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APR 24 1984

FEDERAL DEPOSIT INSURANCE
CORPORATION

FDIC: STABILITY AND CHANGE

An address by

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Presented to the

83rd Annual Convention of The
Conference of State Bank Supervisors

Tarpon Springs, Florida
April 2, 1984

Thank you for this opportunity to discuss some of the initiatives we are taking at the FDIC to respond to changes within the financial services industry and how these actions might affect the banks we supervise and the relations among our agencies.

As a practical matter, our actions simply reflect the reality that the marketplace is deregulating the financial services industry. Choosing between deregulation and re-regulation is not an option. Our responsibility, and our only choice as public officials, is to protect the public interest by attempting to provide for more orderly deregulation than the unplanned, helter-skelter de facto deregulation in progress.

Premises for FDIC Initiatives

The fundamental premise on which we at the FDIC are operating is that the American public continues to demand basic stability in the banking system. We recognize that the provision of federal insurance for deposits has been an indispensable means through which stability has been achieved during the past 50 years. So the first order of business for the FDIC is to do whatever is necessary to maintain the integrity and strength of the federal deposit insurance system.

Our second premise is that the American public wants a private financial system that offers the maximum range of services and competitors consistent with stability and safety.

Definition of a Bank

Many controversies within the financial services industry center on the issue of what is a "bank"? As insurer of bank deposits, the FDIC has understandably given this issue close attention.

A "bank", in our judgment, is an entity the public believes is or should be a safe haven for its funds at least up to some specified amount. The key element, in terms of public perception, is whether an organization holds itself out to the public as a "bank" by using that term in its name. If an organization calls itself a bank, we believe it ought to be required to be FDIC insured and regulated as a bank.* No entity should be FDIC insured unless it both accepts deposits and uses the term "bank" in its name.

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* There should be an exception to the prohibition against the use, by non-FDIC entities, of the term "bank" for government organizations or entities that do not accept the public's funds.

This definition would close the "nonbank bank" loophole. It would also subject banks and thrifts that choose to look like banks to the same regulatory treatment. Finally, it would prevent a recurrence of tragedies, such as those we recently witnessed in Iowa and Tennessee, where uninsured banks failed causing thousands of people to lose their savings at entities that held themselves out to the public as "banks".

Greater Competitive Freedom For Banks

Once we determine what a bank is, we are confronted with the issue of what it may do or with whom it may affiliate. It is no secret that the FDIC has been a leading proponent of much greater competitive freedom for banks. First, we are convinced it would be procompetitive. The American public -- including consumers, small businesses and farmers -- would be given a broader range of financial products at more competitive prices. Second, it would strengthen the banking system by allowing banks to be more viable in the financial marketplace and develop new sources of income to help offset the cost of liability deregulation.

The question, in our judgment, is how far can we go without creating an undue risk to the deposit insurance system or creating a competitive climate that would be unfair to competitors of banks?

From the viewpoint of safety, we believe it appropriate to divide financial services into two categories: those that are offered in an agency capacity and those that are offered by a bank as principal. We believe there is very little risk in a well-managed bank acting as an insurance, real estate or securities agent or broker, and we would permit these activities to be conducted in the bank itself.

When it comes to underwriting insurance or securities or developing real estate, the risks are greater. Accordingly, we would authorize these activities only in affiliates of banks, coupled with other appropriate safeguards, such as requirements for separate capitalization and funding, different names and logos, and strict limits on interlocking management and directors. Safeguards such as these would insulate banks from the greater risks these activities entail and also promote fairness with respect to nonbank competitors.

Antitrust

As the artificial, outmoded barriers to product and geographic expansion by banks are dismantled by legislation or the marketplace, we will need strengthened antitrust enforcement. For example, we believe it would be clearly procompetitive for one of the nation's largest banking organizations to enter a major new product or geographic market on a de novo basis or through a foothold acquisition. On the other hand, the competitive benefit would be nonexistent, or at least much less clear, if it were to enter by acquiring one of the large, established competitors in that market. Yet, current antitrust law largely ignores the long-range structural or concentration effects of an acquisition and would not, in all probability, preclude quite sizeable combinations.

We are concerned about this issue not only from the standpoint of competition, but also from the viewpoint of the safety of our insurance fund. Like any insurer, we want our risk diversified as much as possible and spread among as many institutions as is reasonable.

