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FEDERAL DEPOSIT INSURANCE  
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L. WILLIAM SEIDMAN  
CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION

[<sup>o</sup>Financial Services Industry - Issues.]

ADDRESS TO THE  
COLORADO BANKERS ASSOCIATION

FEBRUARY 17, 1986,  
COLORADO SPRINGS, COLORADO,

## A VIEW FROM THE TOP

GOOD MORNING. IT IS A PLEASURE TO BE HERE IN THE FINE STATE OF COLORADO. MEETINGS SUCH AS THIS ONE PROVIDE ME WITH AN OPPORTUNITY TO GIVE YOU--THE FDIC'S VALUED CUSTOMERS--A BRIEF OUTLINE OF THE ISSUES I SEE CONFRONTING THE FINANCIAL SERVICES INDUSTRY. ALSO, YOUR MEETING GIVES ME A CHANCE TO EXTEND AN INVITATION. I WANT YOU ALL TO KNOW THAT THE DOOR TO MY OFFICE IS ALWAYS OPEN FOR THOSE IN THE BANKING INDUSTRY WHO WANT TO HELP US ADDRESS THE ISSUES CONFRONTING YOUR INSTITUTIONS.

## THE BANKING SITUATION IN THE U.S. AND COLORADO--A TIME FOR PRUDENCE

NO ONE HAS A BIGGER STAKE THAN BANKERS IN ASSURING THAT DEPOSIT INSURANCE OPERATES EQUITABLY AND PROMOTES STABILITY. YOU PAY THE PREMIUMS NECESSARY FOR MAINTAINING PUBLIC CONFIDENCE IN OUR SYSTEM OF DEPOSIT INSURANCE. IT FOLLOWS THAT THE BANKING INDUSTRY SHOULD BE A CO-PARTICIPANT IN SHAPING THE DISCUSSION ON INSURANCE REFORM AS CONGRESS BEGINS A NEW ROUND OF HEARINGS ON THE SUBJECT.

IN THE MONTHS AHEAD, THE CONGRESS, BANK REGULATORS AND THE INDUSTRY MUST WORK TOGETHER ON A NUMBER OF ISSUES, PARTICULARLY THE PROBLEMS CONFRONTING AGRICULTURAL LENDERS AND DEPOSIT INSURANCE REFORM. THESE ARE TWO SUBJECTS I WANT TO DISCUSS WITH YOU TODAY. IN ADDITION, I WOULD LIKE TO MAKE A FEW COMMENTS ABOUT SO-CALLED NONBANK BANKS, AND HOW THE FDIC IS APPROACHING THE RETAIL BANKING MARKETPLACE.

CAPITAL ONCE WAS AN EASY TOPIC TO DISCUSS WITH BANKERS, PARTICULARLY THOSE WHO SERVE THE AGRICULTURAL COMMUNITY. HISTORICALLY, AGRICULTURAL BANKS HAVE BEEN AMONG THE BEST CAPITALIZED INSTITUTIONS IN THE COUNTRY. HOWEVER, CHANGES IN PUBLIC POLICY, THE EMERGENCE OF NEW AGRICULTURAL COMPETITORS ABROAD,

-MORE -

SHRINKING EXPORT MARKETS AND CHANGES IN A COMPLEX SYSTEM OF FARM PRICE AND INCOME SUPPORTS HAVE ACTED TOGETHER AND CONSPIRED AGAINST THE NATION'S FARMERS. WHILE FARMERS HAVE BEEN TRYING TO SURVIVE A LENGTHY DEPRESSION IN THE AGRICULTURAL SECTOR, THEIR BANKERS HAVE BEEN FEELING THE PRESSURE TOO.

I WOULD LIKE TO BE ABLE TO SAY THE AGRICULTURAL ECONOMY HAS FINALLY BOTTOMED OUT AND AN UPTURN IS IN SIGHT. BUT I CAN'T. HOWEVER, I CAN ASSURE YOU THAT AT THE FDIC WE WILL BE MAKING SURE OUR EXAMINERS ARE SENSITIVE TO ECONOMIC CONDITIONS AND TO THE EFFORTS YOU ARE MAKING TO WORK WITH YOUR CUSTOMERS. WE MUST WORK WITH YOU TO MAINTAIN THE INTEGRITY OF THE BANKING SYSTEM.

