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STATEMENT ON

"BLUEPRINT FOR REFORM," THE REPORT OF THE TASK GROUP ON REGULATION OF FINANCIAL SERVICES

PRESENTED TO the

SUBCOMMITTEE ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS, House
COMMITTEE ON GOVERNMENT OPERATIONS,
HOUSE OF REPRESENTATIVES

BY

WILLIAM M. ISAAC, CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

10:00 a.m.
Tuesday, March 26, 1985
Room 2154, Rayburn House Office Building

Mr. Chairman, members of the subcommittee, we appreciate this opportunity to present the FDIC's views on the recommendations of the Vice President's Task Group on Regulation of Financial Services. I commend you for scheduling hearings on this important subject.

The 13 members of the Task Group and their staffs spent many long hours forging the consensus report titled Blueprint for Reform. It is not perfect, and it is not a product that any individual member of the Task Group, acting alone, would have put forward. But it represents a significant improvement over the status quo and it has received the unanimous endorsement of all 13 members of the Task Group, in itself a significant achievement. It could not have been accomplished without the patience and leadership of Vice President Bush and his staff director, Richard Breeden.

The financial services sector in the United States and many other nations is in a period of dramatic change. Technological innovations, the development of new financial products and the elimination of outmoded regulations, such as deposit interest rate controls, are resulting in intensified competition among financial institutions. During the past decade the economic environment has been inhospitable, characterized by accelerating inflation, high and volatile interest rates, two back-to-back recessions and deflation in certain sectors such as energy and agriculture.

Our financial system is one of the most decentralized in the world. There are approximately 15,000 commercial banks and another 25,000 savings associations and credit unions operating throughout the country. In addition there are thousands of firms competing in financial fields such as insurance, securities, real estate, leasing, mortgage banking, credit card operations, and consumer and commercial finance.

The regulatory apparatus governing these various intermediaries has evolved more or less haphazardly over the past two centuries in response to various crises. The firms in some financial fields are virtually unregulated, others are regulated almost exclusively by the states, and others -- particularly banks and thrifts -- by a combination of the states and the federal government.

No rational person would have set out to design the current system of regulation. It is inefficient and inequitable, sometimes completely ineffective, and badly out of step with the times. There has never been a complete review or revamping of the system and there have been no major reforms for 50 years.

The Blueprint for Reform addresses many of the most serious flaws in the system and for that reason we endorse it. Its basic premise is that the regulation of financial services should be organized along functional lines -- for example, it recommends that all firms engaged in the securities business be regulated in the same fashion. The Blueprint calls for the unification of bank and bank holding company supervision and for greater consistency between bank and thrift regulation. It preserves the dual or state/federal banking system. Finally, and most importantly from our perspective, it more sharply defines the role of the Federal Deposit Insurance Corporation and gives us the tools we need to better perform our increasingly critical tasks.

One of my first actions upon being named Chairman of the FDIC in 1981, after three years' service on the board of directors, was to initiate, in conjunction with our senior management, a top-to-bottom review of our operations. We did a lot of soul-searching. We defined our mission and evaluated every activity. If an activity was judged to be critical to carrying out our mission, we resolved to strengthen our performance. If an activity was determined to be unnecessary or of only marginal importance, it was de-emphasized or discontinued to the extent permitted by law.

The fundamental purpose of the FDIC is to maintain a strong and stable free-enterprise banking system. We carry out that mission by insuring deposits and by regulating and supervising banks to the extent necessary -- and only to the extent necessary -- to control systemic risks. Our job is not to prevent all bank failures, it is to ensure that they are isolated or individual events and that they are handled in an orderly way to limit the FDIC's losses and minimize the potential for contagion throughout the system.

We cannot control systemic risks through supervision alone, though that is a critical ingredient which must be strengthened. We must foster a healthy, profitable business environment and we must subject banks and thrifts, to the extent feasible, to the discipline of the marketplace. Sound, successful institutions should be given maximum freedom to grow and prosper while the high-risk, marginal operators should be exposed to swift and certain penalties from both the regulators and the marketplace.