Reliance on Market Discipline

Our role as insurer of bank deposits in a deregulated banking environment presents a threshold question: how, in this environment, do we control destructive competition and abusive practices without adding a new layer of laws and regulations and hiring thousands of additional examiners to monitor and enforce them. There is but one option: increase marketplace discipline as an efficient and reliable supplement to our supervisory programs.

Recognizing that the market's ability to make informed investment decisions requires full and fair disclosure of relevant information, we recently added several important schedules to the quarterly reports filed by banks and available to the public. These cover nonperforming loans, interest rate sensitivity, reliance on brokered deposits and information on contingent liabilities. We may soon issue a policy statement encouraging banks to make available to their customers even more useful disclosures.

Removal of Impediments to Market Discipline

Ironically, one of the principal impediments to the operation of normal market forces in banking has been the working of our deposit insurance system. We have for years too often arranged mergers of failed banks. These mergers have had the effect of bailing out all depositors and other general creditors, no matter how large their balances. Currently, uninsured depositors, particularly at the larger commercial banks, do not feel they are at risk since they recognize the FDIC prefers to handle these failures through mergers. If uninsured depositors are to have sufficient incentive to monitor bank risk -- and select a bank on some basis other than size or interest rate -- this perception by uninsured depositors must be altered.

One way this could be done is for the FDIC to pay off insured depositors in all failed banks. However, paying off a large bank can pose substantial problems. Most notably, uninsured depositors typically must wait several years before they receive any significant payment on their claims. This could prove very disruptive to the payments system when a large bank is involved.

To alleviate these problems, the FDIC has tried a procedure under which a payoff was accomplished by transferring insured deposits to another bank for a premium, and a cash advance was made nearly simultaneously to uninsured depositors and other general creditors based on the present value of anticipated collections by the receivership. Under this type of transaction, disruptions in the financial markets are kept to a minimum while exposing uninsured depositors to some risk of loss. As a result, the uninsured depositors have a strong incentive to select the soundest institutions, rather than simply the largest ones or those paying the highest interest rates. We

have not completed our evaluation of this new procedure. If it proves successful, we will provide ample public notice before implementing it as a matter of course.

Our efforts to encourage more discipline in the banking system will be undermined if nothing is done to limit the practice of brokers sweeping the nation for funds and placing them in banks that pay the highest rates of interest irrespective of the condition of the banks. Competition in banking should not be based solely on the rate of interest paid. Consideration should also be given to such factors as capital adequacy, asset quality, the degree of insider lending, competence of management and the quality of service. Brokers and their investor clients have little reason to consider these other factors because the existence of the FDIC guaranty interferes with the normal working of the marketplace by eliminating risk.

As a consequence, the FDIC and the Federal Home Loan bank Board last week adopted changes in our insurance regulations to limit the federal guaranty on brokered deposits. The rule, which will become effective October 1, 1984, sets a maximum of $100,000 insurance per insured bank for the total deposits placed by or through a single broker.

We are not against brokered deposits or deposit brokers. The FDIC is not denying brokered deposits to any individual or sound institution. What we are doing is making banks compete for funds based on their creditworthiness, not just interest rate. Depositors or their advisors will have to weigh both risk and return.

Our regulation is no panacea. There may be ways for some entities to bypass it. For example, a credit union with $2 million to invest could, rather than going through a broker, place the funds directly in the 20 banks that pay the highest interest rates and obtain full insurance in the process. Our regulation makes this more difficult and less efficient, but not impossible. Moreover, our regulation does nothing to limit the insurance coverage on trusteed deposits placed by government organizations such as the Bureau of Indian Affairs in problem banks throughout the country. Our lawyers are currently considering additional regulatory or legislative solutions to curb these outright abuses and misuses of the deposit insurance system.

Market discipline is also diminished by our system of fixed-rate insurance assessments. To establish a degree of fairness to both the FDIC and well-managed banks throughout the nation, we have proposed legislation to allow the FDIC to replace the present system of fixed-rate deposit insurance premiums and rebates with a system in which the rebates vary according to bank risk. Our proposal also would charge banks for all above-normal costs of supervision, such as the more frequent examinations that problem banks require. Requiring problem banks to pay more for deposit insurance and supervision, instead of spreading the cost among all banks as we do now, would provide an incentive for banks to correct their problems promptly and would certainly be more equitable than the present system. These are not drastic proposals, but they represent steps in the right direction.