AT THE BEGINNING OF THIS MONTH, EACH OF OUR REGIONAL DIRECTORS WAS ASKED TO MAKE SURE ALL EXAMINERS ARE EXERCISING CAUTION AND RESTRAINT IN THE CLASSIFICATION OF AGRICULTURAL ASSETS. CERTAINLY EXAMINER RESTRAINT IS NOT GOING TO SOLVE THE PROBLEMS CONFRONTING OUR FARMERS, NOR WILL IT REPLACE THE CAPITAL BANKERS HAVE LOST IN TRYING TO WORK WITH THEIR CUSTOMERS. HOWEVER, AS LONG AS THE PRICE SQUEEZE CONFRONTING FARMERS PERSISTS, OUR POLICY AT THE FDIC WILL STRESS TWO POINTS: GIVE DUE CONSIDERATION TO THE CURRENT CASH FLOW OF AGRICULTURAL BORROWERS UNDER FINANCIAL STRESS AND ALSO RECOGNIZE THEIR ULTIMATE ABILITY TO REPAY.

THE ECONOMIC OUTLOOK FOR FARMERS SHOULD IMPROVE. BUT AS LONG AS WE HAVE DISORDERLY AGRICULTURAL MARKETS, FDIC EXAMINERS WILL BE MAKING A SPECIAL EFFORT TO BE SENSITIVE TO THE DRAMATIC CHANGES SOME LENDERS HAVE HAD TO ACCOMMODATE. THERE IS MUCH WE CAN DO NOW IN THE EXAMINATION PROCESS TO ACCOMMODATE SPECIALIZED LENDERS.

#### LEGISLATIVE PROPOSAL--DEFERRAL LIKELY

A SUBSTANTIAL REBOUND IN THE FARM ECONOMY OVER THE NEXT COUPLE OF YEARS DOES NOT SEEM LIKELY. WHILE RECENT DECLINES IN INTEREST RATES, ENERGY PRICES,

AND THE VALUE OF THE DOLLAR ARE ENCOURAGING DEVELOPMENTS, GIVEN THE MAGNITUDE OF THESE DECLINES THEY DO NOT APPEAR TO BE ENOUGH BY THEMSELVES TO BRING ABOUT A MAJOR TURNAROUND IN THE FARM ECONOMY. MAJOR OBSTACLES TO A QUICK RECOVERY ARE CONTINUED WEAKNESS IN FARM EXPORT MARKETS AND A LARGE SURPLUS ON HAND. GIVEN THE SUBSTANTIAL INCREASES IN WORLD FOOD PRODUCTION CAPABILITIES OVER THE LAST DECADE, A RETURN TO THE KIND OF EXPORT GROWTH EXPERIENCED DURING THE 1970S IS VERY UNLIKELY.

#### INSURANCE REFORM

I WILL NOW ADDRESS SOME OF THE FUNDAMENTAL ISSUES BEFORE THE BANKING INDUSTRY. THE NONBANK BANK HAS RECEIVED MUCH ATTENTION FROM CONGRESS, THE REGULATORS AND THE BANKING INDUSTRY. AND I THINK IT IS ABOUT TIME TO DECIDE WHETHER THESE LIMITED PURPOSE INSTITUTIONS ARE APPROPRIATE VEHICLES FOR IMPROVING THE SAFETY AND STABILITY OF THE BANKING SYSTEM.

AT THE FDIC WE HAVE INSURED 27 NONBANK BANKS DURING THE PAST TWO YEARS. ON THE ONE HAND, THEY REPRESENT COMPETITION IN THE MARKETPLACE. THAT I FAVOR, FOR COMPETITION IS GOOD FOR THE CONSUMER AND ITS FOSTERS INNOVATION. HOWEVER, AS AN INSURER, I ALSO WANT ALL OF MY CUSTOMERS TO BE PROFITABLE AND HAVE THE ABILITY TO COMPETE FAIRLY IN THE MARKETPLACE. THE LIMITED PURPOSE BANKS ESCAPE MUCH OF THE REGULATORY REQUIREMENTS THAT MUST BE SATISFIED BY A FULL SERVICE INSTITUTION. FOR THIS REASON, I BELIEVE THEY HAVE AN UNFAIR COMPETITIVE EDGE IN THE FINANCIAL MARKETPLACE.

