

Spck

11  
0

W. M. Isaac

ISSUES IN BANKING AND BANK REGULATION

FOR INTERNAL USE ONLY

Money Marketeers, N.Y. University

NEW YORK, NEW YORK  
FEBRUARY 9, 1982

I'M PLEASED TO BE HERE/TO SHARE SOME THOUGHTS/ON A FEW OF THE ISSUES/FACING OUR BANKING SYSTEM. SURELY,/THIS IS ONE OF THE MOST EXCITING/AND CHALLENGING TIMES /TO BE INVOLVED IN THE FINANCIAL SERVICES FIELD. THE CHANGES THAT ARE OCCURRING/ARE FUNDAMENTAL/AND HAVE FAR-REACHING IMPLICATIONS. TODAY I'D LIKE TO REVIEW THOSE CHANGES BRIEFLY/AND THEN CONSIDER SOME OF THE REGULATORY RESPONSES/THAT MIGHT BE NECESSARY. AMONG THE TOPICS I'LL TOUCH ON/ARE: CHANGES THAT MUST COME/IN THE WAY WE SUPERVISE FINANCIAL INSTITUTIONS;/REORGANIZATION OF THE FEDERAL FINANCIAL INSTITUTIONS REGULATORY AGENCIES;/AND REFORM OF OUR DEPOSIT INSURANCE SYSTEM. STORY

## I. THE CHANGING FINANCIAL ENVIRONMENT

A BANKER/WITH MORE THAN THREE DECADES IN THE FIELD/RECENTLY PREDICTED TO ME/THAT THE CHANGES THAT HAVE OCCURRED IN BANKING/OVER THE LAST 50 YEARS/WILL PALE BY COMPARISON/TO THOSE THAT WILL COME IN THE NEXT 10. I HAVE NO DOUBT/THAT HIS PREDICTION WILL PROVE TO BE CORRECT. WE ARE CURRENTLY WITNESSING/A VIRTUAL REVOLUTION/IN THE PROVISION OF FINANCIAL SERVICES/IN OUR COUNTRY. TRADITIONAL DISTINCTIONS AMONG FINANCIAL INTERMEDIARIES/ARE BECOMING SO BLURRED/AS TO CALL INTO QUESTION THEIR SIGNIFICANCE.

AN IMPORTANT IMPETUS FOR CHANGE,/OF COURSE,/HAS BEEN PROVIDED BY RECENT UNSTABLE ECONOMIC CONDITIONS. HIGH AND VOLATILE INTEREST RATES,/A BYPRODUCT OF THE INFLATION/OUR ECONOMY CAN'T SEEM TO SHAKE,/HAVE NECESSITATED CHANGES/IN THE WAY FINANCIAL AFFAIRS ARE HANDLED. UNPREDICTABLE RATES/

DISRUPT TRADITIONAL INVESTMENT AND SAVINGS PATTERNS, WHILE INFLATION DEPRECIATES THE VALUE OF FINANCIAL ASSETS. AS A CONSEQUENCE OF THE ECONOMIC ENVIRONMENT, SOME OF THE TRADITIONAL MODES OF DOING BUSINESS NO LONGER WORK. THRIFTS HAVE BEEN HIT PARTICULARLY HARD.

TECHNOLOGICAL DEVELOPMENTS HAVE PROVIDED ANOTHER MAJOR IMPETUS FOR CHANGE. FINANCIAL MARKETS HAVE BEEN ALTERED DRASTICALLY BY TECHNOLOGIES THAT FACILITATE ALMOST INSTANTANEOUS TRANSFERS OF FUNDS ANYWHERE WITHIN THE DEVELOPED NATIONS OF THE WORLD. IT IS NO LONGER POSSIBLE TO INSULATE U.S. BANKS AND THRIFTS FROM INTENSE COMPETITIVE PRESSURES GENERATED BY A WIDE ARRAY OF FOREIGN AND DOMESTIC FINANCIAL INTERMEDIARIES. THE GEOGRAPHIC BARRIERS THAT ONCE REPRESENTED FORMIDABLE OBSTACLES TO DISTANT COMPETITORS HAVE BEEN RENDERED OBSOLETE BY ADVANCES IN TRANSPORTATION AND COMMUNICATIONS AND THE ADVENT OF COMPUTERS. VEHICLES SUCH AS EDGE CORPORATIONS AND LOAN PRODUCTION OFFICES ALLOW FIRMS TO CONDUCT ALMOST THE ENTIRE RANGE OF BANKING BUSINESS WITHOUT REGARD TO TRADITIONAL GEOGRAPHIC LIMITATIONS.

