

CHALLENGES FOR PUBLIC POLICY
IN FINANCIAL SYSTEM

Remarks by

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at the

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Preparing for the Next Decade

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-- They are many

-- Several touched on yesterday and today

-- Among those which come to mind

- . Industry consolidation
- . Operation of securities markets
- . Deposit insurance reform or restructure
- . LDC debt
- . Unfriendly takeovers
- . 1992 European Economic Community integration
- . General issue: Deregulation vs. reregulation
- . Glass-Steagall revision
- . Debt: LBOs, takeovers, equity credit lines
- . States rights -- Ambach decision. Reg Y
- . Too-big-to-fail doctrine

Federal Reserve doctrine of source of strength

-- Can't take them all -- let's talk about a few.

. Operation of securities markets. October 19

-- Confidence vs. suspicion

-- Knee-jerk -- needs more regulation

to wit circuit breakers -- limits on

programmed trading -- margin requirements

-- Do any restore general confidence

-- Do we run danger of exporting our

capital markets because our operations

are too restrictive

. Deposit insurance reform -- too big to fail

-- Heard a lot about yesterday

-- Won't revisit whole issue but two aspects

touched on yesterday need comment from a

public policy point of view.

1. Rapid cancellation of insurance

. Reason would be examination result

. Result would be a run and bankruptcy.

Public policy questions

. What happens to depositor?

. What principle of insurance practice
is involved?

-- Burning house

-- No alternative supplier

Is this good administration of an insurance

program or a way of liability avoidance
which leaves innocent depositors
unprotected?

In order to punish a wayward institution are
we stranding the depositors we were
intended to protect?

Wouldn't better supervision with more timely
cease and desist orders and stronger
capital requirements be a better way to
go. Consistent with original intent
of funds?

Higher premiums for higher risk.

2. Second issue is much maligned "too-big-to
fail" doctrine. Philosophically any
institution has a right -- maybe a duty
to fail under certain circumstances.
-- But is that really valid regardless
of the consequences. Again we seem
to be intent on punishing
managements and shareholders -- but
what are consequences to others
innocent of any complicity and
perhaps several times removed.

Continental failure would have
impaired dozens of correspondents,
and seriously undermined confidence
in whole system.

Should we have taken that risk to satisfy our moralistic scruples?

Purpose of insurance to supply stabilizing element in times of stress.

. Unfriendly takeovers

-- Very few so far in banking

Most notable Bank of New York - Irving

-- Should safety net justify exemption or special treatment for banks?

-- What circumstances would justify intervention by regulators in free market function?

1. Safety net is basic rationale for regulation.

2. Regulation designed to assure safety and soundness -- therefore only effects which threaten safety and soundness can be basis for intervention.

A. Resulting combination doesn't satisfy established criteria for approval.

B. Fight is so costly to one or the other or both as to impair viability.

C. Diversion of management time, energy, and attention threatens current operations. Tricky.

-- Is banking so special and so central to the

economy that it should be quarantined from unfriendly takeovers?

. Glass-Steagall revision or repeal.

- Competitiveness of U.S. banks -- do they need broad security powers to be competitive in U.S. markets -- world markets?
- What are public benefits?
 - Lower cost services?
 - Better access to capital markets for small companies?
 - Lower interest costs for municipalities?
 - Greater convenience for investors
- What are possible drawbacks?
 - Greater risk to banking system - Boyd
 - Incompetence of bankers to manage
 - Access of investment bankers to banks and payments system
- Who will regulate?
 - Functional vs. unitary
- What organizational structure is best
 - Separate subsidiary of bank holding company
 - Separate bank subsidiary of investment firm
 - Does investment firm become a bank holding company
- What kind of capital requirements

-- Firewalls -- How thick -- do they defeat the
purpose -- do they include prohibitions on
cross selling

Regulation Y -- States Rights -- Ambach decision

-- Court - 4(c-5) - Controller

State approved subsidiaries of State chartered
banks in B.A.C.

-- Expedited consideration