FDIC
Speeches

Restructuring the banking industry:

Remarks By

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Good afternoon.

I'm very pleased to be among the distinguished group who have been asked to speak with the Association of Reserve City Bankers about banking law restructuring.

But as Bismark might have said had he viewed the banking legislative scene today, great decisions are not made through speeches, but by Blood and Bloody Lobbyists.

Let me just start with a few words about your FDIC, and its year end results which we have just received.

1987 was a difficult year, but I'm pleased to say we ended up just in the black with about a $50 million increase in net worth.

The roughly $3.3 billion the FDIC received from premiums and interest last year was needed to handle last year's operating expenses plus the cost of failures and assistance transactions.

One reason -- a BIG one -- for the cost was the First City assistance transaction which we estimate at just under 1 billion dollars. It was the second largest in FDIC history. And, even though it won't be completed until later this year, our reserves for possible losses on the deal will be carried on 1987's books.

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In 1987, FDIC handled a record 184 failed banks. We also assisted 19 banks that otherwise would have failed.

Almost 90 percent of the failed banks, as well as 80 percent of the banks with losses, were located west of the Mississippi. Roughly 85 percent of last year's bank failures were caused at least in part as a result of troubles in the farm and energy economies.

We are heartened that the farm economy, and therefore, farm banks, appear to be on the comeback trail. Unfortunately, problems in the "oil patch" continue.

It might be said of those areas some of our friends have learned that, "good judgment comes from experience. But experience comes from poor judgment.

Our inventory of managed assets from failed banks at year end was about $11 billion exclusive of loss reserves. It stands at about the same level it did a year ago, DESPITE the fact that the number of failed banks in 1987 was ONE THIRD higher than the year before.

This enabled us to keep our cash type reserves at about $16 billion, representing almost 90% of our net worth.

The FDIC fund remains healthy, with over $18 billion in net worth.

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We are prepared to deal with any banking problem we foresee in 1988. With the number of banks on our problem list holding steady at just under 1,600, this year's failure rate is expected to remain about steady.

Overall, we see modest improvement in the banking system in 1988. No unmanageable crisis are in sight despite some doomsayers' predictions to the contrary.

Anyway, as my friend Henry Kissinger said: "There cannot be a crisis next week -- my schedule is already full!"

I trust most of you will not remember that the Association of Reserve City Bankers first meeting took place in the College Room of Chicago's Hotel LaSalle, on December 14, 1912.

At that first meeting, history tells us, the main topic discussed was "what would be the pre-eminent weapons in soliciting bank business."

Although a lot of money has passed over the counter in these past 75 years, that topic is still very close to what I believe we should be talking about today.

From your vantage point as Reserve City bankers, you are acutely aware of both the problems and progress of our ENTIRE banking community.

Let me say that you've shown excellent foresight in choosing this time for your winter meeting.

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Congress has been back in session for a week. As you know, there are several bills on the crowded agendas of the House and Senate that could affect the future of banking. The sausage is being made -- and its not a pretty sight, nor is it clear that the result will be edible.

All of us in this room will have a chance to help shape the course of what will happen during the second half of the 100th Congress, and beyond.

The process we are involved in reminds me of an observation once made, and successfully put into practice, by a great American, General George Patton: "A good plan, executed now, is better than a perfect plan executed next year."

What, for banking, constitutes a "good plan"? What should be our goals for now.

There seems to be agreement that those goals can be stated simply:

-to promote the safety and soundness of our banking system and industry,

While at the same time removing NEEDLESS regulations that stand in the way of a financial marketplace that is efficient and rewarding to all participants -- both providers and consumers alike.

Both the FDIC and your "Emerging Issues" Committee have put forth some practical ideas to achieve these goals.

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They are a tribute to our combined sagacity. I'm please to note that our approaches are quite similar. We came to many of the same conclusions from the different starting points of a banker and a bank regulator.

We AGREE that banks should be permitted to have affiliates that engage in both financial and nonfinancial activities. We AGREE that overall supervision, at the holding company level, is not necessary.

And we agree that regulation of a bank, and its affiliates, should, above all, be along FUNCTIONAL lines.

As the topic of industry restructuring has taken shape, one of the most discussed areas has involved "firewalls" --that is, just WHAT will it take to insulate a bank from its non-bank affiliates.

We AGREE that in a world where there will be a broader definition of what can be affiliated with banks, it is possible to "firewall" the bank from new activities -- while PRESERVING ways for the organization to benefit from new business lines.

