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FACTS AND FALLACIES ABOUT DEREGULATION

by

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This is a particularly opportune time to address such a distinguished group of leaders from the banking industry. We are in the midst of a national debate on the nature and causes of the banking industry's current problems, the desirability of product and geographic deregulation and the need for deposit insurance and regulatory reforms.

We read and hear a great deal of commentary on these subjects from regulators, elected officials, financial leaders, media representatives and others. Some of it is intelligent and thoughtful, some of it misguided. I will use the brief time allotted to me today to try to clear the air about deregulation -- to separate the facts from the fallacies.

A. The Condition of the Banking Industry. The problems in the banking industry have been receiving considerable attention in Congress and the media. It is indisputable that there are more problems in the financial system than in any period since the Depression. There are, for example, more than 900 banks on our problem list, which is significantly higher than the previous peak of 385 banks in 1976. During my tenure as Chairman, the FDIC has handled over 200 bank failures with assets totaling nearly \$30 billion, excluding Continental Illinois, and our losses have exceeded \$4 billion. During the FDIC's first 47 years, the failures totalled only \$9 billion and our losses were a negligible \$500 million. Problems in the thrift industry, agriculture, energy, real estate and in the international debt arena continue to plague us.

That is the bad news. The good news is that the problems are, for the most part, being handled well, and the vast majority of banks are in remarkably good shape. Problem banks still constitute a small percentage of the total, and the failure rate of about $\frac{1}{2}$ of 1% per year remains well below that of any other industry. Earnings have held up well, despite large loan losses, and banks, particularly the larger ones, have added substantial sums to their capital base.

The FDIC insurance fund has never been stronger. When I became Chairman, it stood at \$11 billion. After absorbing losses of \$4 billion during the past four years, it now totals \$18 billion. It is exceptionally liquid, with an average maturity in its investment portfolio of about $2\frac{1}{2}$ years and no market depreciation. Not only has the fund grown dramatically in aggregate dollars, it has increased as a percentage of insured deposits during the past four years, reversing a long-standing decline.

Some people, particularly in Congress and in competing financial services businesses, contend that the problems in the banking industry demonstrate that bankers are inept and are incapable of handling deregulation. They could not be more wrong.

The current problems in the industry are not the result of deregulation. The fact is there has been virtually no deregulation in banking apart from deposit interest rate deregulation, which has been handled exceptionally well by most banks and has been enormously beneficial not only to the banking industry but to consumers and smaller businesses throughout the nation.

The banking industry's problems are the direct result of years of mismanagement of fiscal policy at the federal level. We suffered more than a decade of accelerating inflation -- causing serious distortions in investment and credit decisions -- followed by high and volatile interest rates, two back-to-back recessions and then deflation in sectors such as energy and agriculture.

Frankly, I cringe when I hear elected officials criticize the quality of management in banking while the federal government is running a \$200 billion budget deficit. The federal budget deficit is easily the number one threat to financial stability in our country and even the world. There is virtually no problem in the banking system today that would not be greatly alleviated by a substantial reduction in the deficit.

B. The Need for Deregulation. That leads me more generally into the subject of deregulation. I recently spoke at one of my alma maters and was asked what I would do in the deregulation area, politics aside, if I had it within my power to legislate any changes I thought desirable. I responded that I would phase out geographic restraints, repeal the Glass-Steagall Act, repeal the Bank Holding Company Act and greatly strengthen the antitrust laws. The result would be a far stronger, more competitive and responsive financial system.

Some people contend that there is a long-standing Anglo-American tradition favoring the separation of banking and commerce and that this separation is necessary to protect against unsound banking practices. I believe this view is erroneous on all counts.

As for Anglo-American tradition, England does not have a Glass-Steagall law and does not prohibit the ownership of banks by nonfinancial firms. The United States did not concern itself with the ownership of banks by nonfinancial firms until the Bank Holding Company Act of 1956 and the amendments of 1970. Though we are a comparatively young nation, 15 years or even 29 years can hardly be characterized as a tradition.

Moreover, the Bank Holding Company Act was not adopted out of any concern about unsound banking practices. The father of the Bank Holding Company Act, Marriner Eccles, Chairman of the Federal Reserve, was concerned about the Transamerica

financial empire being assembled throughout the western states by A.P. Giannini, which others were beginning to emulate. The Bank Holding Company Act was intended to guard against undue concentration of economic power, not to correct any safety and soundness problems.

The wall between banking and commerce remains rather porous even today. Real estate developers, auto dealers, insurance agents and others from all walks of economic life own and operate banks throughout the nation. They are prohibited only from placing their banks and other business interests under a common corporate umbrella. Some of our strongest savings and loan associations have been owned by nonfinancial firms for many years. The FDIC insures numerous industrial banks owned by far-flung commercial enterprises. The FDIC has permitted a number of nonbanking firms to acquire nonbank banks since 1969. Not one FDIC-insured industrial bank or nonbank bank has ever been designated a problem bank, much less failed.

Under the Bank Holding Company Act Amendments of 1970, the Federal Reserve is directed to review the operations of any grandfathered company whose bank exceeds \$60 million in size, and the agency is permitted to order divestiture if it finds any conflicts of interest or unsound practices. Over 100 situations have been reviewed by the Federal Reserve without divestiture being ordered.

My point is that we do not have a complete wall between banking and commerce and do not need one to promote safety and soundness. Banks are special, and we do not want them to fail. We want banks to be operated only by people with integrity, managerial acumen and financial strength. I do not believe bankers have a monopoly on these traits; indeed, the banking and thrift industries could no doubt be strengthened by allowing companies like IBM, Sears and thousands of other smaller commercial firms to bring their considerable managerial and financial resources to bear. The Change of Bank Control Act and our examination and enforcement powers give us the tools we need to keep undesirable people out of banking.

Nor do we want the resources of a bank to be tapped to support, or transfer a competitive advantage to, an affiliated company. Rather than prohibit the affiliation, however, we would require that the commercial activities be conducted in a separately capitalized and funded company and would impose stringent limitations on intercompany transactions. Stronger laws against tying practices could be enacted if that were believed desirable.

Neither American tradition nor modern-day reality requires the separation of banking and commerce to promote soundness and stability in banking. It is American tradition to fear, even loathe, concentrations of economic and political power.

We do not need a Bank Holding Company Act or a Glass-Steagall Act to avoid such concentrations. These laws are poor and inefficient substitutes for strong and effective antitrust enforcement.

C. Conclusion. My purpose in raising the Bank Holding Company Act issue is not to suggest that there is a serious prospect for repeal any time soon. Clearly there is not. My objective is to help raise the level of the debate on deregulation to a higher intellectual plane. Misinformation and myths abound and they are impeding sensible, long overdue reform. At the very least Congress ought to move quickly to permit banks and other financial firms to compete head-to-head across the full spectrum of financial-services activities. To do otherwise will only perpetuate an inequitable system that is harmful to both the industry and consumers.

Nor do I want to leave the impression that deregulation does not present potentially serious challenges for bank supervisors. Clearly it does. Interest rate deregulation has already demonstrated the need for more effective examinations and more vigorous enforcement efforts. It has also made stronger the case for deposit insurance reforms such as risk-related premiums. Finally, it has been an important factor in our efforts to improve capital ratios and to find ways to enhance marketplace discipline.

Approached sensibly in this fashion, broad-based deregulation will foster a stronger and more responsive and competitive financial system than America has ever known. The banking industry and the American public deserve no less. I urge you not to settle for less in the upcoming legislative battles.

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