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ADDRESS BY

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FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

60TH ANNUAL CONFERENCE

of the

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

CONTEMPORARY HOTEL
LAKE BUENA VISTA, FLORIDA

MAY 13, 1980

[Condition of the mutual savings bank industry]

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I want to congratulate your new Chairman, Albert B. Hooke, on his election, and to thank your outgoing Chairman John C. Krout for his cooperation this past year.

To a certain extent, I also want to commiserate with Chairman Hooke. We have a tough year ahead of us.

I say "us" because we at FDIC have mutual concerns with mutual savings bankers.

The past year and a half has been a difficult period for most savings bankers. I don't have to recite to this group the series of events that have buffeted your industry.

More recently, we have all noted the suddenness and extent of interest rate declines. A decline in the six-month Treasury bill rate from 15.7 percent on March 24 to 9.5 percent on May 5 -- a drop of about 40 percent in just seven weeks -- is enough to catch anyone's attention.

Later on today I will react specifically to the plan your Executive Committee provided us earlier in the year.

I speak to you frankly as your regulator and as your friend in saying that you are relying too much on Washington to solve your problems.

Your proposals, while sound in some respects, make it clear that you are still clinging too much to the frayed and worn security blanket of Federal protection.

I find nothing in your plan calling for the structuring of a strong and involved trustee system. I find nothing mapping strategy for a major campaign in the State legislature to fight for the things you need. I find nothing calling for a systematic

program for development of younger managers who will guide your industry in the uncertain future.

First, let me bring you up to date on recent developments.

1. DEREGULATION COMMITTEE

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides for an orderly six-year phaseout of deposit interest rate ceilings. During this time thrift institutions should be preparing for the coming era of increased competition.

The new Depository Institutions Deregulation Committee held its organizational meeting last week. Paul A. Volcker, Chairman of the Federal Reserve Board, was elected Chairman. I was elected Vice Chairman.

The other members of the Committee are G. William Miller, Secretary of the Treasury; Jay Janis, Chairman of the Federal Home Loan Bank Board; Lawrence Connell, Chairman of the National Credit Union Administration Board; and John G. Heimann, Comptroller of the Currency, who by law is a non-voting member.

Our first act, by unanimous vote, was to propose a complete ban on the use of premiums as a means of attracting deposits. The Committee also proposed that finders' fees must be in cash and must be included under the interest rate ceilings. The proposed regulation is issued for comment through June 9.

The Committee also adopted two final rules, effective immediately. One permits a depositor to withdraw at any time without penalty all interest earned on a time deposit that was renewed

automatically on the same terms as the original deposit. The other authorizes institutions to pay interest on certificates of deposit for up to seven days after the maturity date.

The premium changes will leave banks free to concentrate on competition and meeting consumer needs on the basis of interest rates, service charges and service to the public. That is as it should be. This also will free the regulators from a substantial demand for time and resources that could be better devoted to our basic mission of safety and soundness in the industry. FDIC Regional Director McKeon in New York reported that from February through April this year his office processed 390 telephone and letter inquiries about premium and gift campaigns. Most were from one bank complaining about what his competitor was doing. Mr. McKeon said that the premium/gift workload for that three months involved 744 hours, time that could better be spent in other endeavors.

I recall that during my first Interagency Coordinating Committee meeting 12 years ago, during my first term on the FDIC Board, the debate concerned premiums. It is still going on today. Frankly, I just can't see us going into the 1980s still arguing about pots and pans and premiums. Too many important developments are taking place in the banking world today.

The Deregulation Committee's next public meeting will be June 2. We have instructed our staff to provide us with detailed background analyses on such issues as the passbook ceiling rates, the maximum rates on ATS and NOW accounts and the entire question of the differential.

2. NEW THRIFT POWERS

The new banking Act gives government, industry and the marketplace the opportunity to work together toward a more stable, more adaptable thrift industry able to hold its own in the economic environment of the eighties.

It is up to you to take advantage of this opportunity.

The new law pre-empted State usury ceilings on most residential mortagage loans, although States have three years in which to reimpose them. This provides an avenue of immediate relief for mortgage lending and gives the homebuyer a better chance of finding funds, even though he or she must expect to pay market rates for them.

