"The new responsibilities of the FDIC as they relate to the thrift institutions"

Remarks by

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Good morning, ladies and gentlemen. It's a pleasure to join the U.S. League here in Chicago.

Many people think Chicago earned the name "The Windy City" because of the strong breezes off Lake Michigan and its cold winters. But, actually, this name refers to Chicago's political history and its often vociferous leaders, not its weather conditions.

Unfortunately, Washington has now proved itself far "windier" than anything produced in this great Midwestern center!

Given all the challenges we all have ahead of us, with the FIRREA legislation simply marking the beginning of a long process, I feel a bit like the golfer gazing over a distant fairway. One morning he teed up his ball, looked to the distant green, and confidently declared that the hole was good for one long drive and a putt.

His swing was off, however, and the ball landed just a few yards off the tee. Stepping forward, this eternal optimist turned to his caddy for a putter, and said, "Now for one heck of a putt!"

That's sort of how I feel. Like you, we at the FDIC have survived a difficult year struggling not only with our own challenges as banking regulators, but also with the significant problems of the nation's thrift institutions. The new legislation provides a beginning to deal with some of the problems we face. But, clearly, we still have one hell of a putt ahead of us!

We are gearing up to meet our responsibilities in both the thrift and banking areas, and above all, of course, to preserve the soundness of the nation's deposit insurance system.

Everyone in this room knows that the resolution of the thrift problem is a job of unprecedented proportions. That means we need each other's help. Together, we can put the train back on its tracks -- and that's how we intend to go about it -- in a positive and cooperative way.

This morning I'd like to discuss the new responsibilities of the FDIC, as they relate to the thrift institutions, and basically give you a report on what we are doing and how it's going.

Let me begin with an overview of how the FDIC plans to fullfil its backup responsibility for supervising thrifts.

We now have the responsibility and authority to examine all insured thrifts. If they are found to be operating in an unsafe or unsound manner, we can take a variety of corrective steps -- including deposit insurance revocation.

We intend to operate in a well coordinated way with the Office of Thrift Supervision, and have signed an agreement that outlines how this will be accomplished.

We have already begun to dispatch examiners to S&Ls that we feel merit the insurer's first on-site presence.

We are also gearing up for a lot more work ahead. Our reorganized Division of Supervision will be expanding its supervisory staff by about 500 over the next year in order to handle its increased responsibilities. We expect to conduct or participate in on-site examinations of approximately 500 to 700 S&Ls during the next year. We also plan to conduct at least a visitation a of every thrift by the end of 1990 -- a considerable challenge.

Let me speak briefly to a question I would surmise is very much on your minds -- what thrifts can expect when they are visited by FDIC examiners.

Actually, I would expect to see only a few clear differences from what you are used to:

First, the FDIC's regulations are generally far less numerous and detailed than the old Bank Board's. We don't try to spell out everything to the last detail in our directives. We like to leave room for management to manage, and for our examiners to examine. In other words, we expect our examiners not only to check for adherence to regulations, but to reach to the essence of the institution to ensure that operations are being conducted in a safe and sound manner.

Second, we place great emphasis on the examiners -- on their judgment and findings. We fully expect our examiners to have exit interviews with both senior management and the board of directors, and to include their comments in their examination report. I want to stress the importance of board participation in this process. In all cases the examiners review your files, talk to you about what they see, and make their conclusions and recommendations.

Third, you will find that we generally send larger teams into examine institutions than you may be used to. We like to get in and get out as quickly as possible. And even with relatively good size thrifts, we will try and get you our report within 60 to 90 days after the exam begins.

Fourth, we are going to do detailed asset quality reviews. Asset quality and interest rate-risk are key to our examination process.

Fifth, it has become commonplace for the FDIC to approach the subject of capital with fervor. We did, we do, and we will, stress rebuilding and strengthening capital. Recent history indicates that a lack of enforced capital requirements leads to expensive disasters.

Having said all that, I firmly believe you will find our examiners extremely competent, professional and helpful. Their goal is the same as yours -- to ensure that your institution's safety and soundness are preserved.

I would also like you to know that although we have been examining thrifts for years -- the savings banks -- we are striving to develop an even better understanding of your industry.

For example, we are in the process of hiring a capital markets specialist to help us deal with the kinds of securities some of your institutions buy and sell as hedging strategies.

Especially important, we look forward to working with the new SAIF Industry Advisory Board, and learning your perspective on the issues. This will be useful in the supervisory area and in our relations with the Federal home loan banks.