## II. REGULATORY RESPONSES

DESPITE THE TREMENDOUS CHANGES THAT ARE GOING ON IN FINANCIAL MARKETS, WE ARE STILL OPERATING IN A REGULATORY FRAMEWORK THAT IS ESSENTIALLY 50 YEARS OLD-- ONE THAT WAS FASHIONED TO MEET CIRCUMSTANCES VASTLY DIFFERENT FROM THOSE IN WHICH WE FIND OURSELVES NOW. ALTHOUGH MANY BENEFITS HAVE ACCRUED FROM THE REGULATORY SAFETY NET ESTABLISHED IN THE 1930s, TIMES HAVE CHANGED. IT SEEMS CLEAR THAT IF OUR

FINANCIAL REGULATORY SYSTEM IS TO FUNCTION EFFICIENTLY, IT MUST BE UPDATED. DURING THE LAST SESSION OF CONGRESS, LEGISLATORS BEGAN TO ADDRESS SOME OF THE SIGNIFICANT ISSUES IN THE FINANCIAL ARENA. THERE ARE, HOWEVER, EVEN LARGER QUESTIONS THAT I HOPE WILL SOON BE CONSIDERED.

SOME PRESENT LAWS GOVERNING FINANCIAL INTERMEDIARIES CONTAIN PROVISIONS THAT RESULT IN UNCONSCIONABLE INEQUITIES. HOW, FOR EXAMPLE, CAN WE JUSTIFY A DEFINITION OF "BANK" IN THE BANK HOLDING COMPANY ACT THAT PERMITS A CONGLOMERATE LIKE GULF AND WESTERN TO BUY A FEDERALLY-INSURED BANK SIMPLY BECAUSE IT DIVESTS THE BANK OF ITS COMMERCIAL LOANS? HOW CAN WE PERMIT THE NATION'S LARGEST RETAILER, SEARS, TO OWN A FEDERALLY-INSURED SAVINGS AND LOAN ASSOCIATION, A MAJOR REAL ESTATE FIRM, AND AN INVESTMENT HOUSE, WHILE PROHIBITING BANKS FROM ENTERING THESE FIELDS? WHY SHOULD AMERICAN EXPRESS BE ALLOWED TO ACQUIRE A SECURITIES FIRM WHICH IN TURN OWNS A FEDERALLY-INSURED, NONMEMBER BANK WHILE SUCH ACTIVITIES ARE FORECLOSED TO MEMBER BANKS? HOW CAN WE PROPOSE SUBSTANTIAL LIBERALIZATION OF THE POWERS OF SAVINGS AND LOAN ASSOCIATIONS, WHILE PERMITTING THEIR OWNERSHIP BY STEEL COMPANIES AND OTHER COMMERCIAL ENTERPRISES, AND STILL MAINTAIN THAT BANKING AND COMMERCE SHOULD BE SEPARATED?

I DO NOT AUTOMATICALLY ASSUME THAT THE WAY TO RESOLVE THESE INEQUITIES IS TO DISMANTLE ALL THE BARRIERS THAT SEPARATE FINANCIAL INTERMEDIARIES FROM EACH OTHER AND FROM COMMERCIAL ENTERPRISES. COMPARED TO MOST OTHER NATIONS, OUR COUNTRY HAS A RELATIVELY DIVERSE ECONOMY AND FINANCIAL

SYSTEM, /FREE OF EXCESSIVE CONCENTRATIONS OF FINANCIAL POWER/  
AND THE ABUSES AND CONFLICTS OF INTEREST /THAT CAN ACCOMPANY  
SUCH CONCENTRATIONS.

WHILE SOME OF THE BARRIERS WE HAVE CONSTRUCTED /MAY HAVE  
OUTLIVED THEIR USEFULNESS, /SOME OF THEM MAY REMAIN VALID.  
I FIRMLY BELIEVE, /FOR EXAMPLE, /THAT WE SHOULD NOT PERMIT  
COMMERCIAL ENTERPRISES /TO ENTER THE BANKING BUSINESS /--  
HOWEVER THAT TERM IS DEFINED -- /OR VICE VERSA. I'M NOT  
CONVINCED THAT MAJOR INSURANCE COMPANIES /SHOULD OWN BANKS /OR  
BE OWNED BY BANKS. NOR AM I CONVINCED THAT BANKS /AND IN-  
VESTMENT BANKING FIRMS /SHOULD BE AFFILIATED, /ALTHOUGH  
PERSUASIVE ARGUMENTS CAN BE MADE /THAT THE CURRENT PROHIBITIONS /  
ARE TOO SWEEPING. I BELIEVE THE CONGRESS /MUST COME TO GRIPS  
WITH THESE FUNDAMENTAL QUESTIONS, /SHORING UP THE BARRIERS  
WHERE APPROPRIATE /AND DISMANTLING THEM /WHERE THEY ARE NO  
LONGER NEEDED.