The new Act also provides for asset as well as liability deregulation. It authorizes a limited degree of commercial bank lending powers for thrift institutions. The important thing is that the law recognizes thrifts' need for additional sources of income to supplement and facilitate the traditional function of housing finance. If thrifts use their new power well, they can make a case to Congress for an increase in the five-percent limit.

Clearly, the message in the new Act is that the financial industry must change and improve and adapt to the times. It cannot look, as it has for almost a half century, to artificial regulatory protections which have become so outmoded today that they actually penalize the industry they were meant to help.

3. DISCOUNT WINDOW

Title I of the new banking law, containing the Federal Reserve membership provisions, makes the discount window available to all institutions required to post reserves under the new Act. Your Executive Committee has recommended that the discount window provisions be put into effect immediately. The Federal Reserve Board is already moving ahead with this.

The relevant provision of the Act was effective upon enactment, but the Federal Reserve says that it will be July 1 before procedures for regular access can be developed.

In the interim, however, the Federal Reserve System is considering individual requests for credit on a case-by-case basis in consultation with the appropriate supervisory agencies. We are working closely with the Federal Reserve to make this system function smoothly. To date we have been consulted on about 40 requests for seasonal lending -- that is, money to help banks meet the seasonal credit needs of farmers, small businesses, resort areas and similar borrowers. Usually, these requests come from banks with less than $100 million in deposits and with no effective access to national money markets.

For liquidity borrowing during the interim, banks should apply to the discount officer of the appropriate Federal Reserve Bank who will review the applicant's eligibility and negotiate terms and conditions. The Federal Reserve has made it clear that in its role as lender of last resort it will consider assistance only after banks have first made full use of alternative sources of funds. The Federal Reserve also indicated that its assistance

would be contingent on the development of a plan for eliminating the liquidity problem of an institution. As with seasonal borrowing, we at the FDIC will be consulted by the Federal Reserve on individual requests from insured State nonmember banks and mutual savings banks for liquidity borrowing.

I suggest that it is not too soon for you to begin getting in touch with the Federal Reserve Bank in your District and firming up your contacts there.

4. EXTRAORDINARY ASSISTANCE BILL

The regulators, under the aegis of the Federal Financial Institutions Examination Council, have submitted to Congress proposed legislation to assist institutions in economic difficulty and to facilitate the handling of a major failure, should one occur. Chairman Reuss and Congressmen St Germain, Stanton and Wylie have co-sponsored the measure in the House, and Senator Proxmire has introduced it in the Senate.

Basically, the legislation would provide the Federal regulators with more flexibility in dealing with financially troubled institutions. The regulators could provide more ways to respond to a crisis before failure becomes inevitable. And, should failure occur, the regulators would have more ways in which to respond. The bill would expand FDIC powers so it would be able to act when it finds a bank is in danger of failing, that severe economic conditions exist which threaten the stability of insured banks in a large geographic area and it is probable that assistance to the failing bank will substantially reduce the risk or avert a threatened loss to the FDIC.

Another provision of the legislation would broaden the field of institutions which may purchase the assets and assume the liabilities of a failed bank. In addition to FDIC-insured banks, under the proposal associations or banks insured by the Federal Savings and Loan Insurance Corporation would become eligible bidders.

A third provision would create a new option for handling a mutual savings and loan association or savings bank in receivership by authorizing the Federal Home Loan Bank Board to approve the conversion, acquisition or merger of such a failed institution into a federal stock savings bank or savings and loan association. Federally chartered stock savings banks, which would be insured by the FSLIC, could be acquired by either savings and loan or bank holding companies and would have the advantage of access to a new source of capital in the form of stockholder equity.

The legislation also contains extraordinary acquisition procedures which would apply only in the event of failure of the leading banks or thrift institutions in a State and only then under certain extraordinary procedures. The bill would establish procedures under which an out-of-State bank holding company may acquire a savings bank in receivership if it has total assets in excess of $1 billion or if it is one of the three largest thrift institutions in a State.

This is a narrowly drawn, very specialized legislation. It provides authority we hope we never have to use. It is important to your industry to have this safety net in place.

5. STATE LEGISLATION

Much of the solution to your problems must come in the form of State legislation.

When I testified before the House Subcommittee on the new banking Act last February 20, I said: "We seek in this legislation to set an example for comparable State action, where necessary, so that overall competitive balance among institutions is maintained while specific powers are improved."

Several mutual savings bank States already grant authority more extensive than in the new Federal law. New England States are among the most liberal.