CONGRESS SHOULD ATTEMPT TO SEPARATE THE NONBANK BANK FROM THE DEBATE OVER INTERSTATE BANKING AND ASSET DIVERSIFICATION. THEY REPRESENT A COMPETITIVE ISSUE THAT SHOULD BE DEALT WITH NOW. MY INTEREST IN DEALING WITH NONBANK BANKS IS MOTIVATED BY THE FACT THAT THE FDIC IS BEING ASKED TO INSURE ALL BANKING INSTITUTIONS. WE WANT ALL OF OUR CLIENTS TO PROSPER, AND WE WANT TO



PROMOTE AN ENVIRONMENT WHERE EACH HAS THE OPPORTUNITY TO DO SO.

IT CERTAINLY SEEMS UNFAIR THAT OWNERS OF NONBANK BANKS FREQUENTLY ARE ENGAGED IN THE TYPES OF BUSINESSES MANY BANKERS WOULD LIKE TO UNDERTAKE. HOWEVER, THESE PARENT FIRMS ARE PROTECTED FROM COMPETITION FROM BANKS DUE TO RESTRICTIONS THAT FULL SERVICE BANKS MUST DEAL WITH BUT THE NONBANK BANKS ESCAPE.

AT THE FDIC, WE ARE ATTEMPTING TO BRING A BIT OF COMPETITIVE EQUALITY TO THE FINANCIAL SERVICES MARKETPLACE. WHERE STATE LAW PERMITS, WE FAVOR OF LETTING BANKS ENGAGE IN INSURANCE, REAL ESTATE, SECURITIES AND OTHER ACTIVITIES, PROVIDED THESE OPERATIONS ARE CONDUCTED IN A WAY THAT REPRESENTS CONTROLLED RISK TO THE BANKING INSTITUTION THE FDIC UNDERWRITES.

MANY IN THE BANKING INDUSTRY HAVE QUESTIONED WHETHER OUR APPROACH FOR REGULATING THESE NONTRADITIONAL BANKING ACTIVITIES--THE ESTABLISHMENT OF SEPARATE SUBSIDIARIES AND SEPARATE DOORS, FOR EXAMPLE--IS OVERLY RESTRICTIVE. I AM LOOKING AT THE REQUIREMENTS AND THE JUSTIFICATION. WHERE NECESSARY, THESE REQUIREMENTS WILL BE MAINTAINED, BUT PERHAPS NOT ALL RESTRICTIONS ARE, IN FACT, REQUIRED. IT MAY BE THAT THE APPROPRIATE WAY TO HANDLE NONBANKS IS TO SAY IF YOU'RE NOT A BANK YOU ARE NOT ENTITLED TO BANK INSURANCE. YOU MUST BE A BANK FOR ALL PURPOSES.

UNDER THE BROAD UMBRELLA OF DEPOSIT INSURANCE REFORM ARE A NUMBER OF ISSUES THAT WILL BE CONSIDERED. ONE OF THESE IS ENHANCING DEPOSITOR DISCIPLINE IN THE DEPOSIT INSURANCE SYSTEM. THE BANKING INDUSTRY GENERALLY HAS EXPRESSED PHILOSOPHICAL AGREEMENT WITH THE NEED TO IMPROVE DISCIPLINE THROUGH DEPOSIT INSURANCE REFORM. SUPPORT FOR CHANGES TO PROMOTE FAIRNESS AND MARKET DISCIPLINE IS ENCOURAGING. ONE OF OUR MOST PRESSING NEEDS IS TO COME UP WITH A PRACTICAL WAY TO HANDLE BANK FAILURES FOR BOTH LARGE AND SMALL INSTITUTIONS. IT IS VITAL THAT WE UNDERTAKE A JOINT INDUSTRY-REGULATOR APPROACH TO RESOLVING THE TECHNICAL AND SUBSTANTIVE PROBLEMS ANY MARKET

DISCIPLINE INITIATIVES COULD CREATE.

