Remarks by

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It gives me great pleasure to address this distinguished group.

I'd like to focus on several changes taking place in the American banking system that help explore the competition and risks in our banking industry. These factors have indeed become significant in this decade.

One of my colleagues went so far as to say that being a bank regulator in the U. S. today reminded him of an add for a lost dog he had recently seen. The add read: "Missing, dog with one eye, three legs, recently neutered, goes by the name Lucky."

The past decade has not been kind to the American banking industry. New competition and risk have increased the challenge for the American banker.

By 1986, for the first time, the amount of money in U. S. mutual funds outside the banking system exceeded the balance in all the nation's checking accounts.

Banks now hold LESS, than HALF of all consumer installment loans.

At the same time, in the midst of an expanding U. S. economy, bank deposits are growing at a rate of only 3.7 percent, steadily falling behind competitors -- and even our inflation rate.

Bank failures are at record highs owing to depressed economies in the energy belt. And in 1987 bank profits hit new all time lows largely because of reserving for developing country loans. Our thrift industry insurance fund is insolvent, as are one-third of the members of the industry.

It is clear that the U. S. banking and thrift industries today faces great challenges.

As Chairman of the FDIC, I, of course, am very much involved. I chair the U. S. agency that provides deposit insurance for all American banks, and also directly supervises more than 8,500 of my country's over 13,000 commercial banks.

The FDIC plays an important role in maintaining the stability of the Americans banking system. It protects depositors from loss up to $100,000, prevents our largest banks from defaulting on liabilities, and has become the lender of next to last resort, after the Federal Reserve system, the lender of last resort.

The FDIC should not be confused with the FSLIC, the bankrupt U.S. agency that insures America's saving and loans. We will have a net worth of over $15 billion by year end. Nevertheless, we have been under pressure this year, and will lose more than two billion dollars in 1988. Fortunately, we will move back into the black next year and resume building our fund.

Dealing with these challenges over the last decade have driven home three important lessons to be learned from the experiences of the U.S. banking system in the eighties.

First, the FDIC AND FSLIC insurance fund experience--the lack of market discipline has taught us that deposit insurance is a powerful tool, which if misused, has the potential to severely damage the financial system.

Deposit insurance in $100,000 blocks effectively gives banks and thrifts the ability to borrow on the credit of the federal government.

Banks need only put up six percent capital, and they borrow the rest from depositors. Because of this, the deposit insurance system must be carefully guarded.

Our deposit insurance system can be compared to a nuclear power plant. It can provide benefits. But at the same time, safety precautions are needed to keep it from going out of control.

A deposit insurance "meltdown" could damage the fabric of our whole economy. One has only to look at the savings and loans industry to see the magnitude of the financial problems of deposit insurance misused the -- to loss is estimated at near $100 billion dollars and must be paid in large part by the taxpayer. That's more than the U.S. contribution to the Marshall Plan in current dollars!

Thus, the FDIC has been reviewing the role of deposit insurance in the current banking environment. Our study on this subject, "A Deposit Insurance System for the Nineties", and will be completed this month.

I would like to share with you five of the major questions we are examining:

(1) First -- Can the supervisory mechanisms that are part of our deposit insurance system control risk?

The answer to this question is perhaps the key to the future of deposit insurance.

As we enter an era where banks will need broader powers to compete, how will supervision need to adapt to keep the banking system safe?

(2) A second question is: How can the market be used to control risk in today's environment?

Can we further promote safety by implementing both statutory and de facto deposit insurance ceilings, changes in coverage to include only short term deposits, or the introduction of private coinsurance on deposits?

(3) Third: Do we price our insurance appropriately?

Right now, all banks pay the same premium for FDIC coverage, regardless of risks, size, or other factors. Would a system of risk-related premiums do a better job than our present system?

Can we arrive at another formula that will be practical, workable, and defensible? If you know one send it to me -- so far we haven't found one that works fairly for everyone.

(4) Fourth: Shall we continue our too-big-to-fail practice?

When Continential Illinois, a bank organization with over 30 billion in assets, got in trouble in 1984, we didn't allow it to fail. This year we allowed First Republic's holding company, a similar sized organization, to default on its obligations to bondholders and shareholders.

Finally - do we need deposit insurance at all? Can we substitute general government assurances or put depositors at risk?

The second competitive lesson we have learned from this decade is that the U.S. banking system is significantly handicapped when compared to its international competitors.

This disadvantage comes in three main areas:

First, our Glass-Steagall law, promulgated in the 1930s, prevents our commercial banks from underwriting securities or affiliating with investment banks in the U.S. This hurts their competitive position, their development of investment banking skills, and their profits.

Second, our laws restrict the geographic expansion of our banks across state, and even county, lines. These limitations have been reduced in the last few years, and will be more so in the future. But nationwide branch banking still does not exist.

This means our big banks are small for the size of our country, and do not have the deposit base they would have as truly national institutions.

Third, our rules separate commercial and financial activities. So, for example, when the FDIC has sought private sector capital to assist us in handling some of the major banking problems in the Southwest, we have been prevented from entering into a transaction with most of the capital in America.

This weakness the capital structure of our institutions, especially when compared to resources available in other countries.

The answer must lie in a new structure designed so that enterprises can own banks, but can also be in other business as you have here in Europe.

Unfortunately, these views are not accepted by the industry or the Congress. It is our guess that in the future this will change, and restructuring will take place.

The <u>third</u> lesson we have learned is that adequate supervision is crucial in deregulated financial system -- particularly one that provides deposit insurance and protects its large banks from default. Deregulation means <u>more</u>, not less, safety and soundness reviews to protect the financial system with or without deposit insurance.

Our experience in the Southwest has also demonstrated that risks can come in many forms, some of which supervision can do a better job of addressing than others.

For example, many banks in our Southwest were the best capitalized and most profitable in the U.S. a few years ago. But they got in trouble through over concentration (nine out of the ten largest have had to be restructured.)

As regulators, we certainly can't tell banks where to allocate their credit.

But supervisors have learned in the U.S. that concentration must be identified and diversification required.

If this had been done in Texas early on, our losses certainly would have been much lower.

In closing, many American bank regulators, lawmakers, bankers, and others, are working hard to take the lessons of the eighties, and use those lessons to create a better, safer, more competitive breed of bank for the next decade, and beyond.

We have already seen American banks responding to the lessons of the eighties.

Bank profits has improved sharply so far in 1988, and set new records for the first two quarters of the year with $10.5 billion in net earnings.

The surge of bank failures brought on in recent years because of depressed regional economies, notably in the "oil belt" of our Southwestern states, has crested, and is now in decline. No new mega banks failures are on the horizon.

1989 will certainly be a year in which Congress deals with banking problems. It has too because of the insolvent thrift insurance fund.

Thus, the reports of the demise of our banking system are premature, but that is not to say that the patient is yet back to full health.