FDIC
Speeches

Restructuring the banking industry:

Remarks By

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Before

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of Bank Women
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Good morning.

Thank you for the opportunity to speak to your meeting.

This group's progress in banking reminds me of the path breaking efforts of Lady Astor. A member of the British Parliament once welcomed Lady Astor as she took her seat there on her first day as the first women ever to be so elected. "Welcome to the most exclusive men's club in Europe!" he said. "It won't be exclusive long." Lady Astor smiled. "When I came in, I left the door wide open!"

The door to banking is increasingly open to woman. Opportunities for woman will continue to grow.

My admiration for the high calibre of woman entering finance was enhanced when I was Dean of the College of Business at Arizona State. In my last year as Dean (1985) 45% of the class were woman, but they earned almost 75% of the awards for excellence in the financial area.

I look forward to these high achievers playing an increasing role in banking. And as an insurer, I hope to see them apply their intelligence and prudence to improving the safety and soundness of the banking industry.

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

1987 was a difficult year, but I'm pleased to say our preliminary statements show 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 transaction are carried on 1987's books.

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, unfortunately, experience comes from poor judgment."

Our inventory of managed assets taken from failed banks was about $11 billion at year end, against which we carry a reserve of over $7 billion. Thus our inventory 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. We fight to keep our inventories down and thus keep our cash up.

We were able to keep our cash type reserves at about level at $16 billion. Cash represents almost 90% of our net worth.

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

We are prepared to deal with the banking problem we foresee in 1988. The number of banks on our problem list is holding steady at a little under 1,600. This list is our leading indicator of the bank failure rate. Since the number of problems remains about the same, it is likely that the number of failures in '88 could be nearly the same as in 1987.

Overall, we see some 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 used to say: "There cannot be a crisis next week -- my schedule is already full!"

I would like to add that we soon plan to send all bank directors our "Pocket Guide for Directors," which we hope will help them meet their duties and responsibilities in the challenging environment they now work in.

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

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.

What should be our goals for this legislation.

There seems to be agreement concerning those goals, which is about the only thing there is agreement on. The goals:

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

-to provide regulations that promote a financial marketplace that is efficient and rewarding to all participants -- both providers and consumers alike.

The FDIC has put forth some practical ideas to achieve these goals in our study Mandate for Change (available free -- just give me your card).

- banks should be permitted to have affiliates that engage in both financial and nonfinancial activities.

- Supervision of banks by bank regulators must be improved and a supervisory firewall built between banks and these nonbank affiliates.

- Regulation of affiliates and subsidiaries should be along FUNCTIONAL lines (i.e. SEC for securities activities, insurance regulators for insurance companies, etc.)

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

The FDIC believes that a "firewall" can be constructed consisting of two major parts:

First - legally separate corporate identities.

Second - enhanced supervisory and enforcement authority, to insure arms length, in the regular course of business, transactions.

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 with stiffer penalties and prohibitions.

The banking bill sponsored by Senators Proxmire and Garn, moves toward the concept our proposal advocates. It is a "good bill" -- meaning in our view there is more plus than minus in it for the banking system, the U.S. economy, and consumers.

But there are bills out there that are not so favorable. The Congress is at a critical juncture, and the leading Senate bill -- the Proxmire-Garn Bill -- appears to need alteration to get the required majority support in the Banking Committee. What will be the likely changes? On one hand, the legislative process could move toward a revised bill providing for more limited securities powers at the cost of limiting banks real estate and insurance activities.

Or, on the other hand, a more comprehensive bill could emerge, one that allows for more of a "Two-Way Street" by allowing other financial organizations to acquire banks in return for new banking activities.

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

Which way will it go, no one knows.

With regard to changes in the current proposal, the bank regulatory agencies were requested by Chairman Proxmire to reach agreement with the SEC on functional regulation of bank's securities activities. In response, we have been working to try to accommodate two areas of SEC concern. Those are: First, the extent to which existing bank securities must be subject to the full scope of SEC regulation and supervision; and Second, what additional protections are needed if banks are to be affiliated with investment companies.

While we have been able to agree in some areas, in others we have not. The time is here to provide language to Chairman Proxmire. If agreement cannot be reached, we'll provide our best thoughts to the Chairman and he will determine how far he wants to go in meeting the SEC position.

This is an example of one of the problems for banking in the Proxmire-Garn Bill. It 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 limit the dual banking system options, or moving normal trust activities to the SEC's turf.

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. Again, the crystal ball clouds.

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.

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

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. The U.S. Court of Appeals decision Monday upholding the Fed's decision to allow banks limited underwriting powers exemplifies that trend.

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. The Comptroller just published an excellent list of permissible bank activities -- at least 20 of them.

And note, a considerable change could come depending on the "newly appointed" 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".

The question is: how many restrictions will bankers want to accept in a new law. They must be sure that "the price will be worth the ride."

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 built on experience.

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

Bankers will need to use
"T. L. A. R." to get banking the right legislation off the drawing board. If it doesn't look flight worthy, it's better not to get on board.

Thank you.