THE FDIC IN 1983 FIRST TESTED THE SO-CALLED MODIFIED PAYOFF METHOD OF HANDLING A BANK FAILURE AS A WAY TO ACHIEVE EQUAL TREATMENT OF LARGE AND SMALL FAILED BANKS AND TO IMPROVE DEPOSITOR DISCIPLINE. THE FDIC USED THE METHOD TWICE IN 1983, 12 TIMES IN 1984 AND SEVEN TIMES IN 1985. IN THIS METHOD, THE FDIC MAKES INSURED DEPOSITS AVAILABLE TO THEIR OWNERS EITHER BY PAYING THEM DIRECTLY OR BY TRANSFERRING THEIR ACCOUNTS TO A HEALTHY INSTITUTION. DEPOSITORS WITH FUNDS IN EXCESS OF THE INSURANCE LIMIT RECEIVE AN ADVANCE PAYMENT ON THEIR DEPOSIT BASED ON AN ESTIMATE OF THE PRESENT VALUE OF THE ASSETS TO BE LIQUIDATED.

MAJOR INDUSTRY GROUPS AND SOME LARGE BANKING ORGANIZATIONS HAVE ENDORSED THE USE OF THE MODIFIED PAYOFF AS A WAY TO IMPOSE GREATER DEPOSITOR DISCIPLINE ON THE BANKING SYSTEM. SUCH AN APPROACH, IF *ROUTINELY* USED BY THE FDIC, WOULD MEAN UNINSURED DEPOSITORS WOULD FACE THE PARTIAL LOSS OF FUNDS WHEN A BANK FAILS, THUS ENCOURAGING THESE DEPOSITORS TO KEEP A CLOSE WATCH ON THEIR BANK'S OPERATIONS. MODIFIED PAYOFFS MIGHT PROVE TO BE A USEFUL TOOL FOR THE FDIC, BUT UNLESS TECHNICAL PROBLEMS ARE RESOLVED IT MIGHT NOT BE AN APPROPRIATE TOOL FOR DEALING WITH LARGE FAILING BANKS. THE METHOD WOULD HAVE AN IMPACT ON THE PAYMENT SYSTEM, DOMESTIC AND FOREIGN INVESTOR DEMAND FOR CERTIFICATES OF DEPOSIT, RECORDKEEPING REQUIREMENTS FOR UNINSURED FUNDS AND LIQUIDITY SUPPORT FROM THE FEDERAL RESERVE.

THESE CONSIDERATIONS MUST BE RESOLVED, IF THEY CAN BE, BEFORE AN ACROSS-THE-BOARD POLICY ON MODIFIED PAYOFFS CAN BE ADOPTED. THE FDIC STANDS READY TO COOPERATE WITH THE OTHER FINANCIAL REGULATORS AND WITH INDUSTRY GROUPS TO DETERMINE HOW MODIFIED PAYOFFS COULD BE USED TO DEAL WITH LARGE FAILING BANKS. IF WE CAN COME TO SOME CONCRETE CONCLUSIONS AND A UNIFIED ANSWER ON WHAT NEEDS TO BE DONE IN THIS AND OTHER AREAS OF DEPOSIT INSURANCE REFORM, WE WILL HAVE DONE A GREAT DEAL TO FACILITATE THE TASK OF ACHIEVING

MEANINGFUL LEGISLATION. IF WE DON'T, THEN WE MUST ACCEPT THE FACT THAT DEPOSITOR DISCIPLINE IS NOT GOING TO BE A MAJOR PART OF OUR INSURANCE SYSTEM.

ANOTHER FACET OF DEPOSIT INSURANCE REFORM IS A RISK-BASED PREMIUM SYSTEM. THE FDIC HAS SENT OUT FOR COMMENT A PROPOSED RISK-RELATED PREMIUM SYSTEM APPLICABLE TO COMMERCIAL BANKS. IT ATTEMPTS TO USE MARKET CRITERIA TO EVALUATE RISK TO DETERMINE PREMIUM LEVELS.

