



NEWS RELEASE

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FDIC CHIEF SAYS INSURANCE FUND IS SUFFICIENT TO HANDLE BANK FAILURES

Although its insurance fund could experience a decline of as much as 10 percent this year -- the first in its history -- the Federal Deposit Insurance Corporation will continue to have sufficient resources to perform its mission, FDIC Chairman L. William Seidman said today.

In a speech to the annual meeting of the Oregon Bankers Association, Mr. Seidman discounted claims that the FDIC faces unmanageable problems, including one suggestion that losses in Texas alone could deplete the insurance fund. "We expect to handle three more large Texas banks this year," he said, referring to First Republic, Texas American Bancshares and National Bancshares Corporation. "Once these transactions are consummated, the main financial cost should be behind us and the insurance fund should begin to grow again in 1989."

Chairman Seidman noted that the insurance fund was \$18.3 billion at the beginning of the year, despite a record number of bank failures and assistance transactions in 1987. He pointed out that the fund grew last year by \$50 million, even though the FDIC accounted for major assistance transactions involving BancTEXAS Group Inc. and First City Bancorporation of Texas.

Chairman Seidman said: "The main banking problems in the U.S. have been, and continue to be, concentrated in those sections of the country suffering severe economic problems. Almost 90 percent of the failed banks, as well as 80 percent of the banks with losses, last year were located west of the Mississippi. Roughly 85 percent of last year's bank failures were caused at least in part by troubles in the farm and energy economies."

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Chairman Seidman pointed out that, since the beginning of 1986, about 50 percent of the banking deposits in Alaska, Oklahoma and Texas have required, or are expected to require, financial support, either from the FDIC or through private sector mergers. "Widespread weaknesses in these states will continue to be a significant burden for the FDIC, at least for the short run," Mr. Seidman said, "but the FDIC fund is sufficient to deal with the problems we can foresee at this time."

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Remarks by

L. William Seidman
Chairman
Federal Deposit Insurance Corporation

Before

Oregon Bankers Association Annual Meeting

June 24, 1988

CHAIRMAN L. WILLIAM SEIDMAN

OREGON BANKERS ASSOCIATION ANNUAL MEETING

June 24, 1988

It's a pleasure to speak today with members of the Oregon Bankers Association.

Throughout your history, from Chief Joseph to Mary Decker Slaney, Oregon has been known for both fighters and leaders. The remarkable improvements in Oregon's economy testifies to those attributes.

At the start of this decade, your state's economy was taking it on the chin, largely because of the nationwide falloff in the housing market and increased imports of foreign timber. That reduced demand for Oregon forest products at a time when your mining, agriculture, and fishing industries were also suffering.

This meant tough times for Oregon's banks.

I'm glad to be able to say that recovery is now underway.-- The Return on Assets for all Oregon banks last year was slightly higher than the average ROA for all U.S. banks, even when the extraordinary reserving for LDC that took place last year is factored out of the comparison. (.70 / .72) Oregon's banks also

did better than the average banks in the West. Your smaller banks have shown especially encouraging improvement.

-- The percentage of Oregon banks reporting earnings losses has dropped by a third since 1984 (31.9/22.2), although 1986 was even better than 1987.

-- Nonperforming assets at Oregon banks have dropped by nearly half since 1984 (4.02/2.30), at a time when your Western neighbors problems are still getting worse (4.02/4.45). And your capital ratios are also getting better.

-- Bank failures have dropped to one a year from a rate of 5 per year in 1983 and 1984. That's the kind of news that makes the banker's insurance company feel warm all over!

Improvements in Oregon's economy have certainly helped your banking industry. Your economy is showing its best performance of the decade. Improvements have been noted in the agricultural and natural resource sectors. Exports to Pacific Rim countries and tourism are also up.

There were more than 200,000 people employed in manufacturing jobs in Oregon in March of this year, the greatest number since 1980. Construction, trade, and retail store employment also showed gains.

