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STATEMENT BY

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on H.R. 5734, FINANCIAL INSTITUTIONS EQUITY ACT OF 1984

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

10:00 a.m.
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Room 2128, Rayburn House Office Building

Mr. Chairman, members of the Committee, I'm pleased to have this opportunity to express our views on H.R. 5734, the Financial Institutions Equity Act of 1984.

Developments in our financial-services markets have been moving rapidly. Those developments have created many inequities -- both among our depository institutions and between depository institutions and other providers of financial services -- which need to be addressed. Moreover, we have deregulated the liabilities of our depository institutions, and they must be given the flexibility of added powers on the asset side to maintain their future viability. Finally, significant reforms to our deposit insurance system are urgently needed.

Definition of a Bank

Section 2 of H.R. 5734 offers a definition of a bank. We would offer an alternative. In order to maintain a stable financial system the public needs to have confidence in the institutions in which it deposits its funds. For at least the past 50 years, the term "bank" has been synonymous with such institutions. If we are to redefine the term "bank," this essential characteristic should be kept in mind.

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 any organization calls itself a bank, and accepts funds from the public, 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.

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 (and at least impede current efforts by some banks to convert to thrift charters in order to obtain more permissive capital and accounting standards). Finally, it would prevent a recurrence of tragedies like 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."

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*This would not apply to government entities, charitable organizations and the like. Laws limiting the use of the term "bank" to licensed depositories currently exist in a number of states.

Expanded Bank Powers

To help achieve a more responsive and equitable financial system, we believe banks should be authorized to engage in a broader range of financial services. This would enable banks to develop new sources of income to help offset the cost of liability deregulation and achieve a degree of asset diversification commensurate with their nonbank competitors. Most importantly, the American public would be the direct beneficiary of increased competition.

To ensure that the stability of the banking system is not compromised, we believe it appropriate to divide financial services into two broad 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 authorize 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, I would authorize these activities only in affiliates of banks. I also recommend other 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.

The FDIC has the responsibility, shared with state banking authorities, of supervising state-chartered nonmember banks.

Because some states have authorized, or proposed to authorize, their state-chartered banks to engage in some activities not authorized to national banks, we have sought to determine what risks these activities may pose to the safety and soundness of banks. Our efforts have involved advance notices of proposed rule making, through which we have sought public comment, and internal studies of the various industries concerned. Our advocacy of expanded powers for commercial banks is founded on the conviction that commercial banks, if they are to remain competitive, must have the flexibility to provide diversified financial services to their customers, as do their nonregulated competitors. Our studies and our day-to-day experience on the firing line do not not suggest that the potential safety and soundness problems outweigh the clear benefit to the industry as a whole and the American public which will flow from expanded authorities.

Role of the FDIC

At this point, Mr. Chairman, I would like to say a few words about the FDIC and its role in the federal regulatory system. The fundamental premise upon which the FDIC operates is that the public wants stability in the banking system. We also believe the deposit insurance system should not become a drain on the U.S. Treasury -- that is, it should continue to finance itself through bank assessments and interest earned on its investment portfolio. In considering reforms to maintain stability and fairness in a more competitive financial services industry, it's imperative that we address the measures necessary to maintain the vitality of our federal deposit insurance system.

We believe it's essential that the FDIC emphasize and strengthen its role as insurer of all banks. To achieve this objective we intend to de-emphasize our role as a routine supervisor of state nonmember banks and reallocate our resources to those areas where our exposure is greatest -- to larger institutions and problem banks. This requires that we cut back on our examinations of smaller, nonproblem banks.

We do not currently have the powers necessary to adequately carry out our primary function as insurer of all banks. We strongly urge that Congress promptly consider H.R. 5738, which Mr. Wylie introduced on our behalf last month. Our proposed legislation would strengthen and refine the provisions of the Federal Deposit Insurance Act.

H.R. 5738 would authorize the FDIC to replace the present system of fixed-rate deposit insurance assessments with a system in which the assessment rebates vary according to bank risk. It also proposes that banks be charged 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. We believe we currently have the capability to implement a comparatively modest variable-rate assessment scheme based on sound, objective measures of risk. Over time, as we gain more knowledge about the factors affecting bank riskiness, we will revise and improve the system. While these proposals will not have a drastic effect on bank behavior, we believe they are steps in the right direction. I might add that this proposal was unanimously endorsed by the Bush Task Group and the A.B.A. Leadership Conference.