Improve Effectiveness and Reduce Burden of Regulation

As I mentioned at the outset, the first order of business at the FDIC is to maintain public confidence in the federal deposit insurance system. In order to do so, we must focus our attention on our insurance function. We are seeking, as part of this process, to strengthen our authority over safety and soundness matters and eliminate or transfer those functions not directly related to this issue. An important element is that state and national banks would be treated alike in those instances in which states are willing and able to handle the job.

The FDIC favors deferral to state authorities whenever possible for state-chartered institutions and their holding companies. Under a proposal of the Bush Task Group, state banking departments certified as providing supervision substantially equivalent to federal supervision would have nearly exclusive jurisdiction over state institutions, and there would be no routine federal supervision. The Federal Reserve would be the federal regulator of state banks and their holding companies in noncertified states.

The Bush Task Group also proposed that the FDIC be responsible, in coordination with the primary supervisor, for examining all troubled banks -- those rated 3, 4 or 5 on our CAMEL system -- irrespective of their charter. We would also sample healthy, 1- and 2-rated banks. In addition, the FDIC would be authorized to take the full range of enforcement actions against all banks, not just state nonmembers, and to approve insurance applications for national and state member banks as well as nonmembers.

Regardless of what happens to the Task Group's recommendations, we will continue to move in the direction of the proposed plan. That is, we will continue to emphasize our role as insurer of all banks and de-emphasize our role as a general purpose regulator of state bank.

Toward that end, we are participating with the Federal Home Loan Bank Board and the Comptroller of the Currency in cooperative examination programs for FDIC-insured federal savings banks and national banks. The programs permit the FDIC to participate in examinations of problem banks and a representative sample of nonproblem banks. We hope similar arrangements can be worked out with the states and/or the Federal Reserve for state member banks. At the same time, we are cutting back, as fast as the the states can pick up the load, on examinations of small nonproblem nonmember banks.

Our desire to focus on our insurance function and to lighten the regulatory burden on banks has led us to recommend legislation removing the FDIC from the approval process for state nonmember banks' applications to establish or relocate branches. These applications constituted over 40 percent of all applications considered by FDIC in 1983. Under our proposal, state banking departments would have exclusive jurisdiction over these matters, and the FDIC would simply receive notice of the states' final dispositions. In the meantime, we are making substantial gains in simplifying and expediting our applications procedures.

Over 90 percent of applications acted on by the FDIC in 1983 were handled under delegated authority, primarily at the regional level. Last year we streamlined the applications process even further. For the first time, our regional directors were delegated authority to approve mergers, and we are currently working on additional merger delegations, which will improve our processing time even more in 1984. When I arrived at the FDIC six years ago, a typical merger required nine months to process; today we have it down to between two and three months.

For applications to establish or relocate branches, we eliminated the requirement to file a formal application. This change by itself may have saved an average of 10 hours preparation time for each applicant bank. Publication requirements also were modified, which further reduced the expense and processing time. The results speak for themselves. For example, in 1982 the average processing time for branch applications was 78 days. For the last quarter in 1983 -- our first full quarter under the new procedures -- three-fourths of the branch applications approved under delegated authority were processed within 18 days. In the case of relocation applications, 85 percent were processed within 26 days.

Conclusion

These are incredibly exciting and challenging times for bankers and bank supervisors alike. Deregulation, if handled properly, will bring enormous benefits to the American public in terms of a broader range of financial services at more competitive prices.

For deregulation to succeed, though, bank supervisors have their work cut out. We must introduce more market discipline to protect the well-managed banks against the abuses and excesses of the outliers. We must improve our surveillance systems and supervisory procedures for those banks that require it, while at the same time reducing the excessive burdens we place on the vast majority of banks that are prudently operated. Finally, we must create a climate in which banks of all sizes are permitted to compete on an equal footing with each other and with the growing legion of nonbank competitors.

It is a big agenda we face. It will require that bank supervisors at the state and federal levels work together more closely than ever before. I pledge to you the maximum support and cooperation of the FDIC.

Thank you.