Remarks by

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It gives me great pleasure to join with my fellow regulators in this discussion of Federal deposit insurance.

It occurred to me on the flight to Louisville that our banks and airlines have many things in common.

For instance:

Both are parts of our everyday life that we often take for granted.

After all, more than 18,000 commercial flights take off and land <u>each day</u> -- but the only time we seem to hear about airlines on the news is on the rare occasion when a plane has an accident.

Likewise, our nation has more than 11,000 healthy banks -- and Kentucky's are among the healthiest. But the only time we seem to read about banks in the news is when they fail.

Banks and airlines have other things in common. Both industries have gone through some deregulation. But whatever other changes this process has brought, both bank <u>and</u> airline regulators still have strong commitments to <u>safety</u>.

And <u>safety</u>, whether it be seat belts, or deposit insurance, is an important part of what makes both banks and airlines such accepted parts of everyday life.

There is a story that underscores how important the safety issue is, and how often we take it for granted.

Kentucky has produced two native sons with the last name Clay -- the great statesman Henry Clay, and the great boxer Cassius Clay -- perhaps better known now as Muhammad Ali.

Once, when Ali was aboard an airliner, a stewardess noticed that his safety belt was unfastened. The stewardess asked the boxer to please "buckle up".

Ali replied: "Superman doesn't <u>need</u> a safety belt!"

The stewardess didn't miss a beat. She told the boxer; "Superman doesn't need an <u>airplane</u>, either!"

Whatever the future of depository institutions, the "safety belt" of deposit insurance will remain an important factor in that future.

I'd like to pause here to compliment Kentucky on the health of its commercial banks. When compared with all other U.S. banks, your banks stand in the top third of the class (15th) for overall performance so far in 1988. Your banks rate a B-plus for earnings; a B for their asset quality; and <u>another</u> B for the quality of your capitalization.

I'd go so far as to say that Kentucky's bank depositors can feel safely "buckled up." So keep up the good work!

The FDIC has been around for over 54 years now. For most of that time, the banking business, and Federal deposit insurance for banks, didn't change all that much.

But within the last five years or so, we have all watched a different story emerge.

First, new competition and risk have increased the challenge for the 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

Commercial banking's share of the domestic financial services market has fallen to about 50 percent.

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.

Second, record numbers of bank failures have put pressure on the banking industry and the FDIC.

The last few years have been especially difficult for the FDIC. Since I became Chairman three years ago, the FDIC has handled over 570 bank failures, involving some $70 billion in assets. That amounts to more failures in the last three years than the FDIC handled in the thirty years following World War II.

Already this year the FDIC has handled over 190 banks that have failed or required assistance. Unfortunately, we will break last years record of over 200 without difficulty.

Despite this record number of problems, the financial condition of the FDIC fund remains sound.

The FDIC's financial statements for 1987, showed the FDIC fund had a year-end net worth of roughly $18.3 billion, most of that being in cash-type reserves.

Our net worth was attested to by the GAO using exactly the same standards for our audit as it does when auditing FSLIC. Those who say there is a difference only are attacking the GAO integrity and ability, a very provacative position.

But the problems in the banking system have taken a toll on the FDIC fund, and we will have our first operating loss ever in 1988.

Our third quarter statement shows our net worth at $16.3 billion, and a loss to date of about $2 billion.

Based on current estimates, the FDIC fund will end the year with between $15 to $16 billion in net worth. This estimate includes the projected cost of handling all the major problems in Texas, and the over 200 other failures and assistance transactions for the year.

Fortunately, 1989 looks like a much less costly year. We expect to add approximately a half billion to our net worth by year-end.

That figure is based on our estimate that the FDIC will need to handle approximately 150 to 175 bank failures and assistance transactions next year. This projected decline in problems is supported by the steady shrinking of our "problem bank list", now down to 1434 from a high of 1624 in June 1987.

Even more importantly, we have taken a good look at our potential major bank exposure in 1989, and have concluded that no mega banks made the list. Of course conditions could change, but as of today we don't anticipate having to handle any banks with more than $3 billion in assets next year.

A third major change this decade, and possibly the most significant for the finical system today, is that the eighties have left the thrift industry insurance fund insolvent, along with over one-sixth of thrift industry.

The cost of handling that problem will easily outstrip the $50 billion in current dollars spent to rescue Europe through the Marshall plan following World War II.

It is clear that the U. S. banking and thrift industry today face great challenges.

