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An Address by

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<u>OUR COMMON INTERESTS</u>

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(Actual Speech)

Good morning! It was about one year ago that I had the first opportunity to speak to your fine organization. Now I have a chance to review my year as a bank regulator and show you what I have learned. In my home town we have a saying "old too soon and smart too late". My job is to prove that even though old, I can still learn.

One thing I learned for sure, your industry -- the thrift industry -- is financially viable, supported as necessary by consumers, and has fine future propects. I believe I can also say that its prospects are brighter when you work together with other depository institutions. Banks and thrifts have more success working together on current problems than they do when they work on each other. That leads me to take a look at a current development which I believe needs to be of common concern.

* One of these is the growth of debt which during the past few years exceeds that of any other period since World War II. All sectors of our economy have participated in the increase. Total public and private debt of the non-financial sector has doubled since 1980. From about $3.6 trillion at the beginning of the 1980s, it has increased to well over $7 trillion today.

* Increased debt, however, must be related to ability to pay. Unfortunately, our national income has not risen proportionally. During the period from the end of the Korean War to the early 80s, the ratio of total debt to GNP fluctuated in a narrow band about 140 percent. Since then, this ratio has increased to about 173 percent. There is now about 34 cents more debt for every dollar of income than there was just five years ago.

* At the corporate level, growth in debt has far outpaced growth in net worth. At the end of 1985, the ratio of corporate debt to book net worth was at a post-World War II high of 46.5 percent. The ratio of household debt to net worth was also at a post-war high of over 19 percent.

* Short and intermediate term consumer credit has grown from about 18 percent of after-tax disposable income in 1981 to 24 percent early this year -- a 25 percent increase to a postwar high.

* Total household debt has also outraced disposable income. Household debt has increased from about 75 percent of disposable income five years ago to 85 percent today -- also a postwar high.

* The real debt burden of the household sector -- the amount of bread and wine that must be sacrificed to repay the debt -- has increased by about 23 percent since 1983.

* It is true that the growth of debt has been a constant trend during the entire postwar period. But at no time since World War II has the simultaneous growth in debt of both the household and business sectors been so rapid.

* Government debt is now growing relative to GNP even more rapidly than private debt. The $1.7 trillion in government debt held by the public represents about 41 percent of GNP -- up significantly from 28 percent in 1981. Prior to the late 1970s, this debt ratio had steadily fallen from the high levels of World War II.

* The simultaneous rapid growth of public and private U.S. debt has been made possible, in part, by importing foreign capital. We have become the world's largest debtor nation. Our net investment position -- the excess of U.S. gross claims abroad over foreign claims on the U.S. -- has deteriorated from a surplus of $141 billion in 1981 to a deficit of $107 billion at the end of 1985.

The growth rate of debt in this country is a trend that requires all financial institutions to take notice. The key question, of course, is whether all this debt is manageable in relation to income. There is no doubt that some of the financial innovations of the past few years have reduced the perception of risk, and perhaps increased the ability to manage debt. No one, however, knows how much debt the financial system can handle without endangering stability. We can all agree, though, that higher debt burdens increase the vulnerability of borrowers to adverse financial events.

Our present high rate of bank failures in the Southwest stems from the prolonged deflation in the agricultural and energy sectors of the economy. These problems have been exacerbated by the unusually high levels of indebtedness in these sectors.

How dangerous are the increased debt levels to the financial system and the economy as a whole? No one knows for certain and reasonable people do disagree on the answer. But most would agree that the current climb in debt to GNP in this country cannot be extended for many more years without the potential for unacceptably increasing risk. The rate of increase is just too steep!

Change must be achieved both by increasing GNP growth rates and decreasing debt levels. In the process, we must proceed with care -- the flashing yellow caution light is operational!

Banks and thrifts as they compete in this new environment will need to deal with difficult but similar problems. What will you need, what will we need, to cope in this environment? Here are some suggestions.

* First, regulators of banks and thrifts must enhance safety surveillance of the system. Aggressive case-by-case action is the way to get at those that would endanger the system. This is not blanket re-regulation of business decision-making for all institutions. It is a program designed to find the few who would act in a manner that endangers safety and soundness.

  We need -- and you need -- an effective program of safety surveillance carried out by a well-trained and well-staffed supervisory force. It is in all our interests that the regulatory authorities be allowed the flexibility to build an examination force capable of monitoring, and where appropriate, limiting risk-taking by individual institutions. Chairman Gray has taken a true leadership position in this effort in your industry.

* Second, banks and thrifts more than ever will need competent management put in place by well-informed and effective boards of directors. Many institutions are finding it increasingly difficult to retain and recruit good outside directors. An important underlying cause of this development has been the scarcity of liability insurance for directors. This problem must be resolved.

  You may be aware that the FDIC has been working with both the banking and insurance industries to increase the availability of such insurance. We think we've had some success in encouraging reinsurers to reenter the market. But, more needs to be done. Perhaps actions like the one recently taken by the U.S. League to establish a reinsurer will help achieve this goal.

  We are working with other federal bank regulators to develop plain english guidelines for directors. We would hope that this work could be useful to your institutions. This guidance should not only help directors do a better job, but could reduce their exposure to liability claims as well. The industry must continue to explore new approaches to ensure the availability of good leadership.

* Third, depository institutions need a level playing field upon which to compete. I'm not just referring to competition between banks and thrifts, but more importantly to the competition with other players in the financial services industry. Banks and thrifts must work together to press for the passage of new financial services legislation to achieve this result.

* My final point, and perhaps most important point, is that we need a clearer concept of where the financial institutions system of the United States should be headed. We must address this fundamental issue with the safety, soundness and competitiveness of the system as primary goals. It is too late to turn back the clock to a simpler time. Even if we could, we need to look forward and not fight futile battles to patch up outdated laws. We must ask what kind of financial services structure makes the most sense for our economy and, more importantly, our place in the world competitive battle.

  Together we need to focus on where we should be going -- not how to get back where we were. And, we need to do it soon!

Thank you for your attention.