In the next several weeks we will be issuing for comment new policies and procedures in several areas that will affect your industry. They include:

-- the exercise of state powers that exceed federal powers;

-- notice of creation of subsidiaries;

-- the divestment of impermissible equities and junk bonds;

-- the use of brokered funds by troubled institutions;

-- and, the role of purchased mortgage servicing rights in determining capital adequacy.

Now, let me turn to one element of thrift supervision that we feel is important to us both, and indeed to the future of your industry -- interest rate risk.

One of our most significant supervisory challenges in the thrift area involves problems related to interest rate mismatches. Many in the thrift industry have traditionally accepted the high rate risk inherent in borrowing short-term to fund long-term, fixed rate, mortgages. The potential for loss in this structure became apparent early in this decade as interest rates and inflation soared. Thrift losses mounted. The new thrift legislation attempts to correct the idea that you can "grow" out of this problem by strengthening capital and accounting standards, and by limiting risky investments. However, the underlying mismatch problem still can remain.

A number of S&L's will have to learn to control interest rate risk exposure. If they can't, we will not be able to receive federal deposit insurance at reasonable cost. Prudent management will use available tools like variable rate mortgages to mitigate interest rate risk.

Some in the industry have addressed this problem with great skill and they should be models for the large group who have not.

There has been discussion lately on the way we will handle failing and failed thrifts. I would like to touch on one aspect of that issue -- the status of open-institution assistance.

Statutorily, the FDIC, through its SAIF operation, can provide financial assistance to an open thrift if it is certified that without such assistance the thrift would fail.

Here are the guidelines the FDIC has generally used in granting open-bank assistance:

*The cost of the proposal must clearly be less than other available alternatives, including liquidation.

*The proposal must provide for adequate managerial resources, sufficient tangible capitalization and reasonable assurance of the institution's future viability.

*The assistance must be accompanied by significant capital infusions from sources other than the government.

*The management, shareholders, and unsecured creditors must be left in the same position as if the institution had failed. That means they must lose their jobs and investments.

*And, very importantly, as is always the case when we sell closed institutions or assets, open assistance transactions will be open to the competitive bid process. We can't provide assistance on an exclusive negotiated basis. We always seek bids.

However, the immediate problem is that SAIF doesn't have the money for such assistance. Thus, even though the legislation allows the FDIC to "consider" open thrift assistance, we can't do much "considering" without funds.

During the next three years the RTC has been given limited funds and the responsibility for dealing with failed and failing thrifts. In practical terms, this means that it's really RTC's call as to whether open thrift assistance is an appropriate way of dealing with a failing thrift. It is up to the RTC Oversight Board to provide the funds that would be needed.

At this point the Oversight Board has not addressed this issue, and as a result it appears unlikely that open assistance transaction will be completed.

Letters of interest for this type of assistance will be put on hold until the funding is available. In the meantime, these applications should not prevent an institution from moving into conservatorship in a timely and prudent fashion.

Based on our experience in banking, very few institutions will be handled on an open basis.

A final issue I'd like to discuss is your insurance premium levels. Over the long-run it is clear that reducing your premium levels to something close to bank levels will be critical to your health, your competitive position, and possibly to the survival of your industry!

The pressure felt by Congress to raise your premium levels is, of course, quite understandable in light of past events. However, given other competitive and regulatory challenges to the thrift industry I do not believe it is reasonable or realistic that you be expected to bear that extra burden and the others imposed by the new law over the long haul.

You need a level playing field -- in premiums and in capital rules -- and I would expect that would be one of your top priorities in the period ahead. But please understand me -- any reductions of your premiums must be based on your industry's financial performance. Your success in managing risk -- especially rate risk -- will provide the basis for lower premium expense. We certainly want to work with you to achieve that goal.

Let me conclude with the promise that in dealing with the thrift industry, the FDIC and RTC will be fair and impartial -- no favoritism for banks or thrifts. That's a promise. If your institution is sound, you will probably find you have more freedom than before. If you are not sound, we will try to help. We share a commitment to housing -- a theme of this year's convention -- but we will always keep firmly in mind our primary duty to protect your insurance funds and the American taxpayer.

Of course, we recognize that we too have some growing to do, and some new skills and talents to learn and develop.

Let us work together and speak candidly -- some say I overdo that -- and create a profitable, safe, and sound thrift industry for the future. An industry dedicated to providing sound financing for good housing for all Americans.

Thank you.