IN RECENT TESTIMONY BEFORE THE SENATE BANKING COM-  
MITTEE, /WE ~~HAVE~~ URGED THE CONGRESS TO UNDERTAKE /A COMPRE-  
HENSIVE REVIEW OF OUR REGULATORY AGENCIES /AND OUR DEPOSIT  
INSURANCE SYSTEM. WHILE THE PRESENT STRUCTURE /HAS LEGIT-  
IMATE HISTORICAL UNDERPINNINGS, /IT'S BECOMING INCREASINGLY  
CLEAR /THAT SUBSTANTIAL REFORMS ARE NECESSARY /IF WE ARE TO  
KEEP PACE /WITH THE DRAMATIC CHANGES OCCURRING /IN THE WORLD-  
WIDE MARKETPLACE FOR FINANCIAL SERVICES.

A. CHANGES IN SUPERVISION

THE FEDERAL BANK REGULATORY SYSTEM/IS, TO A LARGE DEGREE,/A PRODUCT OF THE DEPRESSION. ITS GOALS/WERE TO PREVENT THE PERCEIVED ABUSES OF THE 1920s/ AND TO PROVIDE A REGULATORY STRUCTURE/ THAT WOULD FOSTER THE EXISTENCE OF SOUND DEPOSITORY INSTITUTIONS,/ AVOID FAILURES,/ AND, IN THE FINAL ANALYSIS,/ INSURE MOST DEPOSITORS/ AGAINST THE EFFECTS OF BANK FAILURES. MEASURED BY THE FAILURE RATE,/ THE LEGISLATION WAS A SUCCESS. DURING THE 1920s/ AN AVERAGE OF 600 BANK FAILURES/ OCCURRED EVERY YEAR. THOUSANDS OF BANKS/ FAILED DURING THE DEPRESSION/ -- NEARLY 10,000 BETWEEN 1929 AND 1933. IN CONTRAST,/ DURING THE ENTIRE 49-YEAR HISTORY OF THE FDIC,/ THERE HAVE BEEN ONLY 575 INSURED BANK FAILURES,/ OR ABOUT 12 A YEAR.

THERE IS, HOWEVER,/ A HEAVY COST ASSOCIATED WITH THIS DRAMATIC DECLINE/ IN THE FAILURE RATE. BANK SUPERVISION/ COSTS HUNDREDS OF MILLIONS OF DOLLARS ANNUALLY,/ AND FINANCIAL MARKETS ARE LESS COMPETITIVE/ AND, PRESUMABLY, LESS EFFICIENT.

WHILE I WOULD HOPE THAT NO ONE/ WOULD SERIOUSLY ADVOCATE A RETURN TO AN UNREGULATED FINANCIAL SYSTEM,/ I BELIEVE IT'S TIME TO SHIFT OUR EMPHASIS. INDEED,/ THE BANK REGULATORS/ HAVE BEEN MOVING AWAY FROM A STRICT PROTECTIONIST,/ "PATER-  
NALISTIC" APPROACH/ IN RECENT YEARS. ENTRY STANDARDS FOR NEW BANKS/ HAVE BEEN LIBERALIZED. EXPANSION PROPOSALS BY WELL-MANAGED,/ WELL-CAPITALIZED BANKS/ ARE BEING PROCESSED WITH

DISPATCH. INTEREST RATES ARE BEING DECONTROLLED. EXAMINATION PROCEDURES ARE BEING MODIFIED/TO PLACE GREATER RELIANCE ON STATE EXAMINATIONS/AND COMPUTERIZED MONITORING SYSTEMS. EXAMINATIONS ARE OCCURRING WITH LESS FREQUENCY/AND THEIR SCOPE IS BEING ABBREVIATED/IN BANKS THAT DO NOT EVIDENCE SIGNIFICANT PROBLEMS.

NEVERTHELESS,/MORE CAN BE ACCOMPLISHED. . AGENCY RESOURCES/ARE STILL DEVOTED DISPROPORTIONATELY/TO SMALL INSTITUTIONS. THE TOP 100 BANKING ORGANIZATIONS/CONTROL 50 PERCENT OF DOMESTIC BANKING ASSETS. THE FAILURE OF ANY ONE OF THESE INSTITUTIONS/WOULD BE OF CONSEQUENCE TO THE FDIC/ AND THE PUBLIC. YET,/THE AGENCIES COMMIT ONLY A SMALL FRACTION/OF THEIR COMBINED RESOURCES/TO SUPERVISING THESE INSTITUTIONS.

