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GIANNINI: A MAN AHEAD OF HIS TIME

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An address by

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In keeping with the theme of this conference, I would like to address my brief comments to three areas where we believe that change in the financial system is essential: (1) expanding the permissible activities of banking organizations, (2) modifying the deposit insurance system to foster a greater degree of market discipline and (3) reorganizing the federal regulatory structure as it relates to financial institutions.

This is certainly an appropriate forum for these issues for A.P. Giannini, the man we are here to honor, was a pioneer who developed new ideas and applied them to banking. From the day he opened the Bank of Italy in 1904, Giannini's banking practices bore little resemblance to those of San Francisco's more established banks. Using marketing techniques proven during his earlier career in the produce business, Giannini courted new depositors and borrowers. He concentrated on smaller customers, a market segment then largely ignored by other banks. Following the Earthquake of 1906, the Bank of Italy was able to re-open nearly a month ahead of San Francisco's larger banks, operating temporarily from a desk set up on the Wharf. The considerable public recognition he received for this act must have signaled to the city's other bankers that they could no longer afford to ignore this vibrant new competitor.

The Bank of Italy's phenomenal branch expansion was often opposed by state or federal regulators, but Giannini's flexible and innovative use of the corporate structure allowed the bank to enter most of its targeted markets.

Under the corporate umbrella of Transamerica, Giannini also entered nonbanking fields, such as insurance and real estate. While antitrust concerns led to a partial dismantling of this conglomerate in the 1950s, the entry of a Giannini affiliate almost always resulted in a more competitive market.

Overview

For most of the last half century, competition in financial services was tightly controlled. Price, product and geographic competition were curtailed by law. Entry into the business was carefully regulated, as was expansion. It was rare for a bank to fail.

Today we face a radically different banking environment. Banks are no longer insulated from competitive pressures. Deposit interest rate ceilings have been almost completely dismantled. Product distinctions among banks, S&Ls and other intermediaries are barely discernible. Restrictions on entry and geographic expansion have been eased. Changes in technology and consumer attitudes are transforming what used to be segmented local markets into one giant national arena.

These changes offer many opportunities for the well-managed financial institution of any size and, more importantly, for the general public. Giannini's concept of a banking organization -- extending over much of the country and covering broad product lines -- is once again becoming fashionable.

Expanding Bank Powers

Despite the gains that have been achieved, the deregulation process is far from complete. As some government regulations are swept aside, others increasingly require revision. One area requiring attention is that of bank powers. Nondepository institutions, such as Sears, Merrill Lynch and American

Express, now offer an array of services in direct competition with banks. Banks, on the other hand, are still prohibited from entering many of the so-called nonbanking markets in which these firms operate. This situation is clearly inequitable.

To allow them to cope with the cost of liability deregulation and to remain competitive with their new rivals, banks must be permitted to engage, either directly or through a subsidiary, in a broader range of financial services. The Administration has submitted S. 1609 in furtherance of this objective. While the proposal has met with opposition in some quarters, it represents a significant step forward and has focused the public policy debate on the need for asset-side deregulation. We at the FDIC strongly support adoption next year of S. 1609 or something akin to it.

Some argue that consumers will suffer if product expansion is permitted, contending that the larger banks will dominate these markets and restrict the level of competition. The opposite is more likely to be true. Competition will be enhanced if the barriers separating the different financial markets are removed and more reliance is placed on reasonable antitrust enforcement. Banking history is replete with examples of where new market participants developed creative programs that resulted in important benefits to the general public.

When A.P. Giannini began a program of geographic expansion, there were many who believed the bank's size would enable it to control the markets in which it operated. In fact it was not size but rather the quality and range of services that Giannini provided that made his bank a spectacular success. Smaller customers were the prime beneficiaries of Giannini's actions. While many other banks rarely bothered with loans of $100, the Bank of Italy often loaned as little as $25, and any wage earner could borrow up to $300 on his or her signature alone. Other banks were forced to follow suit and recognize a previously ignored market.

Expansion of bank powers will promote fairness in the marketplace and greatly benefit the banking public. We believe these benefits clearly outweigh concerns that banks will be exposed to higher levels of risk. I say this not because I wish to downplay the importance of a safe and sound banking system -- no one has a more direct stake in that than the FDIC -- but because we recognize that a certain amount of risk-taking is essential to healthy and efficient financial markets.

What is needed is a balanced approach. Thus, at the same time we are urging broader authorities for banks, we are also considering several changes in the deposit insurance system to enable both the FDIC and the private sector to better control excessive risk-taking.

Control of Excessive Risk-Taking

When federal deposit insurance came into existence fifty years ago, A.P. Giannini hastened its acceptance by being the first large banker to support it. Initially, he was not convinced of the necessity for deposit insurance. His change of heart was based on an accurate reading of the desires of his smaller customers. Although the deposit insurance system has since proved to be an enormous success, it has changed very little since the 1930s, despite dramatic changes in the financial environment.