Based on 54 years of experience in supervising banks, the FDIC believes that a "firewall" can be constructed consisting of two major parts:

The first part involves separate corporate identities.

The second part of the "firewall" involves use of supervisory and enforcement authority, much of which is already on the books.

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We see that several elements are needed to establish clearly separate corporate identities.

Those elements include: separate capitalization, limited PHYSICAL separation (so that a customer of the nonbank service knows he is not "making an insured deposit"); clear DISCLOSURE requirements (again, to help the customer avoid confusion between banking and nonbanking services), transaction limits, and some restrictions on overlaps among the officers and directors of banks and nonbanking affiliates.

With regard to enforcement authority, we would strengthen many of the present supervisory and enforcement powers.

The banking bills now being sponsored by Senators D'Amato and Cranston; Congressman Barnard, and to a lesser extent Senators Proxmire and Garn, all move toward the concept our proposals advocate. They are "good bills" -- meaning in our view there is more plus than minus in them for the banking system, the U.S. economy, and consumers.

But there are bills out there that are not so favorable. We are at a critical juncture, and the leading Senate bill -- the Proxmire-Garn Bill -- may not be able to withstand the pressure for change. The legislative process could move toward a Bill, possibly providing for more limited securities powers at the cost of barring real estate and insurance activities. Or there is perhaps a chance that a broader Bill could emerge, one that allows for more of a Two-Way Street by allowing all responsible organizations to acquire banks. Our

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Mandate, your emerging issues position, and the D'Amato legislation would favor a move to this broader approach.

The hope for a movement in this direction is based on forming a banking, insurance, and securities industry coalition of common interest.

One of the problems for banking is that the Proxmire-Garn Bill is not so favorable that it can stand a lot of revisions detrimental to the banking industry. This Bill could quickly lose its value if it moved in the direction of restricting states and limits the dual banking system options.

These sort of issues are not easy to discuss within the beltway, but as Dante pointed out regarding difficult choices, "The hottest place in hell is reserved for those, who in time of great moral crisis, maintain their neutrality."

It seems clear now that the current Moratorium can not be extended by March 1, and that is VICTORY for the industry. Note, I used March 1, -- a renewal later is an unfortunate possibility. What is the situation if no legislation is, in fact, achieved in this Presidential election year?

If no new legislation comes to pass, the bottom line may be undesirable but not unlivable (if there is such a word).

It is likely that banks would have increasing opportunities to offer many of the same services that new legislation would make possible.

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Even without new federal legislation, banks would most likely continue to gain new powers -- through new banking laws and regulations at the STATE level, through court rulings, or through current interpretations of federal law and regulations.

Already, banks can sell mutual funds and commercial paper, offer securities brokerage services and advice, and in some cases, provide insurance and real estate services.

And further change could come depending on the "new" Fed's decision on the scope of the Bank Holding Company Act.

Yes, even if no new legislation is forthcoming, banking could end up with much more than "half a loaf".

So, while we fully support the Proxmire-Garn Bill, as it is NOW presented, we must watch for the type of compromises that MAY be needed to accomplish its passage.

We should ask ourselves the question: how many restrictions do we want to accept in a new law. Lets be sure that "the price will be worth the ride." Depending on the direction the process moves, at every point the banking industry will need to consider whether it still supports new legislation.

In some ways the current situation reminds me of "Gone with the Wind" with Congress playing the famous Scarlett O'Hara to Banking's Rhett Butler. In the

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final scene Rhett Butler, free at last from Scarlett's spell after being led around by the nose for three hours and forty minutes, responds to her ultimate tirade with a sad, debonair: "Frankly, my dear, I don't give a damn."

Just as at that 1912 meeting of the Reserve City Bankers, both bankers and bank regulators will need to continue the search for "the pre-eminent weapons that will be useful in soliciting bank business."

Recently, I came across an interesting idea in a book on the building of the aircraft Voyager.

The Voyager, you may remember, was the first aircraft to fly around the world, nonstop, without refueling.

To build it, the engineers had access to the latest, high-tech material. They had the most sophisticated computer assistance. But even with all this help, the designers still came to crossroads where decisions had to be made that the computers couldn't help with.

When they reached that point, they would fall back on a strategy that seems to have worked. They would look at all sides of the data, and then apply an approach they called "T. L. A. R."

Short for "That Looks About Right." When data and circumstances won't take you any further -- use your best judgment.

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The approach seems to have done the trick. The Voyager flew.

We'll need to use the same approach to get banking legislation off the drawing board and into the air.

Hopefully, we can show the world that banks can win one in the Congress.

Thank you.

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