NOT ONLY DO WE NEED TO CONSIDER/REALLOCATING OUR RESOURCES,/WE ALSO NEED TO REEVALUATE/OUR ENTIRE APPROACH/TO THE EXAMINATION AND SUPERVISION/OF DEPOSITORY INSTITUTIONS. WE NEED TO ASK WHETHER IT MAKES SENSE/TO FOCUS SO MUCH ON TRADITIONAL METHODS/OF ASSET QUALITY REVIEW/WHEN INSTITUTIONS ARE EXPERIENCING MAJOR DIFFICULTIES/CAUSED NOT BY POOR QUALITY LOANS/BUT BY ASSET/LIABILITY INTEREST RATE MISMATCHING. WE ALSO NEED TO QUESTION/THE TRADITIONAL METHODS OF ON-SITE EXAMINATION. IN TODAY'S FAST-PACED FINANCIAL ENVIRONMENT,/GREATER EMPHASIS ON COMPUTERIZED MONITORING OF INSTITUTIONS/MAY BE APPROPRIATE. WHILE

TRADITIONAL METHODS OF SUPERVISION/ARE STILL USEFUL/AND WILL NOT BE ABANDONED,/A WHOLE PANOPLY OF NEW APPROACHES/ARE NEEDED;/WE ARE ONLY JUST BEGINNING TO DEVELOP THEM,/AND I BELIEVE WE MUST QUICKEN OUR PACE.

B. AGENCY RESTRUCTURING

THE PRESENT FINANCIAL INSTITUTION REGULATORY STRUCTURE IN THE U.S./IS COMPLEX/TO SAY THE LEAST. THE FEDERAL RESERVE CONDUCTS MONETARY POLICY;/REGULATES BANK HOLDING COMPANIES;/ PROMULGATES CONSUMER REGULATIONS, SUCH AS TRUTH-IN-LENDING;/ AND REGULATES/(IN CONJUNCTION WITH STATE AUTHORITIES)/ STATE-CHARTERED BANKS/THAT ARE MEMBERS OF THE FEDERAL RESERVE SYSTEM. THE COMPTROLLER OF THE CURRENCY/SUPERVISES ALL NATIONAL BANKS. THE FDIC/INSURES VIRTUALLY ALL BANKS IN THE COUNTRY/AND, THUS, HAS SOME JURISDICTION OVER <sup>ALL</sup> ~~THESE~~ BANKS;/ HOWEVER, THE FDIC'S PRIMARY REGULATORY RESPONSIBILITY/IS TO SUPERVISE/(IN CONJUNCTION WITH STATE AUTHORITIES)/ STATE BANKS THAT ARE NOT MEMBERS OF THE FEDERAL RESERVE SYSTEM. THE FDIC HAS THE PRINCIPAL FEDERAL SUPERVISORY AUTHORITY/ WITH RESPECT TO SOME 9,000 BANKS,/THE COMPTROLLER HAS APPROXIMATELY 4,500 BANKS,/AND THE FEDERAL RESERVE HAS ABOUT 1,000 BANKS. WHILE THE FDIC SUPERVISES/ABOUT TWO-THIRDS OF THE BANKS,/THEY TEND TO BE SMALL/AND ACCOUNT FOR ONLY <sup>ABOUT</sup> ONE-THIRD/OF THE BANKING ASSETS.



IN ADDITION TO THE FEDERAL BANKING AGENCIES, THE NATIONAL CREDIT UNION ADMINISTRATION AND THE FEDERAL HOME LOAN BANK BOARD ARE GENERALLY RESPONSIBLE FOR FEDERAL SUPERVISION OF CREDIT UNIONS AND THRIFTS. NONDEPOSITORY FINANCIAL INTERMEDIARIES, SUCH AS BROKERAGE HOUSES, ARE REGULATED AT THE FEDERAL LEVEL BY THE SECURITIES AND EXCHANGE COMMISSION. REGULATION OF SUCH OTHER INTERMEDIARIES AS INSURANCE COMPANIES, CONSUMER AND COMMERCIAL FINANCE COMPANIES, AND INDUSTRIAL BANKS IS FOR THE MOST PART LEFT TO THE STATES. WHILE THE LIST OF REGULATORY AGENCIES THAT I'VE JUST RUN THROUGH IS BY NO MEANS EXHAUSTIVE, IT GIVES YOU AN IDEA OF THE PROLIFERATION OF ENTITIES AT THE STATE AND FEDERAL LEVELS THAT ARE RESPONSIBLE IN ONE WAY OR ANOTHER FOR SUPERVISING BUSINESSES THAT PROVIDE FINANCIAL SERVICES.

