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Statement by

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before the

Subcommittee on Commerce, Consumer and Monetary Affairs

of the Committee on Government Operations

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I am pleased to appear before this Subcommittee to discuss the Federal Reserve's contribution to efforts to ameliorate the problems of the state-chartered, privately insured thrift institutions in Ohio. The situation in Ohio was touched off by reported losses suffered by Home State Savings Bank (Home State) as a result of transactions with E.S.M. Government Securities, Inc. (ESM), a broker-dealer in government securities, but also was related to more systemic weaknesses in the supervision and insurance of some Ohio savings and loan associations. A detailed chronology of the Federal Reserve System's response to events in Ohio is attached to the statement of President Karen Horn of the Federal Reserve Bank of Cleveland.

As this Subcommittee is aware, reports of losses at E.S.M. precipitated a run on Home State that led to its closing. This development subsequently contributed to more generalized deposit outflows at other ODGF savings and loan associations and savings banks in Ohio, and a number of these institutions experienced heavy depositor withdrawals. Faced with this situation, Governor Celeste of Ohio closed, on a temporary basis, all 70 of the remaining ODGF thrift institutions. Subsequently, the State of Ohio adopted a plan that allows certain institutions found to qualify for federal insurance to reopen on a full service basis. Ohio authorities are pursuing other remedial steps, including the potential merger of weak thrifts with stronger federally insured institutions, designed to resolve the situation and promote the safety of depositor funds. At the present time, all but one of the ODGF thrifts have reopened on either a full or limited service basis; although a permanent solution involving the remaining closed thrift, Home State, and those thrifts that cannot qualify for federal insurance remains to be worked out. The limited service reopenings permit withdrawals of $750 per account per month. The Federal Reserve is lending to the reopened thrift institutions where necessary.

In reviewing this situation, it is helpful at the outset to clarify the Federal Reserve's specific regulatory responsibilities for various types of banking institutions as well as its broader responsibilities as the nation's central bank. The Federal Reserve has primary supervisory responsibility at the federal level for state-chartered banks that are members of the Federal Reserve System and for all bank holding companies. Commercial banks that are members of the Federal Reserve System are FDIC-insured, and commercial banks that are subsidiaries of bank holding companies, regardless of membership status, must by law be federally insured. Of course, the Federal Reserve does not have supervisory responsibility for thrift institutions, and the federal regulatory agencies, including the Federal Reserve, generally do not have direct supervisory or regulatory responsibility for state-chartered, nonfederally insured depository institutions, such as the affected ODGF thrift institutions in Ohio. Normally, such institutions are supervised and regulated by state authorities. It should also be pointed out that the Federal Reserve is not an insuring agency and does not have authority to make direct equity investments in depository institutions. However, the Federal Reserve does have authority to lend through the discount window and, in its role as the nation's central bank, has a fundamental responsibility to foster the stability and orderly functioning of the nation's banking and financial system.

Nonmember depository institutions, including the state-chartered thrift institutions in Ohio, became generally eligible for discount window borrowing in 1980 as a result of the enactment in that year of the Monetary Control Act. Under this legislation, the discount window facilities of the Federal Reserve System were made available to all insured or uninsured depository institutions, throughout the nation, which offer transaction accounts or hold nonpersonal time accounts.

In its capacity as the central bank, the Federal Reserve may assist in efforts to deal with financial disturbances in order to prevent them from becoming generalized financial crises or causing systemic dislocations. An important policy tool to achieve these ends is the discount window through which the Federal Reserve serves as the ultimate source of liquidity.

Throughout this difficult period in Ohio, the Federal Reserve Bank of Cleveland has been prepared to lend and has loaned through the discount window to the affected thrift institutions under terms and conditions established by law for such borrowing. Indeed, on March 6, one day after the public disclosure of possible Home State losses, Federal Reserve examiners were dispatched to Cincinnati to meet with Home State officials, explain borrowing procedures, and begin to review potential collateral. In addition, the eligibility of state-chartered depository institutions, including thrifts, for discount window assistance was stressed in a public statement by the Federal Reserve Bank of Cleveland on March 10. Prior to the temporary ODGF closings, the Federal Reserve Bank of Cleveland provided discount window credit to certain affected institutions, and as the institutions have reopened, they have been eligible for liquidity assistance. The availability of this discount window assistance to reopened institutions was stated publicly by President Horn on March 15 and reiterated by Chairman Volcker on March 20, 1985.

In carrying out its responsibilities as lender of last resort, Federal Reserve System supervisory and examination personnel have worked closely with the affected institutions to inform them of collateral and documentation requirements and to assist them in understanding fully and meeting these requirements. Discount window loans to affected institutions have been made at the regular discount rate, currently 8 percent, and, as required by the Federal

Reserve Act, have been secured by adequate collateral. As is usually the case, this collateral has consisted of government and agency securities, commercial loans, one-to-four family residential mortgage loans, and other loans, and the collateral has been evaluated within normal guidelines. The Federal Reserve has, however, acted in a expeditious manner to facilitate the access of these institutions to the discount window under normal terms and conditions.

