Change and Continuity

Remarks by
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It is just not a cliché for me to say what a pleasure it is for me to speak with you today.

In fact, my colleagues and friends, I feel confident that no other federal official has felt as honored to speak before this group as I am.

I joined this organization in 1980 -- near its infancy. I enjoyed having the regular opportunity to discuss issues involving the banking and financial industries with other members. I made a number of friends over the years. Indeed, I met my Deputy for Policy -- Leslie Woolley -- at a Women in Housing and Finance meeting just after I joined, and I am exceedingly pleased that she agreed to bring her years of experience on financial issues, her good judgment, and winning personality to the FDIC.

It is hard for some people to believe it today, but in the early years Women in Housing and Finance was something of a novelty. Now, it is an institution, and its name is something of an anachronism, because many men are members. I guess that I am something of a novelty, too, as the first woman to head a federal banking agency, but I simply consider myself to be a banking professional who has more hair than some of my predecessors.

Today I want to talk with you about my four priorities as Chairman of the Federal Deposit Insurance Corporation. Three of these priorities involve change and one involves continuity. If you are familiar with the FDIC, the combination will not surprise you. In fact, Change and Continuity would not be a bad title for a history of the FDIC. Change and Continuity suggests the innovation and professionalism that have marked the FDIC's response to new market developments and statutory mandates throughout its history.

During our sixty years of distinguished service to the nation -- in calm and in crisis -- the FDIC has provided the public with solid grounds for confidence in the banking system. In a changing banking environment, the FDIC has represented continuity. In a financial system built on risk, the FDIC has afforded security.

We at the FDIC can say with pride that no bank depositor has lost a penny of insured money **and** that no U.S. taxpayer has paid a single cent for this depositor protection.

As you know, the FDIC was born in 1933 to address the banking crisis of the early 1930s. It was successful in accomplishing its mission of maintaining stability and public confidence in the nation's financial system beyond anyone's expectations, in large part because of the dedication of FDIC employees and the credibility that arose from the FDIC's status as an independent agency. Over time, the means used by the FDIC to accomplish its mission changed -- and so did the organization. That should be expected. Much has happened in the last 60 years. When the FDIC was created, many Army officers considered cavalry to be an essential component of military preparedness. Things have changed, but the military's mission of insuring the nation's security remains the same now as it was then. So, too, is ours.

In its first year the FDIC's staff examined more than 7,500 institutions to qualify them for deposit insurance. The first major change the FDIC faced occurred as it entered its second year -- transforming itself from a crisis management and damage control operation into a permanent force for stability in the financial marketplace. It was a big change, but one that was made smoothly and effectively. Four thousand banks failed in

1933, while nine banks failed in 1934.

For the next ten years or so, the FDIC paid out depositors when banks failed, as they did occasionally. In the 1940s, however, the FDIC went through another period of change, in part to assure economic stability. Instead of using payouts to address bank failures, it switched entirely to selling failed institutions to other banks without closing the bank. Communities benefitted from this practice because their banking services continued uninterrupted. With a sense of pride, the FDIC highlighted the switch in its 1949 annual report -- which brought a storm of protest from Congress. The lawmakers sent the very clear message that the FDIC could facilitate a merger only if it were less costly than a payout. For the next several years the FDIC found that payouts were always the less costly course.

Another change occurred in the mid-1960s, when the FDIC discovered the market and started calling for competitive bids on the purchase of a closed bank, rather than negotiating with a single buyer.

In the later 1970s, the size of the FDIC began to balloon, as more people were needed to take care of problems emerging in the banking system -- a big change toward crisis management again. The staff shrank somewhat in the early 1980s, as problems seemed to subside, only to balloon again to address the most

recent crisis.

That crisis is now behind us.

Thirteen banks insured by the FDIC Bank Insurance Fund failed in 1994, compared to the historical high of 206 in 1989. These thirteen banks held about $1.6 billion in assets, compared to the historical high of $63 billion in failed bank assets in 1991.