OVER THE YEARS THERE HAVE BEEN A NUMBER OF PROPOSALS TO REORGANIZE THE FEDERAL FINANCIAL INSTITUTIONS REGULATORY AGENCIES. THESE PROPOSALS HAVE MET WITH GREAT RESISTANCE FROM BOTH THE REGULATED INDUSTRIES AND THE AGENCIES THEMSELVES. THRIFTS AND CREDIT UNIONS HAVE PREFERRED REGULATION BY AGENCIES ATTUNED TO THEIR SPECIAL NEEDS. BANKS HAVE FAVORED A DIFFUSE, THREE-AGENCY STRUCTURE BECAUSE THEY FEAR THE STULTIFYING ENVIRONMENT THAT A SINGLE, ALL-POWERFUL AGENCY MIGHT CREATE. PROPONENTS OF THE DUAL OR STATE/FEDERAL BANKING SYSTEM FEAR THAT A SINGLE FEDERAL AGENCY WOULD OVERPOWER THE STATE AUTHORITIES AND BRING ABOUT A UNIFORMITY THAT WOULD RESULT IN THE DEMISE OF THE DUAL SYSTEM.

OPPONENTS OF REORGANIZATION CONCEDE/THAT THE PRESENT SYSTEM IS UNWIELDY AND INEFFICIENT,/BUT BELIEVE THAT IS A SMALL PRICE TO PAY/FOR THE GREATER FREEDOM THAT MULTIPLE AGENCIES PROVIDE. THEIR FEAR/IS A NATURAL FEAR OF THE UNKNOWN/AND OF A FURTHER CONCENTRATION OF FEDERAL POWER.

THERE'S A GROWING REALIZATION, HOWEVER,/THAT CHANGES ARE NEEDED. THE FINANCIAL SYSTEM/IS BECOMING LESS COM-PARTMENTALIZED. MARKETPLACE FORCES AND REGULATORY CHANGES/ARE BRINGING U.S. BANKS/INTO MORE DIRECT AND INTENSE COMPETITION/WITH EACH OTHER AND WITH THRIFTS,/CREDIT UNIONS,/FOREIGN BANKS/AND OTHER INTERMEDIARIES. SIGNIFICANT DIFFERENCES/IN MAJOR REGULATORY POLICIES AND PROCEDURES/ARE BECOMING LESS AND LESS TOLERABLE/FROM A COMPETITIVE STAND-POINT. MOREOVER,/IT'S BECOMING INCREASINGLY DIFFICULT/UNDER THE PRESENT DISJOINTED SYSTEM/TO MAINTAIN SOME SEMBLANCE OF ORDER/IN A RAPIDLY-CHANGING/ECONOMIC AND COMPETITIVE ENVIRONMENT.

IN THE LAST COUPLE OF YEARS/LEGISLATIVE EFFORTS TO BRING ABOUT INCREASED COORDINATION/AMONG THE FEDERAL FINANCIAL INSTITUTIONS REGULATORY AGENCIES/RESULTED IN THE CREATION OF TWO NEW REGULATORY BODIES. THE FINANCIAL INSTITUTIONS REFORM ACT OF 1978/ESTABLISHED THE FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL,/COMPOSED OF THE PRINCIPALS OF EACH OF THE FIVE FEDERAL AGENCIES. ITS PURPOSE IS TO COORDINATE/AND TO BRING UNIFORMITY/TO THE ACTIVITIES OF THE AGENCIES. THE DEPOSITORY INSTITUTIONS

DEREGULATION AND MONETARY CONTROL ACT OF 1980/CREATED THE DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE (DIDC),/WHOSE PURPOSE IS TO OVERSEE THE PHASE-OUT/OF INTEREST RATE CEILINGS.

WHILE THE DIDC/WAS ESTABLISHED FOR A LIMITED TIME/AND WITH THE SPECIFIC PURPOSE OF PHASING OUT INTEREST RATE CEILINGS,/THE EXAMINATION COUNCIL WAS DESIGNED/TO BRING OUT GREATER UNIFORMITY/WITHOUT THE TRAUMA OF AGENCY CONSOLIDATION. IT SEEMS FAIR TO SAY/THAT THE EXAMINATION COUNCIL EXPERIMENT/HAS NOT BEEN A SUCCESS. AGENCY PERSONNEL/ARE SPENDING TENS OF THOUSANDS OF HOURS/IN COMMITTEE,/SUBCOMMITTEE,/AND TASK FORCE MEETINGS/WITH LIMITED RESULTS. THE AGENCIES HAVE DEVELOPED/UNIFORM POLICIES IN SOME AREAS,/BUT THEY HAVE NOT BEEN ABLE/TO RECONCILE THEIR DIFFERENCES/ON A NUMBER OF MAJOR ISSUES/INCLUDING CAPITAL STANDARDS,/EXAMINATION PROCEDURES,/AND MERGER POLICIES.

THE SUBJECT OF AGENCY REORGANIZATION/IS COMPLEX AND CONTROVERSIAL,/BUT THERE SEEMS TO BE A GROWING RECOGNITION/OF THE PROBLEMS INHERENT/IN THE PRESENT STRUCTURE. IT MAY BE POSSIBLE/TO FORGE A CONSENSUS/FOR A WELL-DESIGNED REFORM MEASURE/THAT TAKES INTO ACCOUNT/NOT ONLY THE NEED TO REVAMP THE CURRENT STRUCTURE/BUT ALSO THE LEGITIMATE CONCERNS/OF OPPONENTS OF REORGANIZATION.

