[Economic outlook - The results of Black Monday]

Remarks By

L. William Seidman

Chairman

Federal Deposit Insurance Corporation

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On Friday I gave a talk before the National Press Club on the effects of Wall Street's "Black Monday" on banks entitled "Benefits of the Crash." Actually, my subtitle for that speech was "It's An Ill Wind That Blows No Good."

Why? Well, in a check of the pulse and temperature of our nation's banks, we at the FDIC found out that banks, (and I may add, ALL insured depository institutions), may well be WINNERS following the Wall Street shakeup.

In fact, our survey showed that our economy continues a strong upward movement three weeks after the great fall in this history of the Dow. <u>That's not a guarantee it will continue--but so far so good!</u>

Money is moving from our uncertain stock market to the "quality and safety" of insured institutions.

I'm pleased to note that many <u>thrifts</u> are benefitting from this trend, too.

Despite your recent problems, and those of banks, your special role of helping more Americans to own the homes they want is STILL a very important one.

A poll by the Roper Organization recently showed that home ownership was STILL the NUMBER ONE personal goal of most Americans under the age of 35. The thrift industry can help assure that more American families will meet that goal.
Because of the flow of money out of the stock market and into banks and thrifts, our traditional, insured institutions may get a breather from the battering we've all been getting in the fight for deposits.

And I think that banks and thrifts are better able to take advantage of the situation now than at any time in the recent past.

For one reason, adversity has made both banks and thrifts MORE COMPETITIVE than ever.

While some S&L's have problems, the vast majority of the 3,200 savings institutions in your industry remain vigorous.

Last year, total deposits at FSLIC insured institutions reached a RECORD LEVEL -- $890 billion, up from $844 billion in 1985.

But just like banks, thrifts located in the South and Southwest have had a hard time. In 1986, 52 percent of S&Ls and 36 percent of banks in the Southwest were unprofitable. And again just like banks, the losses of the unprofitable segment of your industry do not represent your overall soundness. EIGHTY PERCENT of your industry was profitable in the first quarter of this year.

For the first quarter of this year, the return on assets for the profitable segment of your industry was a healthy 0.91 percent. This is stronger than the 1986 national average ROA of commercial banks (0.64), and nearly as strong as the ROA for banks located in the financially healthy East (0.97).

So, to most of you -- congratulations!

I'd like to offer congratulations on another point, if I may.

Back when I was working for President Ford in the White House, my job was to talk to industries that would come to the government while in trouble and say "look, we need you to bail us out."

I think that the S&L industry is to be commended because it didn't propose to have the government bail it out when your deposit insurance fund got in trouble. You are working to recapitalize using your own funds. All you asked for was to be given a format by which you could bail yourselves out. I commend you for that, and if I were representing you, I could make a reasonable case that some part of your problem could be laid at the door of government.

While congratulations are in order, we must be careful not to rest on our laurels. These are uncertain times and prudence calls for an "ounce of prevention."

I don't want to give the impression that we have time to become experts in the S&L industry. The banks keep us busy enough. However, data we have seen indicate your industry remains significantly exposed to interest rate increases. By the very nature of their business, thrifts bear more rate exposure than commercial banks. However, even when compared to FDIC insured savings banks, the exposure seems much higher.

We drew this conclusion by looking at the relative difference between the amount of assets and the amount of liabilities that matured within different time horizons. In the jargon of the analyst, these differences are called "Gaps." Simply put, the bigger the gap, the more the risk. The longer the gap exists, the greater the risk. The median gap over five years for the S&Ls was six times worse than it was for savings banks.

We also noted that the lower capital, the greater the exposure to interest rate increases became. In other words, those least able to afford the gamble are taking the risk.

Rates are moving lower now. Black Monday's gift to your industry. But they were rising just a few short weeks ago. Take advantage of this opportunity to readjust when you can.

With further respect to the area of deposit insurance, I'd like to go on the record again as saying that both banks and thrifts have problems, and mixing many of these problems together into one BIG problem by merging FDIC and FSLIC sure doesn't make much sense to me.

The conversion of many S&Ls to FDIC insurance would most likely be another harmful move. It would further weaken FSLIC by taking out the strongest and largest thrifts, and it would weaken FDIC because your capital requirements are still so different from those required of banks.

One thing is increasingly clear. ALL the traditional depository institutions, both banks and thrifts, are under increasing competitive pressure from the new, unregulated, uninsured "financial services industry."

To highlight this, in 1986, money market and mutual fund shares EXCEEDED the amount in checking accounts -- for the first time ever.

Banks and thrifts should take this as a warning sign that, in many ways, the fortunes of both kinds of traditional financial institution are LINKED. NEITHER industry is going to succeed unless the other is in good health. In fact, a case could be made that banks and thrifts are really ONE industry already -- the "insured depository institution industry".

We at the FDIC would therefore like to be helpful to you in any way that we can. Cooperation, not merger, offers the best immediate results for both insurance funds.

Despite the financial strength of most banks and thrifts, there are clear warning signs that reforms in our financial structure are necessary.

These warnings are conveyed on a regular basis when you have to pay for your deposit insurance. Thrifts have had to pay a SPECIAL insurance assessment on top of their regular premiums.

Banks' effective premiums have also gone up, since the FDIC has stopped giving rebates on insurance premiums in recent years.

This bill has gotten so large mostly because regional economic problems have hurt well-run banks and thrifts and fatally wounded those that are not. And one big reason they have been hurt is because they were UNDIVERSIFIED, both by geography, and by product.

What should we learn from this experience?

We should learn that diversification INCREASES the safety and soundness of the financial system. Relaxation of restraints on geographic and product diversification, perhaps along the lines of the recent FDIC study on restructuring, should begin as soon as possible.

Our study says that banks and thrifts should be carefully supervised for safety because today they are special. First, because of deposit insurance, they borrow, at least indirectly, on the credit of the United States Government. Second, they are special because any threat to their financial system is a threat to consumer services and savings, the intermediation process, private sector liquidity, the payments system and, most importantly, the U.S. economy.

Because depository institutions are essential to our economy, regulation by the government is necessary. However, the system also has to prosper to be safe and sound. Supervisors cannot order prosperity. It can be achieved only if a fair competitive structure is in place that allows banks and thrifts to compete and to attract capital.

The objective of any restructuring effort should be to find the least burdensome way for the government to maintain a safe and sound banking system. If the banks and thrifts themselves can be made safe and sound by supervision, then supervision beyond the institution is neither necessary nor desirable. Bank and thrift regulation and safety supervision could be focused on the institution--and on the institution alone. Outside the regulated banks or thrifts, in their subsidiaries or holding companies, other activities could be carried on such as securities, real estate and insurance.

While our supervision seeks to protect every bank, we know that no system is foolproof. Our goal must be to keep the overall system safe and sound. Our experience teaches us that when the rules are reasonable the great majority in banks and thrifts will follow the rules. Thus, the supervisory challenge in creating a safety and soundness wall is to identify and restrain the small percentage who will abuse the system. The view of our supervisory staff is that with the right tools they will find most of the small number of abusers. Thus, they will be able to preserve the system's safety and limit the cost of failures.

Costly layers of regulation and supervision that result from overlapping jurisdictions also could be eliminated if proper supervision for safety of banks and thrifts is in place. The resulting functional supervision would permit supervisors to focus their attention on the institution itself and its transactions with its affiliates, subs and owners.

Please take a look at our proposals and let us have your views. We believe they are important to you, they will be good for banks, for your industry and the country.

Again, it has been a pleasure to be with you.