The savings and loan problem:

Remarks by

L. William Seidman
Chairman
Federal Deposit Insurance Corporation

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Good morning! I'm very pleased to be able to join you this morning, ladies and gentlemen. Welcome to Washington -- a place some pundit once described as 67 square miles surrounded by reality.

The combination of the year just past and the coming year I foresee for the FDIC reminds me of the experience of a shipwrecked sailor. After spending three years on a tiny uninhabited island, he was elated to see a boat approaching. As it reached shore, a young officer tossed the sailor a bundle of newspapers. "Captain's compliments", he said, "read the news then decide if you want to be rescued."

I must say that if those papers looked anything like the papers I've been reading, I think I know the choice he made!...

Well, let's get to the business at hand. I want to talk to you this morning about some very important changes now underway in our financial system. That's right, as you have probably guessed, I'd like to talk about my favorite topic these days -- the S&L problem.

I'm sure that lately you have given much thought to the problems with the S&Ls. After all, for some of you they are your principal competitors. Many thrifts also own mortgage banking operations, and you generally share much in common with each other -- except, of course, for deposit insurance with its benefits and hazards.

That is why I believe a discussion of the FDIC's role in the resolution of the thrift crisis would be useful.

As Mr. Robert O'Toole said in his kind letter of invitation, "Mortgage bankers are concerned about the future of the thrift industry." Would I be risking understatement to say that we at the FDIC certainly share that concern?

Let us, therefore, review the situation in hopes of addressing concerns.

The President's S&L initiative is now law and its effects are being analyzed -- they go well beyond the closing of insolvent thrifts. A changed financial system is in the making. What it will look like will be determined by financial and commercial organizations -- in other words, by the "markets" in this country and worldwide.

After the market has done its homework and the regulators have acted, the new financial structure will begin to take shape. At this point it's just too early to tell what this new world will look like. I don't want to try -- my crystal ball already having been consumed as ground glass.

Let me tell you what the FDIC is doing to meet the challenge.

About the only major reminder of the old FDIC may be the headquarters at 550 17th Street and the bank insurance fund.

The FDIC will be handling more money this year then it did in 20 years in the past.

In fact, the FDIC will handle all the money generated under the new law:

Here's how the dollars break down:

(1) RTC with $50 billion.

(2) Old FSLIC, which will handle the cleanup of the thrift deals entered into the past, with at least $44 billion (probably more).

(3) New SAIF, the new thrift insurance fund, with about $18 billion from premiums and the Treasury.

(4) The new increased banks insurance premiums -- about $2 billion a year.

All together, well over a $100 billion in new money. We are putting people, policies, and systems in place right now to carry out this enlarged responsibility. We certainly didn't ask for this larger responsibility -- but we're ready to do what has been assigned us.

Here's a closer look at the FDIC's new list of responsibilities.

(1) SAIF. Pursuant to the new S&L legislation, the FSLIC was dissolved, and the FDIC has taken over the role of insuring S&Ls through our new SAIF fund. Any S&L that fails after August 9, 1992, will be handled by the FDIC through the SAIF fund. All S&Ls that fail prior to that date will be resolved by the RTC.

(2) Supervisory role regarding the thrift industry. Even though SAIF will not become fully operational for three years, the FDIC will have plenty to do in this area well before the summer of '92.

As provided by the new legislation, we have already assumed a new backup supervisory role over the thrift industry. We now have the authority to examine all insured thrifts, and, if they are operating in an unsafe and unsound manner, we can take a variety of corrective steps -- including withdrawing deposit insurance. We have already begun dispatching our examiners to S&Ls that we feel merit the insurer's on-site presence. And we are beefing up for a lot more work ahead.

Our new Division of Supervision (DOS) (formerly called the Division of Bank Supervision) will be expanding its supervisory staff by about 500 people over the next year, and will be well prepared for its significantly increased responsibilities. We expect to conduct on-site examinations or visitations of approximately 500-700 S&Ls during the next year.

One of our most significant supervisory challenges in the thrift area involves the interest rate mismatch problem. The thrift industry has traditionally accepted the interest rate risk inherent when borrowing short-term and lending long-term at fixed rates. The fatal flaw in this structure became apparent early in this decade as interest rates soared and thrift losses mounted.

The new thrift legislation attempts to correct many of the mistaken responses to this problem by strengthening capital and accounting standards and limiting risky investment areas. However, the underlying mismatch problem remains.

The S&L industry will have to learn to control interest rate risk exposure, otherwise it will not be insurable at reasonable cost.

As thrift supervisors, we will look to the private sector for suggestions on ways to control this risk.

(3) Old FSLIC deals. The FDIC has also assumed responsibility over the assistance transactions entered into by the FSLIC before January 1989, which we call our "FSLIC" operation.

With these new operations comes over $11 billion in assets we need to liquidate, and over $60 billion in assets subject to capital loss coverage and income maintenance agreements that we need to manage and ultimately sell to the private sector. For the next 6 months we plan to operate on a "business as usual" basis while we analyze the situation.