Today it is expected that Oregon's economy, and the personal income of its residents, will both grow faster than the U.S. average in 1988. In fact, your personal income for the last three months of 1987 grew at a rate of 8.4 percent!

Your state association is also to be congratulated for the gains made for banking in the Oregon legislature last year.

Oregon law now authorizes wider insurance and real estate powers for state chartered banks. Expanded bank powers will help Oregon banks better compete with other financial intermediaries, as well as provide a new level of service and convenience to bank customers.

Oregon also has a depositor preference statute, which makes the FDIC's job easier.

I would like to take this opportunity today to tell you why I think our deposit insurance system is at a watershed period in its 55 year history.

Deposit insurance was created as a reaction to severe problems the banking industry faced during the Depression. That beginning was not without controversy. Small depositors and small banks supported the plan, while larger institutions stood against anything that would help put smaller institutions on more equal footing. The role and form of deposit insurance as conceived in the 1930's has changed dramatically as the structure of the banking system has evolved. New competition, deregulation, disintermediation, new technologies, and geographic expansion combine to make the banking business a different, and unfortunately, more risky business.

Let's look at a few of the significant changes in the operation of the deposit insurance system -- significant difference from the original concept are apparent.

First, small banks complain about the insurance system. They contend that the deposit insurance safety net -- "the too big to fail doctrine" -- gives unfair advantages to large institutions by not allowing the largest institutions to fail.

Protection of depositors and creditors in failing large banks has distorted the system. However, no major industrial nation allows its banks to fail because the financial fallout is so hard to predict. The international competitive ramifications alone make it unlikely this policy will be changed.

So now an insurance system designed to help small banks compete with big banks now operates to favor big banks over small banks.

Alas, Ceasar lamented, "All bad precedents began as justifiable measures."

Second, the Federal Reserve Board, traditionally considered the lender of last resort, has become the next to last resort. The deposit insurance system has become the last resort for protecting the failing banks, and thus the stability of the system. When First Republic went to the Fed window last winter, withdrawals increased. Depositors and creditors were aware of the Fed's policy of taking collateral for its liquidity lending. When FDIC gave an unlimited guarantee to depositors and creditors, and a loan of \$1 billion, the run was stopped. So the FDIC has become the back up source for banks that need to

be protected even though they are insolvent. This is a role not even dreamed about by the creators of the Fund.

Third, the status of the holding company in the banking system itself has been drawn into question by recent FDIC policy.

When "to big to allow depositors or creditors to suffer" is applied, it is applicable to banks, but not to holding companies. This spring the FDIC guaranteed that all depositors and other general creditors of First Republic's banks will be fully protected, but these guarantees were NOT extend to the holding company creditors or shareholders. This FDIC policy is critical when considering what new activities holding companies should be permitted, as well as such issues as whether it is appropriate to apply the proposed risk-based capital standards to holding companies.

Again, this is a role in the banking system not originally envisioned as part of the deposit insurance system.

And finally, our experience, especially in the Southwest, has taught us that deposit insurance is a powerful tool, which if misused, has the potential to severely damage the financial

system. A concept that was argued by some at the creation of the deposit insurance system, but which was rejected by the Congress in enacting the system.

Deposit insurance effectively gives banks and thrifts the ability to borrow on the credit of the federal government. It must be properly safeguarded or it can threaten the system. Deposit insurance is like a nuclear power plant, it is dangerous that it exists at all. Only appropriate safety precautions can keep it from going out of control. Out of control, it can blow up, with great damage to the entire country.

One has only to look at the problems of the savings and loan industry to see the financial results of deposit insurance misused. And, lest we become satisfied with our bank supervision as the answer, look at the losses the FDIC is incurring in Texas despite supervision by federal and state bank regulators. In Texas all but one of the major banks has had to be rescued -- either by the FDIC or private resources.

We are dealing with our Chernoble right now in the Southwest, and its time to reflect on what we should do about it.

Thus, we are undertaking a complete review of deposit insurance and its role and operation in the current banking environment. Our study on this subject, "A Deposit Insurance System for the 90s", has been underway for several months. It will be completed before year-end.