In addition to these lender of last resort responsibilities, the Federal Reserve has also played an important role in monitoring events in Ohio and in facilitating cooperative efforts among the various parties involved to resolve the situation, to reestablish public confidence and to promote the safety of depositors' funds. In this capacity, Federal Reserve officials have held or participated in numerous meetings with governmental and supervisory officials from the State of Ohio as well as with officials from the Federal Home Loan Bank Board (FHLBB), the Federal Home Loan Bank of Cincinnati, and other federal regulatory agencies. In order to enhance our understanding of the financial condition of the affected thrifts and to assist the State of Ohio and the FHLBB, the Federal Reserve, within a few days of the temporary closings, provided examiners to participate in on-site examinations and asset evaluations of the ODGF institutions. These examinations have helped to determine the availability of collateral for facilitating access to the discount window and, equally important, they have played a critical role in the process of reopening those institutions found to qualify for federal insurance. The information developed in our on-site visits and otherwise has been made available promptly to other federal and state authorities. We hope these actions have supported and complemented the steps taken by Governor Celeste, the Ohio legislature, and the federal insurance agencies to reopen the affected thrift institutions.

As the primary supervisor of bank holding companies and in response to a request by the State, the Federal Reserve has also been in contact with banking organizations, from both within and outside of Ohio, to determine their interest, if any, in acquiring or merging with ODGF institutions, including those which may be unable to qualify for federal insurance or to reopen without additional external support. The day after the temporary closings, Reserve Bank officials telephoned the senior managements of bank holding companies throughout the country to inform them of imminent State plans to hold meetings to discuss the possible sale or acquisitions of certain thrift institutions.

As the Subcommittee is aware, the State of Ohio has adopted a plan requiring federal insurance for essentially all savings and loans, building and loan associations, and all savings banks in the state. The State has also implemented arrangements to provide ODGF thrift institution depositors limited access to their funds. Further, the Ohio legislature acted promptly to advance $50 million in state funds to shore up the remaining ODGF institutions other than Home State. To facilitate the federal insurance requirement, expedited arrangements have been made for review of applications by the FHLBB, the FDIC, and the Federal Reserve. In this process, the Federal Reserve will continue to make field examination personnel available to the FHLBB and to Ohio authorities to assist in examinations and to expedite the process of qualifying for federal deposit insurance. We have been informed that as of March 29, 1985, the State of Ohio had authorized 26 institutions to reopen on a full service basis. Included in this number is a former thrift institution that has converted to commercial bank status and has reopened with FDIC insurance after our Board acted on a bank holding company application. Also included in this figure is a thrift institution acquired by a bank holding company in a transaction approved on an expedited basis by the Federal Reserve Board.

It may take some time for the thrift situation to return to normal in Ohio. A number of ODGF institutions have obtained federal deposit insurance. Others will, apparently, need an injection of capital from present owners or new investors, and still others may need to be acquired by stronger depository institutions. I assure you that the Federal Reserve will continue to provide assistance through the discount window, the provision of examination personnel to assist the FHLBB and State authorities, and the expeditious review and action on applications for mergers or acquisitions that require our approval.

While a longer range solution with respect to all of the affected thrifts remains to be worked out, the Ohio events underscore the importance of full cooperation among appropriate federal and state supervisory authorities in dealing with any strains or pressures involving depository institutions that could have adverse systemic implications for the banking or financial system. Such adverse developments must be met with timely and effective action to restore confidence and maintain the stability of the financial system. In the case of the thrifts in Ohio, I believe that, in general, the remedial procedures that have been taken should significantly reduce any lasting impacts on financial markets.

One of the questions raised by the recent events in Ohio relates to the role of private deposit insurance funds. Clearly, deposit insurance is an important factor in maintaining public confidence in depository institutions. Indeed, as I have noted, commercial banks that are members of the Federal Reserve System are FDIC-insured, and all commercial banks that are subsidiaries of bank holding companies are required by law to be federally insured. I believe that it is too early to make a definitive judgment about the role of sole insurer private insurance funds and even state sponsored funds in our financial system.

There may be industry structures which could be adequately supported by private arrangements as sole insurers, structures involving large numbers of small institutions, a substantial reserve fund not dependent upon deposits by the insured institutions, and featuring adequately strong examinations and auditing procedures. Such a structure might consist of a large number of smaller credit unions. Any such arrangements suffer from a certain degree of confusion as to whether and to what extent the resources of state government are behind the private sole insurers' reserves. However, industry structures consisting in part or in whole of sizable depository institutions, reserve funds dependent upon the deposits of its members, and with an examination and regulatory procedure in part justified to its membership as less rigorous than federal procedures, raise substantial questions as to whether the public interest is served thereby. The Board supports the movement of several state legislatures away from private insurance funds. Whatever approaches may ultimately prove feasible, the events in Ohio do serve to remind us of the potential consequences of the loss of public confidence in individual depository institutions and of the celerity with which that loss can spread to other institutions. In view of these concerns, the Federal Reserve System will continue to cooperate fully with the State and federal authorities seeking a long run solution to thrift institution liquidity problems in Ohio.