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DEC 5 1984

HOLD FOR RELEASE UNTIL:
12:30 p.m. (EST) December 4, 1984 PR-146-84 (12-3-84)

FEDERAL DEPOSIT INSURANCE CORPORATION

FINANCIAL SERVICES: WHERE WE'VE BEEN
AND WHERE WE'RE GOING

an address by

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before the

National Council of Savings Institutions'
1984 National Council Management Conference

San Diego, California
December 4, 1984

It is a pleasure to once again address a meeting of the National Council of Savings Institutions. With your indulgence, I would like to spend a few minutes reminiscing about the past before turning to some of the major issues confronting us today.

We have been through a great deal, together, during the years that I have been at the helm of the FDIC. This period has been marked by persistently high and volatile interest rates which have played havoc with an industry built on the assumption that rates would remain low and stable.

At the beginning of my term we were faced with a crisis of serious proportions. High interest rates were threatening a host of savings banks, many of them sizeable. It was not known how high rates would go or for how long. Many people in the media and even in the savings bank industry wondered aloud whether the FDIC would have sufficient resources to cope with the probable failures.

We were swimming in uncharted waters; neither the FDIC nor the industry had ever faced a comparable situation, even during the Great Depression. There was considerable anxiety, which I shared, about possible depositor reaction. We were confident we could handle the failures if the public would remain calm, but that was a big "if" and not one on which we could count.

The first savings bank failure was indeed ominous. We were working on a merger of the $2.5 billion Greenwich Savings Bank in October 1981 when word of our efforts leaked to the press. That sparked a substantial deposit run, replete with depositor lines and T.V. coverage.

We responded with a public statement acknowledging the bank's problems, confirming we were working on a merger and pledging that no depositor would suffer any loss or inconvenience. We accelerated our time schedule and consummated a merger on November 4 at an estimated cost to the FDIC of $450 million.

Two more FDIC-assisted mergers of savings banks were put together in 1981 and six more in the first four months of 1982, including the $4.5 billion New York Bank for Savings. Altogether, the FDIC has assisted 15 savings bank mergers, with assets totaling $18 billion, at an estimated cost to the FDIC of $1.5 billion. Barring another rise in rates, the worst seems to be behind us, though significant problems remain.

While there was considerable tension and controversy at the time of these mergers, I believe the system worked exceptionally well. The savings bank industry was strengthened

through the acquisition of failing savings banks by much stronger institutions with substantial cash assistance from the FDIC. Depositor confidence was restored and even enhanced. Despite the record FDIC expenditures and the dire predictions of some, the insurance fund grew much stronger. Importantly, all this was accomplished without the expenditure of one penny of taxpayer money and without resorting to "regulatory accounting" or other gimmickry that would have plagued the industry for years.

The second major issue we faced together during that period was deposit interest rate deregulation. Market interest rates were so far above the controlled rates on passbook and other consumer accounts that the industry was hemorrhaging. To stem the tide and compete against the money market funds, which grew from $50 billion to more than $230 billion in just three years, thrifts and commercial banks skirted outmoded regulations by devising "loophole certificates," "retail repos" and other ingenious new products.

There were many in the industry, Congress and elsewhere who wanted to try to turn back the clock. They argued for additional protective regulation.

Fortunately, in my opinion, more enlightened policies prevailed. The Depository Institutions Deregulation Committee, after some false starts, deregulated virtually all consumer deposit accounts more than two years ahead of schedule.

There were two big winners: the American public, which reaped tens of billions of dollars in additional interest from accounts at banks and thrifts, and the industry itself, which stopped the erosion of market share dead in its tracks. The money market mutual funds actually declined in size from $230 billion to less than $180 billion during the year following introduction of the money market deposit account, while deposits at banks and thrifts grew by over 12 percent.

On any significant public issue, there are always the doomsayers and the doers. There are the voices longing for days gone by and the proponents of change. There are some whose primary focus is on narrow self-interests and others who give greater weight to promoting the public good. There are those who advocate expedient, short-term solutions and those who would build for the future. Both sides have made their presence felt in the financial-services industry in the past and both are being heard from today.

Nowhere is this more evident than in the current debate over continued deregulation of the financial-services industry. Liability-side deregulation is an accomplished fact. It will not and cannot be reversed.

The question now is whether and how we are going to complete the half-finished task. Will we give banks and thrifts the opportunity to offer a broader array of financial services to help offset the enormous cost of deposit deregulation? Will we allow the American public to gain access to more convenient services at more competitive prices?