The Pennsylvania Legislature is considering a significant legislative package aimed at achieving parity between State and Federal law concerning powers of mutual savings banks. Other legislation is also pending in New Jersey and Rhode Island.

In New York, Superintendent Seibert has sent to Governor Carey a sweeping package of legislative proposals for submission to the State Legislature.

Basically, the Seibert report calls for:

-- Expanding the authority of savings banks, savings and loan institutions, credit unions and finance companies to enter additional kinds of transactions.

-- Increasing the maximum interest rates permitted on consumer credit and providing review and upward or downward adjustment of the ceiling as appropriate every six months.

-- Strengthening existing State prohibitions against geographic "redlining" in bank mortgage practices.

The recommendations concerning mutual savings banks propose new powers that parallel those granted by the new federal banking Act to federally chartered mutuals.

The legislative package also contains other thrift provisions, including unlimited branching powers, personal and corporate trust powers, liberalized savings bank borrowing powers, authority to make variable rate mortgages and rollover mortgages, and an increase in the usury ceiling for credit card loans.

Another recommendation in the package is that trustees of State-chartered savings banks be elected by depositors. Under the proposal the election of a full board of trustees would be phased in over six years, and proxies executed by depositors would be of limited duration.

Superintendent Seibert predicted that without appropriate changes in State law there may be widespread conversions of mutual savings banks to federal charters to take advantage of more liberal powers. This year four mutual savings banks in New York with assets of $6.7 billion and one in New Hampshire with assets of $50 million, have applied to the Federal Home Loan Bank Board for federal charters. A number of other major savings banks are also actively considering the move, as you well know.

6. PRESIDENTIAL TASK FORCE ON THRIFTS

Finally, in another action on the national front, the Presidential task force established by the new banking law is working on recommendations for ways to stabilize and improve the thrift industry. The task force consists of the Secretary of

the Treasury, the Secretary of Housing and Urban Development, and the five financial regulators. The task force is charged with making recommendations to the President and the Congress in three areas:

-- options available to provide balance to the asset-liability management problems inherent in the thrift portfolio structure;

-- options available to increase the ability of thrift institutions to pay market rates of interest in periods of rapid inflation and high interest rates; and

-- options available through the Federal Home Loan Bank system and other federal agencies to assist thrifts in times of economic difficulties.

This is the mandate of the law. Staff for the task force is already organized and functioning.

The task force has scheduled a meeting on the staff analyses later this month.

The law requires that we report by June 30.

EXECUTIVE COMMITTEE PROGRAM

That concludes the wrapup of current developments that affect mutual savings banks. Now let me turn specifically to your Executive Committee program.

1. Implement new Federal Reserve discount provisions. I covered this earlier. The window will be available, and I suggest that you start getting acquainted with the Federal Reserve Bank in your District.

2. Adopt realistic penalty provisions for premature withdrawals from time accounts. This is an issue we have talked about frequently, one that received considerable attention in the ICC and one that will continue to receive attention in the new DIDC. The short-run problem has gone away, perhaps temporarily, as interest rates have declined. We are and will be looking at alternatives to modify early withdrawal penalties. These include a minimum holding period for CDs and possible modification of the present penalties involving loss of interest for three months and six months. The penalties prevailing prior to July, 1979, will not be restored. There is no sentiment to do this among the regulators. In the long run, I do not believe that those severe penalties will be in your interest. They would significantly weaken your competitive position relative to alternative savings outlets. The NAMSB suggestion that penalties be market-linked may have considerable merit, although such penalties could get very complicated. We would welcome some specific suggestions in this area.

3. Restore thrift institution differential on 6-month money market certificate. This issue was debated by Federal regulators several months ago. I do not believe that a majority of the DIDC would vote for restoration of the differential above nine percent at this time, and the differential may well be removed below nine percent. Impact studies of all the alternatives are now underway. You may find that depositors' attention to the 30-month or over CD is picking up and that the differential you have there will prove to be increasingly important to you. There is certain to

be intense debate on the differential issue and you should be prepared to make your case.

4. Restrain money market funds. If money market rates decline further and the yield curve takes on a decided upward slope, the appeal of money market funds will markedly decline. We may see a certain flow of funds back to thrifts, but money market funds won't disappear. The funds have a special appeal for investors who keep balances with stockbrokers and other account holders who would not move their deposits to thrifts.