MOST BANKERS FEEL THAT A RISK-BASED PREMIUM SYSTEM IS A SOUND THEORETICAL CONCEPT AND IS WORTH DOING, BUT IS NOT WITHOUT PROBLEMS. IN THEIR FAVOR, RISK-BASED PREMIUMS ARE FAIRER THAN THE SYSTEM WE HAVE, AND THEY PROVIDE A FINANCIAL INCENTIVE FOR BANKS TO AVOID EXCESSIVE RISK-TAKING. AS IMPORTANT, THEY SEND A STRONG SIGNAL TO A PROBLEM BANK'S MANAGEMENT AND BOARD OF DIRECTORS BY MAKING A FINDING OF HIGHER RISK STATUS AND ATTACHING A COST TO THE FINDING. BUT, RISK-BASED PREMIUMS ARE HARD ON INSTITUTIONS THAT ALREADY ARE EXPERIENCING DIFFICULTIES AND ADD TO ADMINISTRATIVE COSTS OF THE SYSTEM.

IN THE DEBATE ABOUT RISK-BASED PREMIUMS, SOME HAVE PROPOSED IMPLEMENTING RISK-BASED CAPITAL REQUIREMENTS AS A SUBSTITUTE FOR SUCH PREMIUMS. BUT THEY AREN'T REALLY ALTERNATIVES TO EACH OTHER. ONE DEALS WITH INSURANCE PREMIUMS, WHILE THE OTHER BASES AN INDIVIDUAL BANK'S CAPITAL STANDARD ON THE TYPE OF ACTIVITIES THAT THE BANK UNDERTAKES. ACTIVITIES DEEMED BY A REGULATOR TO ENTAIL GREATER RISK WOULD REQUIRE LARGER CAPITAL RESERVES WHILE INVESTMENT IN LOW-RISK, HIGHLY-LIQUID ASSETS WOULD NEED LITTLE OR NO CAPITAL.

IT SHOULD BE RECOGNIZED THAT THE FEDERAL REGULATORS ALREADY EMPLOY RISK-BASED CAPITAL STANDARDS. NOT LONG AGO, THE FEDERAL BANKING AGENCIES ADOPTED FOR THE FIRST TIME A UNIFORM MINIMUM CAPITAL STANDARD FOR ALL SIZES OF BANKS. WE BELIEVE THAT A RISK-BASED CAPITAL SYSTEM HAS MERIT. THE FDIC USES IT IN ITS SUPERVISORY PROGRAM, BUT THE RISK EVALUATION IS AN OVERALL JUDGMENT RATHER THAN BEING BASED ON DEFINED ASSET GROUPS. PERHAPS THE SYSTEM CAN BE REFINED. OUR ONLY CONCERN IS THAT WE REGULATORS RETAIN A CERTAIN NEUTRALITY



WHEN ESPOUSING OUR ABILITY TO PREDETERMINE RISKS BY NARROW ASSET CLASSIFICATIONS.

ONE OF THE MORE FAR-REACHING PROPOSALS FOR REFORM OF THE DEPOSIT INSURANCE SYSTEM HAS BEEN TO MERGE THE FDIC AND THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION (FSLIC) AS A SOLUTION TO THE LATTER'S FUNDING PROBLEMS. I AM SURE SUCH A MERGER IS THE *WRONG* APPROACH FOR INSURING FINANCIAL INSTITUTIONS THAT UNDERTAKE MINIMAL COMMERCIAL LOAN-MAKING ACTIVITIES, AND FRANKLY WE HAVE PLENTY TO DO ON OUR OWN. IF CONGRESS DECIDES WE SHOULD TAKE SPECIFIC ACTIONS TO BE OF ASSISTANCE TO THE FSLIC, WE WILL DO SO.

THERE ARE A NUMBER OF OTHER ISSUES THAT AFFECT OUR INSURANCE SYSTEM. I WILL ADDRESS THREE--THE ARIZONA EXPERIENCE ON INTERSTATE BANKING, BROKERED DEPOSITS AND DISCLOSURE.