Indeed, after repeated earnings records, the banking industry as a whole has never been in better financial condition.

Given the ending of the banking and thrift crises, we are about to write another chapter on change at the FDIC, and the first item on my agenda concerns a big change involving the Bank Insurance Fund.

From 1982 through 1993, almost 1,500 banks, with assets of more than $235 billion, failed. In response to these failures, and the drain on the insurance fund they represented, insurance premiums for banks increased dramatically. In 1981, the FDIC received about $1 billion in assessment income from banks. Last year, we received close to $6 billion, following $5.8 billion in 1993, $5.6 billion in 1992, and $5.1 billion in 1991.

As a result of record bank earnings, the banking industry has been able to pay these premiums and replenish BIF much faster than had been anticipated only three years ago. The Fund will likely be recapitalized at or near midyear.

When the Fund is recapitalized, I expect that well-capitalized and well-managed banks -- about nine-out-of-ten banks in America today -- will see their deposit insurance premiums drop substantially. For the last three years, these premiums have been major operating expenses for the industry. For the best banks, that will no longer be true. These banks will be able to compete more effectively in the domestic and global financial marketplaces -- and that benefits U.S. businesses, the U.S. economy and all of us.

Nevertheless, we still need to take into account potential risks to the Bank Insurance Fund from those institutions that are less well-managed and less well-capitalized. As many of you know, Congress instructed the FDIC to set our insurance premiums for banks to reflect the risks that individual banks pose to the insurance fund. As the Fund nears recapitalization, we must decide just how great the spread in premiums should be to reflect the risks of less well-capitalized and less well-managed institutions to the Fund <u>and</u> to motivate the management of those institutions to improve their financial condition.

Today, there is an eight basis point spread between the premiums the best banks pay and the premiums the worst banks pay. There are nine gradations in that range. Given the recapitalization of the Fund and Congressional intent, it would seem to make sense for the eight basis point spread to widen -- probably considerably. While I cannot say by just how much -- that is a matter for the FDIC Board as a whole to decide -- I can say that the premiums must be large enough to be a real incentive for banks to improve their condition, without being so large that they cause more problems than risk-based premiums would resolve.

These are the kinds of issues discussed in a regulatory proposal that the staff will make to the FDIC Board. In the next several days, the Board will consider issuing that proposal for public comment.

Another item on my agenda involves management issues arising from the end of the banking crisis.

FDIC staff levels declined dramatically in 1994. From an historical high of 15,585 employees in the second quarter of 1993, staffing declined to 11,627 employees at year-end 1994, about 25 percent. FDIC staff will decline to fewer than 10,000 by year-end 1995 -- and there will need to be further reductions.

Making this downsizing more difficult is our need to

assimilate RTC staff into the FDIC, an assimilation that must occur over the next 11 months, as the RTC approaches its sunset date. This could potentially involve some 1,500 RTC employees with reemployment rights at the FDIC.

In a way, we face the same types of challenges here as the military faces in shifting from war to peace. These challenges involve more than cutting workforce. They involve a redefinition of our mission and our role. Therein lies new opportunities, which relate to my third agenda item: transforming the FDIC into an organization dedicated to identifying and addressing risks to the banking industry and the deposit insurance funds.

Between 1985 and 1993, the FDIC's principal job was to resolve failed banks. Going forward, we must concentrate on the goal of helping banks and other financial institutions stay open.

Given the changes in the financial marketplace over the last decade, banks and savings associations are exposed to types and levels of risk different from anything the financial system has before experienced. New categories of risk seem to emerge every day. The FDIC must broaden its focus and increase its expertise to understand and address these risks.

I have begun several initiatives that will lead us toward an FDIC that is dedicated to identifying and addressing risk -- in

order to keep banks open instead of closing them.

We are near the end of drafting a strategic plan that aims toward that goal. This will be the first formal strategic plan the FDIC has adopted in its history.