Even if money market funds diminish in importance over the next year or two, the funds may flourish again the next time short-term rates rise above those paid by thrifts. You may be able to make a case that the activities of money market funds in periods of rising rates divert funds in an undesired direction. But any move to impose significant permanent restrictions on money market funds runs counter to the general trend toward freer competition.

5. Raise minimum denominations on Treasury and Federal agency obligations. Minimum denominations on Treasury bills were raised from $1,000 to $10,000 in 1970 specifically for the purpose of lessening competition between such instruments and instruments of depository institutions. This is not the only area in which government policy has favored the big over the small to minimize deposit flow problems of institutions. Other notable examples are the removal of interest rate ceilings on accounts over $100,000 and establishment of the minimum denomination of six-month money market certificates at $10,000. Over time I think we need to move in the other direction. High

minimums discriminate against small savers and do not guarantee a flow of funds into thrifts.

6. Change accounting treatment of realized losses on the sale of low-yield mortgages. The Federal Financial Institutions Examination Council has had this question under consideration and unanimously decided last week that it cannot concur with this change. The deferral of realized losses would result in an artificial inflation of reported earnings and would overstate the amount of capital available to absorb future losses and prevent insolvency. The Examination Council determined that the proposed change in accounting procedure could prove not to be in the interest of those who must rely upon the objectivity and accuracy of financial reports or consistent with our responsibilities for promoting the safety and soundness of the institutions under our supervision.

LEGISLATIVE PROPOSALS

Now let me deal with your four proposals for legislative action:

1. Broaden FDIC authority to purchase capital notes from savings banks under certain circumstances. I have discussed this earlier in terms of the extraordinary assistance bill submitted to Congress. The FDIC now has the authority to provide assistance for a merger between two open banks when one is in danger of closing. Any move to broaden the proposed legislation to provide assistance to banks not in danger of closing would kill the bill.

2. Provide longer term, low-rate loan program for thrift institutions; and

3. Permit the exchange of low-yield mortgages for variable rate debentures issued by Federal agencies. Both of these options are on the study list of the Presidential task force.

There are problems associated with these proposals. To have a substantial impact on thrift earnings, any effort of this nature would have to involve a massive cost or financial transfer. The related problem is deciding how institutions shall qualify for assistance. It is hard to rationalize selective assistance. The total dollar value of low-yield mortgages in thrift portfolios is substantial, and to attempt to convert it all, or a large part of it, would entail a vast commitment of resources. Additionally, many small commercial banks with large, low-yield mortgage portfolios certainly have the same problem as thrifts. How are they to be treated?

I don't want to prejudge what is likely to be recommended. However, the current period of sharp restraint on government spending is likely to continue for some time, and I would not hold out much hope for any legislative proposal that would entail a substantial amount of funds in the next year or so.

4. Enact a broadly based, long-term, tax deferral provision. Included in the recently enacted energy "windfall" profits tax law is a provision that provides an income tax exemption of $200 for individuals and $400 for married couples for interest and dividends beginning in 1981. I would not expect to see further legislation of this nature in this Congress. Possibly, consideration by a future Congress would be within the context of comprehensive federal tax policy.

STATISTICS

Our federally insured mutual savings bank industry numbers 325 institutions in 17 States with $147 billion in assets.

Thirteen of these institutions (MSBs) were in the red for the year 1979. Thirty-two were in the red in the last half of 1979. In the first quarter of 1980, only 18 of the 75 largest mutual savings banks were operating in the red, but that reflected an abnormal spurt in penalty income -- ten times the level of a year before -- as savers accepted early withdrawal penalties to invest in higher yielding instruments. With interest rates declining, and penalty income returning to a normal level, we now expect severe losses for the mutual savings bank industry in the second quarter that will wipe out the artificial gains of the first quarter.

However, we hope that over the entire year, the decline in interest rates will help materially in returning mutual savings banks to profitability.

CHALLENGE AHEAD

I am here to pledge a continuation of the working partnership between your industry and the government. But I say again that the industry itself must take the lead.

I believe that you have the examples for constructive, affirmative solutions right here within your own industry. The image of the entire industry as a problem area is too pat. There are problems, we agree; but there are also mutual savings banks that are doing quite well, especially in States with liberal powers.

I look forward to continue working with you as we move through the uncertain future.

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