Remarks by

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REMARKS BY CHAIRMAN L. WILLIAM SEIDMAN

NEW MEXICO BANKERS ASSOCIATION MEETING

It gives me great pleasure to speak with the members of the New Mexico Bankers Association.

I feel a special pleasure speaking with this group. Not only because, as bank regulator and banker, we share many professional concerns, but because I try to spend as much time as I can here in the "Land of Enchantment" on my ranch near Wagon Mound.

A biography of Kit Carson, another sometime resident of this area, says something about Carson's time that is still very true about this state.

The biography pointed out that this great scout and frontier diplomat "discovered in New Mexico that there was room at the top, even for a rough mountain man."

A lot of things have changed since Kit Carson's days. But the fact that New Mexico is still a land of opportunity is not one of them!

Consider these facts about our state's economy:

-- New Mexico has a diversified economy, from space and nuclear research, to lumber and stone products, to electrical and glass products.

-- As a former CFO of Phelps Dodge, I am well aware that our state boasts mining resources in natural gas, petroleum, copper, and potassium salts.

-- The agricultural extension service says that net farm income has been growing steadily for over four years. New Mexico's mining and manufacturing sectors also reported significant gains last year.

-- And even though employment in oil and gas is still far below 1985 levels, last year jobs in this sector of New Mexico's economy grew by ten percent. Employment in manufacturing jobs also increased by an estimated 2.7%.

-- The Four Corners Region has economically outperformed the rest of the nation, according to the Arizona Business Gazette.

-- In the next few years, Dona Ana and Luna Counties are poised to become the site of an important, developing border economy with Mexico.

-- And Albuquerque is one of the west's, and the nation's, fastest growing cities.

As your motto goes, "Crescit Eundo" ("It grows as it goes.")

It won't be news to anyone here that because of the troubled oil economy, most of the southwest has not been having an easy time of it. And, unfortunately, not all is bright and shiny for our state. New Mexico's income and general employment growth has lately trailed the national average.

But as the Indians say, "Never criticize a man until you've walked a mile in his moccasins."

So we at the FDIC are focusing on the fact that New Mexico's banks are working hard in this challenging environment, and deserve an "A" for effort:

-- Last year the Return on Assets of New Mexico banks was the best in the Southwest Region (.77 / -.47), and ahead of the national average, even if the effect of extraordinary LDC debt reserving is factored out.(National average was .12, but without LDC reserving was .70, compared to .77 for New Mexico) This achievement was especially impressive for your 24 institutions with assets over $100 million. (.92)

-- Net charge-offs fell by nearly 30 percent last year for your larger banks.

-- Your nonperforming assets were half the regional average (4.20 / 8.83).

-- Your ratio of primary capital to assets is higher than that for U.S. banks in general (8.61 / 7.58); as is your ratio of equity capital to assets (7.74 / 6.13).

-- And unlike most other states in the southwest, bank failures have not been a major problem in New Mexico. Only five New Mexico banks have failed over the last 6 and a half years. Given your company, that's the kind of news that makes the bank's insurance corporation feel warm all over.

-- I would say if there is an area of concern, it is with some of your smaller banks. These institutions earned an average annualized ROA of .46 last year, a significant decline from the .67% reported in 1986. Nonperforming assets for these size banks are also up, as are the number of small banks reporting operating losses. (20%) Moreover, while your banks did well compared to the rest of the southwest, they generally lagged behind national averages in the net charge-off, earnings losses, and nonperforming asset areas.

The New Mexico Bankers Association should be congratulated for its efforts to encourage the expansion of branching privileges for state chartered banks.

When S&Ls have the power to branch statewide, while banks can only branch in their home counties, it presents a competitive inequality that should be addressed.

The Association should also be pleased with your new law authorizing nationwide nonreciprocal banking in 1990.

I would like to take this opportunity today to tell you why I think our deposit insurance system is at a watershed period in its 55 year history.

Deposit insurance was created as a reaction to severe problems the banking industry faced during the Depression. That beginning was not without controversy. Small depositors and small banks supported the plan, while larger institutions stood against anything that would help put smaller institutions on more equal footing. The role and form of deposit insurance as conceived in the 1930's has changed dramatically as the structure of the banking system has evolved. New competition, deregulation, disintermediation, new technologies, and geographic expansion combine to make the banking business a different, and unfortunately, more risky business.