H.R. 5738 also would provide the FDIC the tools it needs to limit its exposure to loss in problem banks by granting the FDIC the authority to take the full range of enforcement actions against any bank it insures. Today we have that authority only with respect to state nonmember banks, which, because of their generally small size, present the least exposure to the insurance fund. With respect to state member banks and national banks, we currently have authority to terminate an institution's deposit insurance, but not to issue cease-and-desist orders, levy fines or remove or suspend bank officers or directors. This is of great concern to us because national and state member banks represent the larger institutions that pose the greatest potential exposure to the deposit insurance fund. Since authority to terminate a bank's deposit insurance is useful in only the most extreme situations, these less drastic enforcement powers would be of considerable benefit. This proposal was also unanimously endorsed by the Bush Task Group and the A.B.A. Leadership Conference.

I might note that we recently entered into cooperative examination programs with the Comptroller of the Currency and the Federal Home Loan Bank Board for federally chartered banks and thrifts insured by the FDIC. These programs will help us monitor our exposure in banks we insure and prepare in an orderly way for their failure when it cannot be avoided. These two agencies are to be commended for putting the overall good of the system ahead of interagency political concerns. It's our hope that a similar arrangement can be worked out with the Federal Reserve and/or the states for state member banks.

Our proposed legislation would also curtail the insurance coverage on deposits made in banks by insured depository institutions and federal government agencies. These entities are currently placing billions of dollars in fully insured accounts at troubled banks and thrifts based solely on the rates of interest paid. Credit unions, S&Ls, commercial banks and government agencies clearly ought to be able to make informed judgments about the condition of the financial institutions in which they place their funds. If they were forced to make such judgments, banks and thrifts would have a powerful incentive to curb excessive risk-taking.

We are not moved by the argument advanced by some credit unions that they are such unsophisticated lenders that deposit insurance is essential for funds placed by them. If credit unions are unable to retain competent financial advisors, they can place their funds through an established network of corporate centrals which have been formed for the purpose of investing excess funds from member credit unions. Unfortunately, many credit unions choose not to use this convenient vehicle because they are able to receive an extra 25 or 50 basis points by dealing, directly or through brokers, with problem banks. During 1983, deposits placed at corporate centrals by credit unions actually declined despite an $8.5 billion increase in overall credit union deposits.

By creating checks on risk-taking, we would be helping to ensure the continued strength and effectiveness of the federal deposit insurance system -- and we would be reinforcing our commitment to the American public to maintain stability in the financial system.

Our proposed legislation includes a number of other refinements designed to increase discipline in the financial system, such as strengthening our authority to remove or suspend officials and streamlining our Section 8(a) procedures. To better enable us to determine the condition of an institution we insure, we would have the power to define, in connection with FDIC examinations, which companies are bank "affiliates." Standard priorities would be established for distributing the assets of failed insured banks. Importantly, those claims that are categorized as "contingent" would be subordinate to the claims of depositors. Since contingent claims generally relate to commercial transactions (such as loan participations and letters of credit) with financial institutions and other businesses, these firms would have an additional reason to ascertain the soundness of banks with which they do business. The proposed legislation also relaxes the restrictions on Deposit Insurance National Banks, making them much more useful vehicles for handling bank failures, especially large ones. The FDIC would be established as the receiver for all insured banks that fail. Finally, the procedural requirements that state banks must fulfill before they are eligible to branch would be relaxed.

We urge the Committee, in the strongest possible terms, to immediately consider these proposals for deposit insurance reform, either as part of a larger package or -- should that not prove feasible -- as a separate bill.

Conclusion

In July of 1983 I suggested legislation to the Congress for a moratorium/divestiture bill, which in many respects parallels the bill before you today. When I submitted that language, I urged against its enactment, favoring instead comprehensive legislation.

There is still time, and a real need, for Congress to address the issues of bank powers and deposit insurance reforms. Events in the marketplace are moving far faster than the legislative, regulatory and insurance systems. Most of the issues before us have been debated for years and are well known to you and members of this Committee. We continue to urge enactment of a comprehensive package.

Mr. Chairman, you have been an effective leader of this Committee with a vision of the future. I've listened closely to your words over the years I've been in government. I'm certain you recognize the need for substantial reform of our nation's financial-services industry. I believe you would like to move ahead as rapidly as is politically feasible with much needed, progressive legislation. I hope you'll find it possible to do that in 1984 and not settle for H.R. 5734.

Should you find it necessary to enact a limited measure, we totally support your position that divestiture, rather than grandfathering, is the appropriate way to handle nonconforming activities no matter when commenced. We will forward in a few days some amendments to H.R. 5734, which we believe will be helpful.