**Oral Statement**
**of**
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**Chairman**
**Federal Deposit Insurance Corporation**
**Before the**
**Committee on Banking and Financial Services**
**United States House of Representatives**
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Mr. Chairman, Congressman LaFalce, and members of the Committee, I deeply appreciate your very kind comments. I am pleased to have this opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on legislation to modernize the nation's banking laws, and I commend you for this effort to strengthen our financial system.

I also want to thank you and the other members of the Congress for passing legislation last year providing immediate financial stability to the Savings Association Insurance Fund (SAIF). The SAIF still faces long-term risks because it insures far fewer, and more geographically concentrated, institutions than does the Bank Insurance Fund (BIF). To distribute these risks more broadly, the FDIC strongly supports a merger of the two funds as soon as practicable.

Mr. Chairman, I have detailed written testimony to submit for the record. This morning, I will discuss briefly three topics: one, the lessons we have learned from our analysis of the most recent banking and thrift crises that should guide us in considering financial modernization; two, the key questions that financial modernization should address; and, three, the independence of the FDIC.

First, several of the lessons we have learned in our in-depth analysis of bank and thrift failures between 1980 and 1994 -- the worst financial crisis since the 1930s -- should be useful to this Committee. Our analysis points to the need for financial modernization. Geographic and product constraints on insured institutions resulted in inadequate diversification of income. Restrictions on financial activities combined with increased competition may have led many banks into riskier lending. Our analysis, however, also underscores the need for caution in easing restrictions on activities of banking organizations beyond those financial in nature. We found that without adequate supervision rapid expansion of insured institutions into unfamiliar activities had undesirable consequences. We also found that there is no substitute for regular, on-site examinations of depository institutions for addressing specific problems, nor for the authority to close failing institutions in a timely way.

Second, my written testimony discusses five key questions that any financial modernization proposal should address. I will briefly discuss several of them here.

What activities should be permitted? Financial organizations should be permitted to engage in any type of financial activity, unless the activity poses significant safety and soundness concerns or is potentially harmful to consumers or small businesses. We should, however, avoid at this time combinations of commercial firms and banks because they may result in undue concentrations of economic power that could affect the general availability of credit during an economic downturn and could present other significant conflicts of interest. The alternative that I favor would permit merchant banking activity through noncontrolling investments in nonfinancial firms by well-managed Financial Services Holding Companies (FSHC), as H.R. 10 would permit. Should Congress, nevertheless, take a "basket approach" to mixing banking and commerce that permits controlling investments in commercial firms, our research shows that a commercial "basket" comprised of five percent of a banking organization's revenue may be sufficient to allow most financial service firms to affiliate with banks without divesting their commercial activities.

How should activities be regulated? Financial reform must ensure that any regulation of a diversified holding company will not result in duplicative regulation or in the artificial restructuring of banking operations and services. It must also ensure adequate safeguards for the protection of consumers and investors. Finally, regulators must be able to review transactions between insured banks and their affiliates and subsidiaries as part of the regular examination process for insured banks. To address concerns regarding the stability and liquidity of the financial system, it may be necessary to provide for some general federal oversight of consolidated financial organizations, but supervising nonbanking companies as banks are supervised is not necessary.

What safeguards are necessary to protect the insured entity and the deposit insurance funds? Any proposal should be consistent with the safeguards of Sections 23A and 23B of the Federal Reserve Act, and the capital adequacy of an insured institution should be determined after deducting the institution's investment in subsidiaries.

Lastly, my foremost concern is preserving the independence of the FDIC. The FDIC's ability to do its job of stabilizing the banking system in times of stress rests on its independence. To promote stability, the FDIC must make unbiased assessments of risk in the financial system and act upon those assessments without fear or favor. Independence gives the FDIC the legitimacy and credibility it needs to serve the public interest.

Given the lessons of the recent banking and thrift crises, the proposals the Bankers Roundtable announced Tuesday to limit deposit insurance protections that Americans have enjoyed for three generations are extremely misguided and shortsighted, and would ultimately result in the unfortunate and unnecessary politicization of the process for addressing financial institution failures.

Mr. Chairman and members of the Committee, the FDIC stands ready to assist the Committee in evaluating how best to reform our financial system. I would be happy to respond to your questions.

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