Let's look at a few of the significant changes in the operation of the deposit insurance system -- significant difference from the original concept are apparent.

First, small banks complain about the insurance system. They contend that the deposit insurance safety net -- "the too big to fail doctrine" --gives unfair advantages to large institutions by not allowing the largest institutions to fail.

Protection of depositors and creditors in failing large banks has distorted the system. However, no major industrial nation allows its banks to fail because the financial fallout is so hard to predict. The international competitive ramifications alone make it unlikely this policy will be changed.

So now an insurance system designed to help small banks compete with big banks now operates to favor big banks over small banks.

Alas, Ceasar lamented, "All bad precedents began as justifiable measures."

Second, the Federal Reserve Board, traditionally considered the lender of last resort, has become the next to last resort. The deposit insurance system has become the last resort for protecting the failing banks, and thus the stability of the system. When First Republic went to the Fed window last winter, withdrawals increased. Depositors and creditors were aware of the Fed's policy of taking collateral for its liquidity lending. When FDIC gave an unlimited guarantee to depositors and creditors, and a loan of $1 billion, the run was stopped. So the FDIC has become the back up source for banks that need to be protected even though they are insolvent. This is a role not even dreamed about by the creators of the Fund.

Third, the status of the holding company in the banking system itself has been drawn into question by recent FDIC policy.

When "to big to allow depositors or creditors to suffer" is applied, it is applicable to banks, but not to holding companies. This spring the FDIC guaranteed that all depositors and other general creditors of First Republic's banks will be fully protected, but these guarantees were NOT extend to the holding company creditors or shareholders. This FDIC policy is critical when considering what new activities holding companies should be permitted, as well as such issues as whether it is appropriate to apply the proposed risk-based capital standards to holding companies.

Again, this is a role in the banking system not originally envisioned as part of the deposit insurance system.

And finally, our experience, especially in the Southwest, has taught us that deposit insurance is a powerful tool, which if misused, has the potential to severely damage the financial system. A concept that was argued by some at the creation of the deposit insurance system, but which was rejected by the Congress in enacting the system.

Deposit insurance effectively gives banks and thrifts the ability to borrow on the credit of the federal government. It must be properly safeguarded or it can threaten the system. Deposit insurance is like a nuclear power plant, it is dangerous that it exists at all. Only appropriate safety precautions can keep it from going out of control. Out of control, it can blow up, with great damage to the entire country.

One has only to look at the problems of the savings and loan industry to see the financial results of deposit insurance misused. And, lest we become satisfied with our bank supervision as the answer, look at the losses the FDIC is incurring in Texas despite supervision by federal and state bank regulators. In Texas all but one of the major banks has had to be rescued -- either by the FDIC or private resources.

We are dealing with our Chernoble right now in the Southwest, and its time to reflect on what we should do about it.

Thus, we are undertaking a complete review of deposit insurance and its role and operation in the current banking environment. Our study on this subject, "A Deposit Insurance System for the 90s", has been underway for several months. It will be completed before year-end.

In order to get the right answers in a study of this sort, you must first ask the right questions. I want to raise some of these issues with you now.

And I want to ask you to help us provide some answers for policy makers of our country.

Today's banking environment requires a new look at deposit insurance in a world of deregulation in rates and territories, of expanded international financial markets, and of evolving computer based technologies. Ten years ago none of these factors loomed large -- now they are overpowering.

And think for a minute on the effect on banking -- no less Congressional mail offices -- if we withdrew the entire deposit insurance or reduced it to $2500, as it originally began.

Here are some of the fundamental questions to be answered in constructing a better deposit insurance system.

-- Can Supervisory mechanisms control risk? This is key to the future of the system. If supervision doesn't work, the ability to borrow on credit of the U.S. can destroy. As we enter an environment providing banks with greater powers, how will supervision need to adapt to keep the system safe and sound? Are our present supervisory resources, such as examination procedures, off-site monitoring systems, and supervisory sanctions adequate?