(4) <u>RTC review of Old FSLIC contracts</u>. As required by statute, we will be analyzing the 1988 FSLIC deals to determine what actions to reduce cost are appropriate. Guidelines for this review will be developed with the RTC Oversight Board.

(5) <u>FADA Dissolution</u>. The legislation has mandated that within six months FADA must be dissolved. We are now developing a plan to facilitate this restructuring in a manner that minimizes structural and personnel disruption.

(6) <u>RTC</u>. The smallest part of the new spending is actually our assignment as manager of the Resolution Trust Corporation ("RTC") -- which is, as you know, the vehicle designed to handle the current thrift problem under the FDIC's management. The RTC is a separate operation, independent from the FDIC. FDIC employees will be detailed to the RTC -- 750 so far -- since the RTC cannot hire people directly.

The FDIC will also provide the RTC with support services on a contractual basis. But notwithstanding those relationships, I want to underscore that the RTC and the FDIC will be separate operations.

There will be several key players in the new RTC structure. David Cooke, who showed his abilities as my former deputy, has taken on one of the most difficult posts in government, the Chief Executive Officer of the RTC.

I know he will be a well qualified leader. Bill Roelle, who has been in charge of our S&L conservatorship program, is now the RTC's Director of Resolutions and Operations. He is the guy to contact if you are interested in purchasing a thrift from the RTC. In fact, for those of you who are interested, we just announced 5 large institutions for sale as of now.

The final member of the RTC's top management team is Lamar Kelly, who is the RTC's Director of its Asset and Real Estate Management Division.

Lamar is in charge of all the assets (normally called "bad" assets) the RTC will assume through its resolution process. Lamar was in charge of our FDIC San Francisco office of asset liquidation.

As you can imagine these fellows are already quite busy. The FDIC has turned over to the RTC more than 273 insolvent S&Ls for disposition, most of which have been under the FDIC's control pursuant to the President's conservatorship initiative. The RTC has started out with institutions with over $110 billion in liabilities, and will grow from there as other institutions become insolvent.

The RTC is now under way in its initial task of using $20 billion before the end of this month, as required by the new legislation. We will spend about $8-10 billion of that on restructuring and closing down insolvent S&Ls. The remaining of these funds, will be used to reduce reliance on high cost brokered deposits and Federal Home Loan Bank borrowings.

We expect that where these funds are used, funding costs will be reduced by as much as 250 basis points -- saving the government as much as a half billion dollars on an annual basis.

Another important part of the RTC's huge job is to pursue civil and criminal actions against directors and officers of failed thrifts where mis- or malfeasance is present.

One thing is abundantly clear -- running the RTC will not prove the most popular job or the easiest job in town. The RTC -- or as I sometimes call it, "The House of 1000 auditors" -- will be, I believe, the most heavily audited agency ever created. GAO, IG, RTC Oversight, Congressman Annunzio's Task Force, OMB and the Senate Banking Committee will all be looking over the RTC's shoulders. And, the RTC will be spending billions of taxpayers funds without buying anything -- the money will go to fill the deficit hole of sick S&Ls so depositors can be paid. The RTC will be selling billions of dollars in real estate in weak markets to try to regain some of the funds provided to depositors.

And it will be pursuing thousands of lawsuits across the country (we have identified 30,000 already) as we go after crooks and pursue claims related to the failures and asset disposition.

For those reasons we are in many ways fortunate to be able to say that unlike the case with other FDIC operations, the buck does not stop entirely with our Board.

The RTC will be managed by the FDIC, with the same directors sitting on both the FDIC and RTC boards. But, and this is a big "but", the RTC will follow policies set by the RTC Oversight Board. This Board is composed of the Secretary of Treasury, the Secretary of HUD, the Chairman of the Federal Reserve Board, and two private sector appointees yet to be named.

It will have it's hands full with tough political issues, such as what policies should be used to sell properties without dumping assets. We will be working closely with them.

Of course there's much more to do. We have identified 103 special new responsibilities for the FDIC, reports, etc. which require action -- and we'll probably find more. Well, that's a quick review of the FDIC's new challenges and responsibilities.

President Bush and Secretary Brady deserve great credit for stepping up to the plate to face the facts and meet the challenge. Congress also did a laudable job in getting the legislation through in impressive time and with considerable improvements. Now the tough job is ahead for the RTC, OTS and the FDIC to carry out this mandate.

Well, I believe I've covered my topic, and I'll quit now so we'll have time for some of your questions and comments that I much look forward to.

If you'd like a summary, I guess I'd put it this way:

> Much of the thrift industry is a huge mess!
>
> We're doing our darndest to fix it!
>
> Stay tuned!

Some philosopher once wrote that the difference between education and experience is really very simple. Education is what you get from reading the fine print. Experience is what you get from not reading the fine print.

For years, we all failed to read a lot of fine print for the thrift industry. Now we're getting lots of experience!

Thank you.