The FDIC has recommended to Congress that the present system of flat-rate deposit insurance assessments be replaced by a system of risk-related premiums. This will allow us to price FDIC coverage to reflect the risk of individual banks. We have also proposed that banks be charged for all above-normal costs of supervision, such as the more frequent examinations which problem banks require. Requiring that problem banks pay their own supervision costs, instead of spreading the cost among all banks in the form of lower premium rebates as we do now, would provide a small but important incentive for banks to correct their problems promptly. Also, like risk-related premiums, it would be more equitable than the existing system. These are not drastic proposals, but they represent steps in the direction we should be moving.

We believe that one of the most effective ways to control excessive risk-taking is to expose banks to the discipline of the market, an ingredient that the working of the deposit insurance system has tended to stifle. A promising potential source of market discipline is the large depositors, those who have deposit balances in excess of the $100,000 insured limit. Although we refer to them as "uninsured" depositors, in practice we have for years provided them with de facto 100 percent coverage in most bank failures, especially failures of larger banks.

This results from our practice of merging failed banks into other banks. Currently, uninsured depositors at the larger commercial banks do not feel that they are at risk since they recognize the FDIC prefers to handle large bank failures through mergers. If uninsured depositors are to have sufficient incentive to monitor bank risk, then the risk exposure of uninsured depositors must be increased and equalized for banks of all sizes.

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

To alleviate these problems, the FDIC has been considering procedures where a payoff is combined with a cash advance to uninsured depositors and other general creditors based on anticipated collections by the receivership. If this type of transaction could be effected quickly, disruptions in the financial markets could be kept to a minimum. At the same time, uninsured depositors would be exposed to some risk of loss. As a result, bank customers would have a strong incentive to select the soundest institutions, rather than simply the largest ones or those paying the highest interest rates.

Whatever methods are adopted to increase the role of the marketplace in influencing banks' risk behavior, it is imperative that sufficient information be publicly available to ensure knowledgeable decisions. Toward this end, we have decided to make public the newly collected call report data on banks' interest-rate sensitivity and nonperforming assets, and we are considering additional disclosure of information pertaining to insider lending practices and enforcement actions. These disclosures will enable depositors and others in the financial markets to identify the marginal, high-risk banks. We believe this policy of increased disclosure will deter unsound banking practices and destructive competition and help maintain stability in a deregulated environment.

Regulatory Reform

The entire structure of federal supervision and regulation of financial services must also be addressed. Our current system is inefficient, inequitable and increasingly ineffective. At the federal level alone, five different regulatory agencies plus the Securities and Exchange Commission and the antitrust division of the Justice Department are charged with responsibility for overseeing the affairs of insured deposit-taking institutions. There is far too much fragmentation and unnecessary duplication of supervisory efforts.

At present, the staff of the Bush Task Group is considering recommendations to reform the regulatory framework. The options include:

- Creating an autonomous federal bank agency to assume most of the chartering and supervisory roles for national banks and their holding companies (the Comptroller's Office would naturally constitute the nucleus of any new agency with contributions from the Federal Reserve and the FDIC);
- Limiting the regulatory responsibilities of the FDIC to safety and soundness concerns, specifically institutions representing a threat to our fund;
- Consolidating securities regulation in the SEC and antitrust enforcement in the Justice Department;
- Relying more heavily on states for supervision of the nation's nearly 10,000 state-chartered banks;
- Streamlining procedures for holding company regulation;
- Preserving an important -- indeed, in many respects strengthened -- oversight role for the central bank; and
- Redefining the term "thrift" and moving toward common capital and accounting standards for thrifts and banks.

These, of course, are merely some of the elements which have been receiving consideration, and there are a wide variety of alternatives under review in each area. The members of the Task Group have not yet met to consider the specific proposals and no decisions have yet been reached. However, my personal expectation and hope is that the Task Group will in the near future adopt a series of far-reaching proposals to simplify and strengthen the current regulatory system.

Reforms such as these are necessary now. The financial-services industry has passed us by and shows no sign of slowing down. We hope Congress will agree that the system for regulating the nation's financial-services industry is in urgent need of repair and will act swiftly to reform it. We believe a realignment of federal supervisory responsibilities would produce administrative cost savings by reducing duplication of offices, support staff and enforcement activities; but, far more importantly, it would mean considerable improvement in the supervision of federally insured banks and thrifts and a strengthening of our dual banking system.

Concluding Comments

The next several years promise to be a very interesting and important period for the financial markets. I believe that industry and government leaders have an obligation to help shape events to best serve the public interest. The regulatory barriers to more competitive financial markets need to be re-examined and in some instances eliminated. Innovators like A.P. Giannini have sometimes been able to bypass these barriers to the great benefit of the American public, but today the restraints on truly competitive behavior are still too many and people of Giannini's caliber too few.