"What's new" at FDIC and why it is making life more difficult for all who deal with us:

Remarks by

L. William Seidman
Chairman

Federal Deposit Insurance Corporation

Before

The Garn Institute of Finance
Key Largo, Florida

Friday, November 10, 1989

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Why You Can't Live With The FDIC

Good morning, ladies and gentlemen, it's my great pleasure to be able to speak to you here in beautiful Key Largo.

Being in Key Largo surrounded by this lush almost jungle-like environment reminds that today marks the 118th anniversary of another jungle encounter: Stanley's meeting with Livingstone in the wilds of Africa.

When Stanley spoke his famous line, "Dr. Livingstone, I presume," Livingstone should have answered, "Get Lost." For Livingstone, far from being lost or in need of rescue, was wisely quite happy to remain unnoticed and unbothered. Like Livingstone the FDIC's feeling on FIRREA is we would have preferred not to be discovered.

A great deal has happened to our financial sector since we last met here a year ago. At that time, we discussed reforming deposit insurance and the too-big-to-fail policy. Since that gathering, many of the reforms we discussed have been codified into law -- but too-big-to-fail is still with us.

Change is everywhere -- and it is clear that <u>the</u> FDIC, we all once knew and loved -- or hated -- will never be the same. In some ways for the FDIC FIRREA has turned out to be just what it sounds like, a new kind of social disease! So for reasons beyond our control we're harder to live with.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

So "what's new" at the FDIC and why is it making life more difficult for all who deal with us. It's a fast changing target so I may have to call the office for an update before the end of this session.

New Number One -- RTC Marketing.

One of the principal areas of change involves the marketing of insolvent thrifts and related assets.

The new RTC will learn to be a sales specialist because it is essentially a marketing agency.

Current projections indicate that the RTC will handle as many as 600 failed thrifts over the next three years, with $300 billion in assets.

Already the RTC has handled 33 institutions with aggregate liabilities of $13.3 billion. In doing so, they have made an outlay of $10 billion, and estimate the final cost to be about $5.8 billion. Most of these transactions have involved simple insured deposit transfers.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

We now seek to do more complex transactions, including involving the sale of assets.

In this respect we are dedicated to giving maximum access to potential bidders. The more bidders the better.

In the next couple of weeks we will release a new set of instructions that will be a "how-to-bid" guideline explaining the thrift bidding process, and will give names and contact points for key RTC officials.

We will also make available a package containing information for each institution in conservatorship available for any prospective bidder. Parties can then let us know of their interests. An 800 number will be established that will give prospective bidders quick access to information on the status of institutions in conservatorship.

Once an institution is scheduled for resolution the RTC will publish a tentative timetable in appropriate media and in the Federal Register. Thus, all sales will be widely advertised to ensure the greatest possible level of participation. All qualified bidders are welcome to attend the open bid meetings that will follow.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Bidders will also be given a reasonable period to perform due diligence. Bidders will be qualified by their present or proposed primary federal regulator. Except for state nonmember banks, the FDIC will not decide who is an eligible bidder. The RTC's primary role in the eligibility process will be to maintain a list of interested bidders -- not to decide their eligibility.

When granting preliminary clearance to facilitate diligence, the primary regulators will look at the integrity and financial resources of prospective bidders.

Purchasers will be invited to bid on a menu of transactions. Options may include the entire institution and most of its assets, the institution and just the good assets, or even some or all of its branches. The RTC will consider branch sales where practical, pro-competitive, and cost effective. Our objective is to provide a flexible array of options, and thus enhance the ability of the market to determine the best way to buy a given institution.

This is a new process, so give us a chance to get it working. Constructive suggestions are always most welcome.

<u>What's new Number Two -- Reorganization of Old FSLIC.</u>

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

We have reorganized our FSLIC operation.

First, FSLIC's $13 billion in book value assets will become the responsibility of the FDIC's Division of Liquidation and will be converted to FDIC systems. The nearly 1200 FSLIC employees in this area will be offered positions in DOL. FSLIC's regional offices will be converted to consolidated DOL sites.

Second, the nearly $60 billion in covered assets under the 217 assistance transactions FSLIC entered into will be the responsibility of our new Division of FSLIC Resolutions. This Division will also be charged with marketing the five Southwest plan institutions that were "stabilized" but not resolved last year. In this process the FSLIC Resolution Fund will follow standard FDIC procedures. If deals cannot be reached with the level of funding booked by the FSLIC in 1988, these institutions will eventually end up in the RTC's hands.

Finally, certain FSLIC employees, especially those involved in transactional work, will be moved permanently to the RTC to help with the case load there.