We have already moved far along this path. Our examinations are being focused on troubled and larger institutions, irrespective of charter, and we are de-emphasizing routine exams of smaller, nontroubled firms. Particularly noteworthy are the cooperative exam programs we have implemented with the Comptroller of the Currency and the Federal Home Loan Bank Board covering national banks and federal savings banks.

We have been working with the Federal Reserve to develop a similar program for state member banks, and it is our hope we will soon be able to come to an agreement. We are making major efforts to upgrade the quality and training of our personnel. Our offsite monitoring and analysis programs are being enhanced. Enforcement actions against problem banks and their managements and boards have increased manyfold over the past few years. We have initiated a program to write each director of a troubled bank putting him or her on notice of the bank's condition and the board's responsibility for ensuring that the problems are corrected. We have taken a number of steps to improve public disclosure of the condition and practices of banks and thrifts under our jurisdiction. We are struggling to control the massive abuses of the deposit insurance system by money brokers. Capital requirements for banks and thrifts under our supervision have been increased and even higher standards are in the offing. We have been at the forefront in encouraging greater freedom for sound banks and thrifts to offer the full array of financial products to American consumers and businesses. We have streamlined our applications procedures to eliminate most of the paperwork and greatly expedite processing times. Finally, we have proposed legislation to reform and strengthen the deposit insurance system.

We are enthusiastic about the Blueprint for Reform as it relates to the FDIC and our strategic plans. It contains a number of proposals especially important to us:

- It clearly recognizes the FDIC's right and responsibility to examine any troubled FDIC-insured bank or thrift, irrespective of charter, and to sample nontroubled institutions, including affiliates. To the extent feasible, these exams would be coordinated with the primary supervisor.

- It would grant the FDIC the authority to take the full range of enforcement actions against any problem bank or thrift we insure.

- It would grant the FDIC authority, based on managerial or financial factors, to veto deposit insurance applications by new national or state member banks.

- It recommends granting to the FDIC the authority to implement risk-related deposit insurance premiums.

- It would relieve the FDIC of the burden of handling securities regulation, antitrust enforcement and routine branch applications by state nonmember banks.

- It would strengthen the FDIC's board by substituting a full-time, Presidentially-appointed voting member for the Comptroller of the Currency and adding a nonvoting representative from both the Federal Reserve and the proposed Federal Banking Agency.

- It would direct the FDIC and the FSLIC to phase in common capital and accounting standards for banks and thrifts.

- It recognizes and preserves the FDIC's right to require reports on the condition and activities of any insured institution and its affiliates.

Mr. Chairman in your letter of invitation you specifically requested that I note any areas where I might take issue with the Blueprint. There are some. The Blueprint is a compromise product, which balances a lot of competing political interests and policy considerations, and almost by definition that means no one will be entirely satisfied with the result.

If the FDIC had been solely responsible for drafting the Blueprint, we would have curtailed to a much greater degree the Federal Reserve's involvement in day-to-day supervision and regulation. We believe the current and even the proposed level of involvement is unnecessary, inefficient and unwise. We are particularly concerned about the role the Blueprint proposes for the Federal Reserve in the certification of state banking departments and in the determination of permissible activities for bank holding companies.

It is no secret that we also favored other major reforms. We would have recommended that the FDIC and the FSLIC be merged. Moreover, in our opinion the Federal Banking Agency should have been made independent from Treasury and been governed by a board.

Having said all that, I hasten to reiterate that I voted for and accepted the entire product. Despite the flaws that we perceive in it, we are enthusiastic about the Blueprint's recommendations for the FDIC and believe that in total it represents a significant improvement over the status quo.

I thank you once again for this opportunity to testify on behalf of the Blueprint. I will be more than pleased to respond to any questions.

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