I have created an internal Task Force on Capital Markets to analyze the potential risks posed by capital markets activities and instruments, such as financial derivatives, and to make recommendations on the ways the FDIC can be more prepared to analyze and manage the potential risks that these instruments pose to individual institutions, the banking system, and the insurance funds. Let me say here that derivative instruments can be exceedingly useful for hedging risks. We also need to understand when they pose risks that are not well known or effectively monitored by market participants. The Task Force is expected to begin reporting its findings and recommendations to me this spring.

We have begun processing data on bank failures from the past 12 years into a form that will enable us to develop more effective failure models and to have a better understanding of what factors led to losses to the insurance funds.

We are implementing a new survey of examiners on credit underwriting practices of banks in our eight supervisory regions. This survey, which we are field-testing this month, could serve as an "early warning" system for banking problems. Now is the time to set such systems in place -- when the banking industry is healthy.

Clearly, the purpose of concentrating on risk is to change the FDIC from an organization skilled in crisis management to an organization dedicated to crisis prevention. Because this shift in focus will require enhancing and building upon many of the functions the FDIC has long performed -- rather than exploring unknown territory -- the transition will involve retooling rather than reconfiguring the agency.

I also want to note that the focus on risk cuts another way -- to eliminating or reducing regulation where it no longer reflects risk to the insurance funds. Again, banks will be more effective competitors in the marketplace if they are freed from outdated laws -- like Glass-Steagall Act restrictions -- and unnecessary regulation.

The fourth and most important item on my agenda is my determination to keep the FDIC an independent agency, in fact as well as name.

As the deposit underwriter for all banks and savings associations, the FDIC must be able to make underwriting decisions independently.

Before 1991, the FDIC was required to insure any bank chartered by another federal bank regulator -- in effect paying for other people's mistakes by having to insure institutions insufficiently prepared to meet the risks of the marketplace. Congress changed that four years ago: We now have the authority to make the initial underwriting decisions independently of the chartering authority for new national banks and new state member banks.

We also have the responsibility to assure that the institutions we insure are operated in a safe and sound manner. To meet that responsibility, we need meaningful -- I did not say duplicative or burdensome -- back-up authority. As former-FDIC chairman Bill Isaac recently wrote in the American Banker: "Two sets of eyes looking at things from different perspectives tend to produce better results than one set of eyes." Two sets of eyes are not necessary in every case but they may be necessary in

problem situations, changing circumstances, and where there are other risks to the deposit insurance funds.

For those few of you who are not close observers of the bank regulatory scene, the independence issue must seem rather Byzantine. Let me state it simply: Two of the three bank regulatory agencies -- the FDIC and the Federal Reserve System -- are independent agencies created by Congress to achieve public policy objectives in addition to bank regulation -- objectives that, at the time of the agencies' creation, were considered to be so essential to the public interest that the agencies were made accountable directly to the Congress. Having served at the Federal Reserve, I can say that independence works.

The FDIC's independence often has been tested, but it has never been compromised. Congress has made it absolutely clear that it intends for the FDIC to have the necessary power to protect the Bank Insurance Fund -- and by extension, the American taxpayer -- from the kinds of losses that depleted it -- and that decimated the savings and loan fund -- in the 1980s.

To protect the insurance funds -- and to retain the public's trust -- we at the FDIC must play it straight -- we must make unbiased judgments and we must act upon them -- without fear or favor. Independence gives us credibility and legitimacy.

The integrity of the insurance funds rests ultimately on the integrity of the people who manage them and who assess the risks in the financial system to which the funds are exposed. Whether intentional or unintentional, whether through machination or legislation, attempts to compromise our independence are necessarily attempts to compromise the FDIC's ability to do its job.

In closing, let me say that I am proud to be a part of the long tradition of public service at the FDIC. I seek to assure that the FDIC will perform its mission of maintaining stability and public confidence in the financial system -- that it will change to maintain continuity, and that it will maintain continuity in the midst of change. That is what the logo "insured by the FDIC" is all about.

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