Forecast of 1990 Fund Losses, Recapitalization and Restructuring

REMARKS

BY

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Good morning ladies and gentlemen. It's a pleasure to be back with the Association of Bank Holding Companies and to see so many old friends still looking prosperous.

I hope you will understand if I keep my remarks brief today. As you can see I'm on one crutch and I hope this gives me a good excuse for a short speech. Perhaps you know that last summer I had a little disagreement with my horse. In the process of winning the argument, the horse managed to rearrange my skeleton. This horse was an old friend raised on our place. I remember looking up at him after he bucked me off, and saying, "I expect this from my friends inside the Beltway, but not from you."

So three weeks ago I went back to New Mexico for some repair work. Hence, the crutch.

I arrived back in town just in time for the beginning of the holiday season ---- which started me thinking about what I want for Christmas.

Do you know what I really want to find under my tree on Christmas morning? I want to find a big pot of money marked FDIC.

Let me explain why this is at the top of my Christmas wish list. When we began 1990 we had $13.2 in the insurance fund. By mid-year the fund was down to $11.2. At about that time we predicted we would end 1990 with a loss of $3 billion bringing the fund down to $10.2. That prediction was based the assumption that the economy would remain sluggish but not deteriorate significantly.

Although the 1990 figures are not in and we are still in the process of analyzing what they will likely show, it looks like our 1990 loss could exceed $3 billion. I can't give any more definitive estimate at this time, but the trend is clearly in the wrong direction, because our results include accruals for losses that appear reasonably certain in 1991. Our loss numbers essentially will depend on the future performance of the economy.

How likely is further economic deterioration? The question puts us in the nebulous and very uncomfortable world of economic forecasting. Every time we're asked to make a prediction, I make it a policy to review Fiedler's three central laws of forecasting -- which are:

1. Forecasting is very difficult. Especially if it's about the future.
2. If you must forecast, forecast often.
3. If you're ever right, never let 'em forget it!

Incidentally, my mother always said "I told you so" were the worst four words in the English language, but gentlemen we <u>did</u> start warning about real estate risks about two years ago.

So my tendency is to leave forecasting to the experts.

But no less a notable expert than Fed Chairman Greenspan says we are experiencing a "meaningful downturn" in the economy as a result of oil prices, war fears, and a tightening of credit. I would also add the over-built real estate market as a factor.

Two days ago, before the House Banking Committee, Chairman Greenspan said "...events in the Persian Gulf have altered the immediate economic situation rather substantially."

How substantially the economy will be altered depends on how you forecast the mental stability of Saddam Hussein and I doubt if even Sigmund Freud could make that determination.

But whether you call our altered economy a recession or not, the information does not bode well for our bank fund reserves.

As you know, the law requires the fund to maintain a ratio of 1.25 to every dollar of insured deposits. Currently we are functioning with substantially less than 50% of the required reserves.

At this point in time, I think it is prudent for us at the FDIC and for you as bankers, to consider the question of how we should recapitalize the fund if it is required that we do so. The fund is solvent now and we believe we can meet our obligations as we see them under current conditions. But it will likely be a different story if we do in fact, have a prolonged economic slow-down, so as the Boy Scout motto says, "Let's Be Prepared!"

Since I gave up believing in Santa Clause a number of years ago and since nothing I've experienced in Washington has caused me to reconsider the belief, I think it pretty unlikely that I'll find a pot of money under my tree to alleviate our problems.

So I guess it's up to all of us to figure out how the fund should be recapitalized if it is needed. Secretary Brady in a speech today says the Treasury will recommend a plan for recapitalization as part of its overall restructure proposals. There are a number of options available to us --- from raising premiums, to a one-time across the board assessment. Or perhaps a plan whereby banks could purchase preferred stock from the FDIC, or allocate some of their Federal Reserves to the insurance fund.

We hope the members of this association as well as others in the industry will take an active part in determining how to improve the financial position of the fund. I'm sure we all agree that the responsibility for the fund should fall to the banks and not to the taxpayers.

The Department of Treasury will be making its recommendation soon and I think you would be wise to get your message to them before they've made decisions in this area.

But increasing the fund's reserves will not accomplish anything if we don't make some changes in the system to improve bank performance and to reduce bank failures. Without restructure, we'd be throwing good money after bad.

I'm not going to give you my speech on restructuring the system, but a good start would be to repeal most of the Glass-Steagall Act, the Bank Holding Company Act, and the McFadden Act.

Restructure is essential before any recapitalization effort is put in place. President Bush supported restructure yesterday when he spoke to you. It will take a great leadership effort to accomplish change under current conditions -- the administration will have to go all out to get it done -- and I believe they will make the effort.

While we're on the subject of restructure, some improvement to reduce the complexity of the federal regulatory structure may be in order. One federal regulator may be the way to go --- but that's another speech as well.

I've enjoyed being with you today. I'll be pleased to take any questions.