And, once problem banks have been identified, are our present regulatory powers sufficient to deal with institutions that pose a high risk to the insurance fund? How can we avoid the cost of another Southwest debacle.

-- How can the market be used to control risk in today's environment? Is depositor discipline really alive and well despite insurance and big bank protection? Can we increase market supervisions and thus promote safety by statutory and de facto deposit insurance coverage ceilings, changes in coverage to include only short-term deposits, or the introduction of private coinsurance. Should we control rates paid on insurance deposits, or provide insurance only for individuals and not corporations?

-- How far should the "safety net" extend? The FDIC's treatment of certain large Texas banks demonstrates our present position that we will not extend the "safety net" to holding companies.

So, the world is certainly not standing still as our study progresses -- and in fact, the changes taking place out there underline the need for this type of review.

-- How can we improve the way we handle failing banks? Should large bank depositors be protected, and if so, by whom. How can we handle failed banks so as to treat large and small banks more equitably?

-- Should the FDIC operate more in the manner of a Reconstruction Finance Corporation ("RFC") of the 1930s? An

RFC approach would involve loaning capital to banks that are still solvent but clearly in trouble. This approach might save us losses by preventing failures, but on the other hand this means greater government intrusion into the market place. And the government probably would have told Texas bankers in the early 1980's to diversify into oil, cattle and real estate!

-- Do we price deposit insurance appropriately? Would a system of risk-related premiums do a better job than our current system of explicit and implicit pricing? Can we find a formula that will be mechanical, accurate, and defensible?

Of course no look at deposit insurance would be "for real" without addressing the question, should there be a merger of the FDIC and FSLIC funds?

The difficulties of the thrift industry and the FSLIC are having negative ramifications on the banking industry. These problems are creating a higher cost of funds, forcing banks to compete in an unfair environment against insolvent institutions, and undermining sound credit analysis. Therefore, the resolution of the FSLIC's problems is important to the banking system and the entire financial system.

As we have said many times, we do not favor a merger under current conditions.

But to be fair, we need to be ready to deal with the many suggestions that a merger is needed to save the system. If such a merger is to take place, how might it be structured?

We have suggested that an administrative merger might be cost effective, but a financial merger is not possible under present conditions.

If we have one regulator of banks and thrifts, it would be a real challenge to keep supervision fair and even handed.

The future of our deposit insurance system -- both the FDIC and the FSLIC -- depends on how we deal with these issues. We need an improved system if deposit insurance is to be viable in the 90's. This is a problem likely to be high on the agenda of our next President. The new president -- Mr. D or Mr. B -- may want to act on this problem early in his honeymoon period, following the good advice, "Get the tough ones behind you in the first 100 days." We hope our study suggesting improvement in the federal deposit insurance system will be helpful.

And we ask for your suggestions and help.

In many ways, New Mexico is still as much of a frontier state as it was in Kit Carson's time. Although, now, the frontiers to be won are as much economic as geographic, with financial cycles replacing environmental changes as the day's greatest challenges.

New Mexicans have long been famous for their ability to weather challenging times.

You can see this in the wartime cartoons of New Mexico native Bill Mauldin, whose G.I.s Willie and Joe always triumphed over the worst situations with humor and ingenuity.

You can also see this in the story of a "G.I." of a much earlier era.

That "G.I." was General Lew Wallace, a famous battlefield commander of the Civil War.

His days in uniform had ups and downs. He was severely criticized for his actions at Shiloh, and his career was thought to be over. In the late 1870s, he was appointed military governor of the territory of New Mexico, and many in Washington thought that he would not be heard from again.

But Wallace refused to stay down.

Self educated, General Wallace had long been interested in history, particularly the history of the Roman Empire. While he served as military governor, he was constantly reminded how closely New Mexico resembled territory described in the Bible. So inspired, he sat down and used his historical knowledge to write a powerful story that has rarely been out of print in the century since. If you've never read the novel, I'm sure you've seen the movie. It's called Ben Hur.

There is a moral here for New Mexico's bankers and for bank regulators struggling with the challenges of a evolving financial system.

You're in the right place, with the right heritage and traditions, to succeed.

So as your convention theme suggests, let's make some waves.

Thank you.