### C. DEPOSIT INSURANCE REFORM

THERE ARE SEVERAL ISSUES/RELATING TO OUR DEPOSIT INSURANCE SYSTEM/TO BE CONSIDERED/AS WE ADDRESS THE NEED/TO SUBSTITUTE MARKETPLACE DISCIPLINE/FOR THE DISCIPLINE OF THE

REGULATORY RESTRAINTS/THAT ARE BEING EASED. LET ME EMPHASIZE/  
THAT I'M NOT CURRENTLY ADVOCATING/ANY OF THE POSSIBLE RE-  
FORMS/IN THE DISCUSSION THAT FOLLOWS. IT'S IMPORTANT,  
HOWEVER,/THAT WE KEEP AN OPEN MIND/ABOUT THE KIND OF REGU-  
LATORY REFORMS/THAT THE EVOLVING FINANCIAL ENVIRONMENT/MAY  
REQUIRE.

SOME PEOPLE QUESTION/THE WISDOM OF SEPARATE DEPOSIT  
INSURANCE FUNDS/FOR CREDIT UNIONS,/THRIFTS/AND BANKS,/  
PARTICULARLY AS THE DISTINCTIONS AMONG THESE INTERMEDIARIES/  
ARE DIMINISHED. THE EXPERIENCE IN THE UNITED STATES/DURING  
THE 1800s AND EARLY 1900s/WITH STATE-SPONSORED DEPOSIT  
INSURANCE PLANS/INDICATES THAT IT'S DESIRABLE/TO HAVE AN  
INSURANCE FUND/WITH AS MUCH SIZE AND DIVERSITY/AS POSSIBLE.

DURING THE LAST SESSION OF CONGRESS,/CHAIRMAN JAKE GARN  
OF THE SENATE BANKING COMMITTEE /INTRODUCED A BILL/TO MERGE  
THE FEDERAL SAVINGS AND LOAN INSURANCE FUND/AND THE CREDIT  
UNION SHARE INSURANCE FUND/INTO THE FEDERAL DEPOSIT IN-  
<sup>CORPORATION FUND.</sup>  
SURANCE, ~~FUND~~. ALTHOUGH WE BELIEVE THE ISSUES INVOLVED/  
REQUIRE FURTHER STUDY,/WE FAVOR THE CONCEPT. IT SEEMS CLEAR/  
THAT IN THE LONG RUN/A SINGLE DEPOSIT INSURANCE FUND,/WITH  
THE COMBINED STRENGTH OF THE THREE CURRENT FUNDS,/MAKES  
SENSE.

SOME THOUGHT/MIGHT ALSO BE GIVEN/TO REEVALUATING THE  
WAY IN WHICH PREMIUMS/FOR OUR PRESENT FUNDS/ARE DETERMINED.  
MANY QUESTION THE FAIRNESS AND WISDOM/OF OUR PRESENT ASSESS-  
MENT SYSTEM/WHICH CHARGES INSTITUTIONS A FLAT FEE/BASED ON

DEPOSIT VOLUME. IT'S ARGUED/THAT A RISK-RELATED ASSESSMENT SYSTEM/WOULD BE FAIRER/AND WOULD DISCOURAGE EXCESSIVE RISK-TAKING. THE MAIN PROBLEM WITH SUCH AN APPROACH/IS THAT IT'S DIFFICULT TO DEVISE/A RISK-RELATED ASSESSMENT SYSTEM/THAT DOES NOT INVOLVE/A CERTAIN ARBITRARINESS. THE FACT THAT THE GOVERNMENT/HAS A MONOPOLY ON THE INSURANCE/CAUSES FURTHER CONCERN. IT'S HARD TO KNOW HOW THE INDUSTRY/WOULD REACT TO A PROPOSAL TO RELATE DEPOSIT INSURANCE ASSESSMENTS TO RISK,/ BUT A RISK-RELATED SYSTEM/MIGHT BE MORE EQUITABLE/AND MORE PRUDENT /THAN OUR PRESENT SYSTEM, /WHICH ARBITRARILY ASSESSES EACH BANK/IN THE SAME MANNER /IRRESPECTIVE OF ITS RISK.