Dealing with these challenges over the last decade have driven home important lessons.

Experience 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 guaranteed by the U.S.A.

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.

It's time to take a new look at the deposit insurance system.

For most of this year 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", will be completed this month.

I would like to share with you six of the major questions we are asking.

(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.

What we have learned from dealing with the problems of the eighties -- particularly in the Southwest -- must be used to improve the system of supervision. The banks in Texas alone have cost us about $7 billion since 1986. We know that we need more supervision with more sophisticated techniques -- the kind that prevents disasters, rather than just cleans them up.

One thing we have already learned is that without sufficient portfolio diversification -- both geographically and by loan type -- banks are too vulnerable to economic fluctuations. This is an area we have already begun to monitor with renewed vigor.

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

What careful steps can we take to increase market supervision without destabilizing the boat?

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?

Should the FDIC control the interest rates paid on insured deposits, or provide insurance only for individuals, and not institutions? Should $100,000 in insured deposits be limited on a per person basis rather than on a per bank basis?

If you can answer this one satisfactory, we will build a statue of you on the front plaza of the FDIC building across the street from the White House grounds.

(3) Third: How can we improve the way we handle failing banks to reduce insurance costs?

(4) Fourth: Do we price our insurance appropriately?

(5) Fifth: Should we protect big banks against default?

(6) And of course, sixth: Should there be a merger of the FDIC and FSLIC insurance Funds, or what should the structure of deposit insurance funds be for the Nineties?

Clearly the job of rescuing the thrift insurance fund is one of the most difficult tasks facing our government today. We at the FDIC understand the magnitude of the challenges facing Chairman Wall and his Board.

The problems of the thrift and banking industries are joint problems in many ways. The difficulties of the thrift industry and the FSLIC are having many negative repercussions on the banking industry.

Among those effects are higher funding costs for banks and sound thrifts, forcing them to compete in an unfair environment against insolvent institutions.

I can't stress too strongly that the resolution of the FSLIC's problem is important to our financial system as a whole.

As I have said many times, the FDIC opposes the idea of imposing the cost of the S & L problems on banks through merger or any other method.

There are, however, many suggestions that a merger is needed to improve the system. So our study will evaluate merger approaches. It will try to answer the question: if Congress requires a merger, how should it be structured?

Let me outline some guidelines we are considering, and will suggest to Congress, in this regard.

First, all insured institutions should be regulated according to common standards.

Second, if a separate thrift industry is to be preserved, it should have a separate insurance fund. The risk factors of the banking and thrift industries generally vary widely, and that dictates a separate fund for each.

Third, any new deposit insurance agency should be independent as the FDIC is today. The FDIC operates almost like a private insurance company -- banks pay us premiums to insure their deposits, and we use those premiums both to build up our deposit insurance fund, and also to cover our operating expenses. No outside government subsidies are provided.

The FDIC is a success story today to a considerable extent because of this independence and freedom from political pressure. Without this independence, the FDIC might be prevented from taking the swift action system stability demands.

Fourth, the agency should be independent of chartering authorities and have the ability to determine what institutions should be entitled to insurance no matter who charters or supervises them.

The power to determine who should be insured is the power to deny institutions the right to behave in an unsound manner. The agency insuring does not create new powers, but only prevent unwise activities. This creates a powerful built-in incentive to control risks.

Fifth, banks should not be singled our to pay for the problems of their competitors in the S & L industry.

And sixth, the governing board of the agency should be chosen in the same manner, and operate under the same rules, as the FDIC Board.

You can be assured that the FDIC wants to see the thrift insurance problem solved, and an improved system put in place for all insured institutions. We stand ready to help in any and every way we can.

Well, my time is about up.

As I mentioned at the start of my speech, Kentucky has given us two famous native sons named Clay.

Your great Kentucky statesman, Henry Clay, had something to say about long-winded speakers.

Once, Mr. Clay took a fellow Member of Congress to task because his colleague's speeches tended to go on and on.

The offended Congressman took umbrage, and replied, loftily: "Mr. Clay, <u>you</u> speak for the <u>present</u> generation -- but <u>I</u>, sir, speak for <u>posterity</u>!

"Yes," replied Mr. Clay, "But <u>you</u>, sir, seem determined to <u>keep</u> <u>talking</u> until <u>your</u> audience arrives!"

With that story in mind, I'll bring my comments to a close!

Thank you.