In order to get the right answers in a study of this sort, you must first ask the right questions. I want to raise some of these issues with you now.

And I want to ask you to help us provide some answers for policy makers of our country.

Today's banking environment requires a new look at deposit insurance in a world of deregulation in rates and territories, of expanded international financial markets, and of evolving computer based technologies. Ten years ago none of these factors loomed large -- now they are overpowering.

And think for a minute on the effect on banking -- no less Congressional mail offices -- if we withdrew the entire deposit insurance or reduced it to \$2500, as it originally began.

Here are some of the fundamental questions to be answered in constructing a better deposit insurance system.

-- Can Supervisory mechanisms control risk? This is key to the future of the system. If supervision doesn't work, the ability to borrow on credit of the U.S. can destroy. As we enter an environment providing banks with greater powers, how will supervision need to adapt to keep the system safe and sound? Are our present supervisory resources, such as examination procedures, off-site monitoring systems, and supervisory sanctions adequate?

And, once problem banks have been identified, are our present regulatory powers sufficient to deal with institutions that pose a high risk to the insurance fund? How can we avoid the cost of another Southwest debacle.

-- How can the market be used to control risk in today's environment? Is depositor discipline really alive and well despite insurance and big bank protection? Can we increase market supervisions and thus promote safety by statutory and de facto deposit insurance coverage ceilings, changes in coverage to include only short-term deposits, or the introduction of

private coinsurance. Should we control rates paid on insurance deposits, or provide insurance only for individuals and not corporations?

-- How far should the "safety net" extend? The FDIC's treatment of certain large Texas banks demonstrates our present position that we will not extend the "safety net" to holding companies.

So, the world is certainly not standing still as our study progresses -- and in fact, the changes taking place out there underline the need for this type of review.

-- How can we improve the way we handle failing banks? Should large bank depositors be protected, and if so, by whom. How can we handle failed banks so as to treat large and small banks more equitably?

-- Should the FDIC operate more in the manner of a Reconstruction Finance Corporation ("RFC") of the 1930s? An RFC approach would involve loaning capital to banks that are still solvent but clearly in trouble. This approach might save us losses by preventing failures, but on the other hand this means greater government intrusion into the market place. And

the government probably would have told Texas bankers in the early 1980's to diversify into oil, cattle and real estate!

-- Do we price deposit insurance appropriately? Would a system of risk-related premiums do a better job than our current system of explicit and implicit pricing? Can we find a formula that will be mechanical, accurate, and defensible?

Of course no look at deposit insurance would be "for real" without addressing the question, should there be a merger of the FDIC and FSLIC funds?

The difficulties of the thrift industry and the FSLIC are having negative ramifications on the banking industry. These problems are creating a higher cost of funds, forcing banks to compete in an unfair environment against insolvent institutions, and undermining sound credit analysis. Therefore, the resolution of the FSLIC's problems is important to the banking system and the entire financial system.

As we have said many times, we do not favor a merger under current conditions.

But to be fair, we need to be ready to deal with the many suggestions that a merger is needed to save the system. If such a merger is to take place, how might it be structured?

We have suggested that an administrative merger might be cost effective, but a financial merger is not possible under present conditions.

If we have one regulator of banks and thrifts, it would be a real challenge to keep supervision fair and even handed.

The future of our deposit insurance system -- both the FDIC and the FSLIC -- depends on how we deal with these issues. We need an improved system if deposit insurance is to be viable in the 90's. This is a problem likely to be high on the agenda of our next President. The new president -- Mr. D or Mr. B -- may want to act on this problem early in his honeymoon period, following the good advice, "Get the tough ones behind you in the first 100 days." We hope our study suggesting improvement in the federal deposit insurance system will be helpful.

And we ask for your suggestions and help, as we keep in mind the advice of a great Oregonian, Dr. Linus Pauling, who said: "Take

time to study and deliberate, but when the time for action arrives, stop thinking and go!"

Thank you, and I would be pleased to respond to any questions.