ONE POSSIBLE WAY /OF ESTABLISHING A RISK-RELATED ASSESSMENT SYSTEM/WOULD BE TO BASE PREMIUMS/ON THE RATING ASSIGNED TO AN INSTITUTION/AS A RESULT OF EXAMINATION. THE THREE BANKING AGENCIES/CURRENTLY EMPLOY WHAT IS KNOWN AS THE CAMEL RATING SYSTEM,/ WHEREBY EACH OF FIVE ASPECTS OF AN INSTITUTION/-- CAPITAL,/ ASSETS, /MANAGEMENT, /EARNINGS /AND LIQUIDITY --/IS EVALUATED/AND ASSIGNED A NUMERICAL RATING,/ OF FROM 1/FOR THE BEST/TO 5/FOR THE POOREST PERFORMERS. AN OVERALL NUMERICAL RATING/IS THEN ASSIGNED,/ WHICH GIVES A GENERAL PICTURE OF THE BANK'S CONDITION. ASSUMING A SYSTEM/SUCH AS "CAMEL" /COULD BE ADEQUATELY REFINED,/ IT COULD BE A VEHICLE /FOR ASSESSING DEPOSIT INSURANCE PREMIUMS/BASED ON RISK IN AN INSTITUTION.

A THIRD POSSIBILITY/FOR MODIFYING OUR CURRENT DEPOSIT INSURANCE SYSTEM/WOULD BE TO ADOPT SOME FORM OF "CO-INSURANCE,"/UNDER WHICH LARGE CREDITORS WOULD BEAR A PORTION OF THE RISK/OF A BANK'S FAILURE. THE FDIC HAS FOR A NUMBER OF YEARS/HANDLED NEARLY ALL BANK FAILURES/THROUGH A PURCHASE AND ASSUMPTION TRANSACTION/WITH ANOTHER BANK/RATHER THAN SIMPLY PAYING OFF INSURED DEPOSITORS. THIS AVOIDS DISRUPTION/OF LOAN AND DEPOSIT CUSTOMERS/AND A POSSIBLE ADVERSE IMPACT/ON PUBLIC CONFIDENCE/IN THE FINANCIAL SYSTEM. IT ALSO NORMALLY RESULTS/IN A PREMIUM AND SIGNIFICANT COST SAVINGS/TO THE INSURANCE FUND. HOWEVER,/IT HAS THE UNFORTUNATE SIDE-EFFECT/OF MAKING ALL GENERAL CREDITORS WHOLE/ AND THEREBY ERODING THE DISCIPLINE/THAT THE MARKETPLACE WOULD OTHERWISE IMPOSE/ON DEPOSITORY INSTITUTIONS.

A SYSTEM OF CO-INSURANCE/MIGHT BE A DESIRABLE WAY/OF REFORMING OUR DEPOSIT INSURANCE SYSTEM. FOR EXAMPLE,/ONE MIGHT CONSIDER /INSURING THE FIRST \$100,000 IN FULL/AND SOME PERCENTAGE/-- SAY 50% --/OF ALL AMOUNTS OVER \$100,000,/ REGARDLESS OF WHETHER THE FAILURE WERE HANDLED/AS A PAYOFF OF INSURED DEPOSITORS/OR AS A PURCHASE AND ASSUMPTION OF THE FAILED BANK'S ASSETS AND LIABILITIES/BY ANOTHER INSTITUTION.

IT'S INTERESTING TO NOTE/THAT THE FEDERAL DEPOSIT INSURANCE SCHEME/ORIGINALLY CRAFTED IN 1933/CONTEMPLATED INSURANCE COVERAGE/BASED ON A SLIDING SCALE PERCENTAGE OF DEPOSITS,/SO THAT DEPOSITS UP TO \$10,000/WERE 100% INSURED,/ AMOUNTS BETWEEN \$10,000 AND \$50,000/WERE 75% INSURED,/AND

AMOUNTS OVER \$50,000/WERE 50% INSURED. BECAUSE OF SIGNIFI-  
CANT MODIFICATIONS/TO THE FEDERAL DEPOSIT INSURANCE ACT/IN  
1935,/THE ORIGINAL PLAN WAS NEVER IMPLEMENTED,/AND THE  
TEMPORARY INSURANCE COVERAGE/WITH AN ABSOLUTE DOLLAR LIMIT/  
WAS MADE PERMANENT.

A FOURTH MATTER/RELATED TO OUR DEPOSIT INSURANCE SCHEME /  
ALSO INVOLVES CHANGING THE BASIS/ON WHICH INSTITUTIONS ARE  
ASSESSED. NOT ONLY MAY IT BE MORE REASONABLE /TO ESTABLISH  
THE PREMIUM ACCORDING TO AN INSTITUTION'S RISK,/ IT MAY ALSO  
MAKE SENSE/TO REDEFINE THE BASE OF OBLIGATIONS/AGAINST WHICH  
INSURANCE PREMIUMS/ARE ASSESSED. IN THE INTERNATIONAL AREA,/  
FOR EXAMPLE,/AN EXEMPTION FROM DEPOSIT INSURANCE COVERAGE/  
CURRENTLY EXISTS FOR DEPOSITS PAYABLE/AT FOREIGN BRANCHES OF  
U.S. BANKS./ (THE EXEMPTION WAS RECENTLY EXTENDED/TO COVER  
IBF DEPOSITS.)