#### BROKERED DEPOSITS

COOPERATION AMONG REGULATORS IS IMPORTANT, AND I AM HAPPY TO REPORT, THE FDIC HAS BEEN WORKING WITH THE FEDERAL HOME LOAN BANK BOARD (FHLBB) TO REACH A COMMON APPROACH FOR REGULATING THE VOLUME OF OUT-OF-TERRITORY DEPOSITS (BROKERED) FLOWING TO FINANCIAL INSTITUTIONS. WE CANNOT IGNORE THE FACT THAT BROKERS ARE AN EFFICIENT WAY TO TRANSFER OR OBTAIN FUNDS. THE AGENCIES BEEN PARTIALLY SUCCESSFUL IN LIMITING THIS ACTIVITY, BUT IT REMAINS A POTENTIAL PROBLEM AS SOME BANK MANAGERS CONTINUE TO DEMONSTRATE THEY ARE UNABLE TO RESPONSIBLY USE BROKERAGE SERVICES.

THE ORIGINAL SOLUTION JOINTLY PROPOSED BY THE FDIC AND FHLBB--LIMITING INSURANCE ON BROKERED DEPOSITS--WAS TOO EFFECTIVE IN THAT IT ATTEMPTED TO ELIMINATE THE BENEFITS OF THE FINANCIAL MARKETPLACE. WE ARE DOING OKAY NOW AND WILL NOT PROPOSE NEW MEASURES.



DISCLOSURE OF BANK INFORMATION

DISCLOSURES OF BANK INFORMATION--A SENSITIVE ISSUE BUT THE FDIC MUST TACKLE IT. DEPOSITORY INSTITUTIONS DEPEND ON PUBLIC CONFIDENCE AND MOST EARN THE PUBLIC TRUST. THERE ARE CALLS FOR MORE BANK DISCLOSURE. BEFORE MY ARRIVAL, THE FDIC APPROVED A PLAN THAT WAS TO BE EFFECTIVE JANUARY 1, 1986, WHICH REQUIRED DISCLOSURE THROUGH PRESS RELEASES CONTAINING THE NAMES OF ALL BANKS AND PERSONS PARTICIPATING IN THEIR AFFAIRS TO WHOM THE FDIC HAS ISSUED FINAL ORDERS CONNECTED WITH FORMAL ENFORCEMENT ACTIONS. HOWEVER, THE FDIC HAS POSTPONED THE EFFECTIVE DATE OF THE PLAN IN FAVOR OF WORKING WITH OTHER FEDERAL BANK REGULATORS ON A UNIFORM AND MORE BALANCED APPROACH FOR SUCH DISCLOSURE.

THERE ARE LEGITIMATE ACCOUNTING AND OPERATIONAL QUESTIONS THAT SHOULD BE OPEN TO PUBLIC SCRUTINY. WE ARE REVIEWING THIS WHOLE AREA AND OUR GOAL WILL BE TO SEEK DISCLOSURE POLICIES THAT STRENGTHEN THE INDUSTRY AND ASSURE IT OF THE CONFIDENCE OF THE BANKING PUBLIC. THIS IS AN AREA WHERE BANKERS CAN PROVIDE GUIDANCE AND LEADERSHIP. WE WILL LOOK TO YOUR ADVICE BEFORE ANY RULES ARE ADOPTED.

IN SUMMARY, I'VE COVERED A LOT OF ISSUES TODAY--BANKING CONDITIONS IN THE NATION AND IN COLORADO, AGRICULTURAL BANKING PROBLEMS, NONBANK BANKS, AND THE ELEMENTS OF INSURANCE REFORM SUCH AS RISK-BASED PREMIUMS, INTERSTATE BANKING, BROKERED DEPOSITS AND DISCLOSURE. I'VE UNLOADED A LARGE WAGON OF ITEMS FOR CONSIDERATION.

THESE ARE THE ISSUES THAT WILL AFFECT YOUR JOB AND MINE. I AM HAPPY TO BE WORKING ON THESE ISSUES WITH YOU. I FEEL CONFIDENT THAT TOGETHER WE CAN MEET THE CHALLENGES OF OPERATING IN A CONSTANTLY CHANGING ECONOMIC ENVIRONMENT AND ACHIEVE SOLUTIONS TO PROBLEMS FACING BOTH THE INDUSTRY AND THE FDIC.

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