerial decision making; it will affect an institution's bottom line; and it will expose officers and directors to penalties for poor decisions. Just as many of the other provisions of the law do.

And that leads me, I believe, to the proper note on which to open a conference such as this one: FDICIA will not go away. The challenge for bankers -- and their legal representatives -- is to find a way to turn back FDICIA's undue burdens and find ways to live with what remains. Meeting that challenge means making decisions. There is no better time to start than now.

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