As I listen to the debate, I sometimes get a tremendous sense of deja vu: "Banks and thrifts don't have the management to handle greater freedom and will not be responsible and intelligent enough to compete sensibly." Sound familiar? It ought to. The argument was previously used by the opponents of deposit deregulation.

Then there is the "heads I win, tails you lose" approach. It goes like this: "Banks and thrifts don't have any expertise in the area, they have nothing special to offer, and they'll have an unfair competitive advantage."

If these two arguments are not taken seriously enough by the listener, the heavy artillery is rolled out: "If banks and thrifts are permitted to [check one or more of the following: sell securities, offer insurance, pay market rates for deposits; or, add your own], another economic depression will surely follow."

As the head of the agency that is always called upon to pick up the pieces whenever things go awry in the system, I want to make one thing clear: given deposit deregulation and the dramatic upsurge in competition from unregulated financial conglomerates, the absence of asset-side deregulation is a threat to the banking system. It is as simple as that.

There are many steps we can and should take along the path toward deregulation to protect against unsafe or abusive practices and to assure competitive equity. First, we must reform the deposit insurance system to help instill more private-sector discipline and equalize the handling of large and small bank failures. Last year the FDIC submitted to Congress a study entitled "Deposit Insurance in a Changing Environment" and a few months later submitted a bill containing a number of important reform measures. We are currently working with the Administration's Cabinet Council on Economic Affairs to see if we can formulate a joint reform proposal.

I have long been convinced that it would be foolhardy to proceed with deregulation of banks and thrifts without at the same time considering fundamental reforms to the deposit insurance system. I am heartened by the support we have received on this score from the American Bankers Association and by Chairman Garn's recent statements that he will include deposit insurance reform in next year's deregulation package.

Second, to maintain a level playing field between insured depository institutions and their uninsured competitors, to permit functional regulation and to establish safeguards against undue exposure to insured banks, at least some of the proposed new activities should be required to be placed outside the bank in a bona fide, separately capitalized and funded subsidiary. In this vein, the FDIC recently adopted a regulation requiring securities underwriting activities to be placed in a bona fide subsidiary and last week issued for public comment a similar set of rules for insurance underwriting and real estate development activities.

Third, the quality of bank supervision must be enhanced. A deregulated environment will be more challenging for both the industry and bank and thrift supervisors. While there will be more potential for banks and thrifts to be successful and profitable, there will also be more opportunity for mistakes. Examiners must be given more extensive training, offsite surveillance systems need to be upgraded and enforcement activities with respect to poor management should become even more vigorous. Noteworthy progress is already being made in each area, but we recognize the need to do more. Moreover, serious consideration should be given to substantial agency realignment at the earliest possible date. At a minimum, the recommendations of the Bush Task Group would seem appropriate.

Fourth, to guard against misuses or concentrations of economic power, our antitrust laws, as they relate to banking, should be overhauled. The current laws are fairly effective, though perhaps overly stringent, in dealing with mergers of firms engaged in direct competition in the same market. But they are almost completely ineffective in dealing with market extension mergers by larger organizations. Some consideration might also be given to strengthening the anti-tying provisions in the antitrust laws, though a less segmented, more competitive financial-services environment would be an even more effective deterrent against tying practices.

Finally, in a more competitive, less controlled environment, capitalization of banks and thrifts must be strengthened. The agencies are already moving in this direction. The FDIC first issued formal capital guidelines in 1981 and recently published for comment new, higher standards. I suspect even this latest proposal will be augmented in the future. At the same time, I should note that we are keenly aware of the transition problem many thrifts face and are searching for an appropriate means to permit them to phase into compliance.

In sum, I believe there are three possible alternatives for dealing with deregulation in the financial-services field. Congress might choose to forego asset-side deregulation. In my judgment, that would constitute a serious blow to consumers and small businesses throughout the nation and a threat

to the continued vitality of the banking and thrift industry. The second possibility would be to proceed with asset-side deregulation without addressing deposit insurance reform and the other measures I have suggested today. Frankly, I am not sure whether that would be better or worse than the first scenario. The third and clearly preferable alternative, in my judgment, would be to move forward concurrently with both asset-side deregulation and at least most of the other reforms.

As I close, I want to thank you once again for the support you have given over the years. We have been forced to deal with a number of very controversial subjects, and I know that at times some of you have disagreed with our policies. But in the end the support has been there, and we appreciate it.

Thank you.

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