AT THE TIME THAT EXEMPTION WAS ADOPTED/-- MORE THAN 40  
YEARS AGO --/FOREIGN ACTIVITIES OF U.S. BANKS/WERE MINIMAL.  
TODAY, HOWEVER,/OVERSEAS ACTIVITIES OF MAJOR U.S. BANKS /  
REPRESENT A SIGNIFICANT PORTION/OF THEIR TOTAL BUSINESS. AS  
OF YEAR-END 1980,/ASSETS IN FOREIGN OFFICES/REPRESENTED  
17.4% OF CONSOLIDATED ASSETS/OF OUR BANKING SYSTEM. A  
PROPER EVALUATION/OF THE OVERALL RISK OF AN INSTITUTION/MUST  
INCLUDE BOTH ITS FOREIGN AND DOMESTIC ACTIVITIES.

WHEN WE CONSIDER THE CUSTOMARY REMEDIES/USED BY THE  
CORPORATION/IN RESOLVING FINANCIAL DIFFICULTIES/OF FAILING  
BANKS,/THE CURRENT ASSESSMENT MECHANISM/BECOMES DIFFICULT TO

RATIONALIZE. IN LIEU OF A DEPOSIT PAYOFF, THE CORPORATION HAS INCREASINGLY UTILIZED REMEDIES AVAILABLE UNDER SECTIONS <sup>OF OUR LAW</sup> 13(C) "DIRECT ASSISTANCE" AND 13(E) "PURCHASE AND ASSUMPTION" ~~OF THE FDI Act~~, PARTICULARLY IN THE CASE OF LARGE BANKS WHICH ARE LIKELY TO HAVE FOREIGN OFFICES. UNDER EITHER PROCEDURE, UNINSURED CREDITORS, INCLUDING FOREIGN OFFICE DEPOSITORS AND OTHER GENERAL CREDITORS, ARE MADE WHOLE. WHILE WE CANNOT STATE UNEQUIVOCALLY THAT ALL LARGE BANK FAILURES WOULD BE HANDLED UNDER SECTION 13(C) OR 13(E), THERE IS A HIGH PROBABILITY OF USING EITHER OF THESE METHODS. GIVEN THIS LIKELIHOOD IT SEEMS INCONGRUOUS THAT THE ASSESSMENT BASE DOES NOT INCLUDE FOREIGN LIABILITIES.

REFORMATION OF OUR DEPOSIT INSURANCE SYSTEM IS BECOMING AN INCREASINGLY IMPORTANT ISSUE AS WE ENTER INTO A DEREGULATED ENVIRONMENT. AS CONTROLS ARE REMOVED IT'LL BE IMPORTANT TO CONSIDER VARIOUS WAYS OF FOSTERING GREATER MARKETPLACE DISCIPLINE TO CONTROL DESTRUCTIVE COMPETITION AND EXCESSIVE RISK-TAKING. <sup>NOT ADVOCATING</sup> <sup>REQUIRE LEGISLATION</sup>

### III. CONCLUSION

IF THE BANKER WHOSE PREDICTION I MENTIONED <sup>AT THE OUTSET</sup> ~~EARLIER~~ TURNS OUT TO HAVE BEEN PROPHETIC -- AND I BELIEVE HE WILL -- THOSE OF US WHO ARE INVOLVED IN THE FINANCIAL SERVICES FIELD MUST NOW BE REACTING TO AND PLANNING FOR THE CHANGES THAT ARE COMING. IN COPING WITH THE HERE-AND-NOW OF PROVIDING AND REGULATING FINANCIAL SERVICES, WE MUST NOT NEGLECT TO OCCASIONALLY STEP BACK AND TAKE A LONGER VIEW, TO ASK



OURSELVES/WHERE WE ARE HEADED /AND HOW BEST TO GO ABOUT  
GETTING THERE; //IN OTHER WORDS, /WE MUST APPLY CREATIVE  
THINKING AND INITIATIVE /TO THE CHANGING FINANCIAL ENVIRON-  
MENT /SO THAT WE CAN SHAPE CHANGE /RATHER THAN BE OVERTAKEN BY  
IT. OCCASIONS SUCH AS THIS, / I BELIEVE, /PROVIDE VALUABLE  
OPPORTUNITIES /TO ENGAGE IN THAT KIND OF THINKING; //I THANK  
YOU FOR INVITING ME /AND I LOOK FORWARD TO ANSWERING ANY  
QUESTIONS /YOU MAY HAVE.

\* \* \* \* \*