We believe this new organization will allow us to better use FSLIC's talented employees, and to more efficiently integrate our operations.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

What's new Number Three -- Funding.

Our transactional work and asset disposition activities all cost money -- and lots of it. One of our most pressing problems is how to fund our operations through interim financing.

The new legislation provides the RTC with $50 billion. We estimate it will take at least that much to cover the insolvent thrifts' net loss when we are all finished.

Of course, if we had all that money right now it would help, and would probably take care of our cash flow needs most of the way through 1990 -- but we don't. At last word we expect to receive funding at a rate of about $4.5 billion a quarter. But even more cash is needed to finance the RTC disposal of assets. Cash is also needed to reduce current funding by high cost deposits -- which could save us as much as an estimated one million dollars a day.

The question is -- How do we borrow to provide the interim financing? As you can see the problem is one of short-term cash needs, not of long-term cost. Actually, more cash now will give us the flexibility to reduce overall costs.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The FDIC, the RTC Oversight Board and Treasury are working to determine the best method to generate this interim financing. In doing so, we will have to address legitimate concerns in Congress and elsewhere over whether the financing will be on- or off-budget, and whether adequate safeguards are in place to ensure that such financing cannot be used to increase the costs to taxpayers.

One thing is clear. A policy for providing this financing must be put in place soon if the RTC is to be able to continue to restructure insolvent S&Ls at a cost effective pace.

What's new Number Four -- New Ethics Rules.

The RTC Board has already adopted an interim statement of principles regarding ethical standards of conduct for independent contractors. These principles are designed to preclude activities that could be viewed as clouding a contractor's objectivity, independence and judgment, including:

-- Performing services that could affect one's own financial interests, or those of a related entity.

-- Profiting from both sides of a transaction.

-- Using non-public information improperly.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

-- Using RTC property for personal use.

-- And accepting gifts and favors from those whose financial interests might be affected by the performance or nonperformance of a contractor's duties and responsibilities to the RTC.

Together with the Oversight Board, we are in the process of developing proposed regulations that will implement the conflict-of-interest provisions of FIRREA. In so doing, we will formulate definitions of what constitutes a "default," "a pattern or practice of defalcation," and a "substantial" loss to the Federal deposit insurance funds. We'll minimize paper work to the extent possible.

What's new Number Five -- New Rules in the Near-Term and for the Longer Term.

Over the next several weeks we will be issuing new policies and procedures in several areas that will affect the thrift industry. These include:

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

-- the notice of creation of subsidiaries;

-- the divestment of impermissible equities and junk bonds;

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

-- the use of brokered funds by troubled institutions;

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

Over the longer run, we have also identified a few relatively minor modifications to improve FIRREA -- we'll save the big changes for the really long run!

Possible follow-up legislation might include:

-- Legislative affirmation of court decisions holding that the bankruptcy of a holding company will not interfere with the liquidation of an insured financial institution.

-- Legislation should specifically provide full faith and credit behind FDIC guarantees or indemnities.

-- The FDIC Board transition needs attention. On March 1, 1993 -- shortly after the next inauguration -- all of the FDIC's appointed Board members must step down and new members appointed and confirmed. There is no provision to hold over board members until successors are confirmed. As a result, for a time the board could be composed of only the heads of OCC and OTS if they are in place then -- or there well could be no members at all. Some might find this an improvement, of course.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

-- We need to refine an exception to the 5-year rule for conversions of financial institutions between BIF and SAIF that permits "insubstantial" sales affecting less than 35 percent of an institution's aggregate deposits. Because this test applies to both selling and buying institutions, smaller banks are severely limited in purchasing branches from S&L's since a small bank's size can make it difficult for it to meet the 35 percent test.

-- The cross-guarantee provisions need improvement. These provisions generally apply to a bank affiliate when a bank fails, but not to holding companies. Consequently, there is an incentive prior to failure for holding companies to sell off good banks and upstream the proceeds to the parent. Moreover, institutions that foreclose on a stock loan and take possession of bank stock are not liable under the cross guarantee. This creates an incentive for holding companies to encourage secured lenders to take possession of the failing bank to insulate the holding company's remaining bank subsidiaries from liability. We need modifications here.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The bottom line is that we all have plenty to do in the period ahead. For our part, I'm reminded almost daily of what the wise old philosopher once said: Competence is that brief shining moment that occurs after you come up with a prized solution and before you discover that Governor Sununu doesn't like it, Bob Clarke thinks it requires too much capital, Secretary Robson finds it repugnant as an intrusion into Treasury's prerogatives, the Oversight Board finds it needs oversighting, and, of course, the Fed finds it inflationary. But we'll keep trying!

Thanks for your kind attention this morning. Now I look forward to your questions, and particularly to your comments.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis