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"The Smartest Animals in the Kingdom"

The Future of Community Banks

An Address ~~by~~

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Good morning.

I am delighted to be here with representatives of the heart of the U. S. banking industry. For many of our nation's 200 million or so people, the community bank is the U.S. banking industry. These bank customers, in large measure, decide what level of public confidence the banking industry will enjoy. And their continued confidence in your industry is a tribute to you and this association.

My remarks this morning are offered in the hope they will help you to continue to be the smartest animals in the kingdom. I'll be courageous and talk about the future of community banks. Speculating on events yet to happen can be somewhat dangerous, as we all know. I generally leave predictions of this kind to the professional economists. Allowing these specialists to use a crystal ball means that they, not I, will have to wade through the broken glass sometime in the future.

The continuing debate surrounding the future of banking has provided a forum for every sector of the financial services industry. Some bankers and legislators cry out that change is coming too fast, that we must slow down, if not reverse, the pace to avoid dismal results. Others see just the opposite. They complain the banking industry will lose out if held in check while other competitors make great advances. They predict exciting new horizons for the world of financial services if restrictions are suddenly relaxed -- they tell us that unbridled competition will create a healthier environment -- a kind of financial survival of the fittest.

I must admit to being more in the latter school. However, I think that banking in particular and financial services in general are so vital to our Nation's economy that we must move forward at a well reasoned and cautious pace. I am convinced banking will become increasingly competitive. The public will benefit but there is little doubt more banks will find it increasingly difficult to prosper and, yes, even to survive.

Well, the smartest animals in the kingdom know that adaptation is the key to survival -- the means of obtaining a winning edge over their would-be predators or competitors.

In the past, the financial kingdom was pretty much insulated from outside sources of competition. Today's banking business, however -- which allows management a hand -- means that bankers are more like other businessmen. They are freer to make mistakes as well as thrive in the new competitive environment. There is no reason to believe that community bankers will not be active participants in the new competition. All of you should and will use your comparative advantage in creating a successful future.

As a long time participant in the private sector, and a sometimes too heavy user of your services, let me give you my observations on why most of you can use your present position to be winners. First, you have the customers. At the business school (I deaned at ASU), we put a latin motto over the door. Harvard has one why shouldn't we. It said

Sine Emplore
Nullum Negotium

Another area where community banks can display their adaptability is by using participation agreements and secondary markets to diversify asset holdings without frustrating local credit needs. Pooling risk could provide a better diversified portfolio than any one bank could achieve on its own. Moreover, origination and servicing fees could become a significant source of non-interest income.

We have supported the idea of a secondary market for agricultural loans to help diversification. There is some movement in Congress now to establish a secondary market for farm mortgages and related loans. A secondary market should help provide farm producers with a source of fixed-rate, long-term credit at more reasonable rates than they are now experiencing. In addition to the ultimate benefits from enhanced diversification options, in the short run, this new source of credit should also help to support depressed farm real-estate prices. This is an idea that you must really push to enhance your inherent advantage.

Please note, I do not say that because you have opportunity all of you will be winners. Those that don't move to take advantage of your current position will almost certainly be losers. Community banks certainly have an important role in the future of banking. The least adaptable will be the first to succumb to the forces of increased competition. Some banks simply will choose to be absorbed into larger organizations and others will choose to consolidate with fellow community banks.

Of course we are aware that some smaller banks have been severely affected by the adverse economic conditions existing in the energy and agricultural sectors of our economy. These problems undoubtedly will take a long time to resolve, and will result in significant losses being realized by the affected banks and by the FDIC. We, at the FDIC, want to help these troubled banks survive. The capital forbearance program initiated by the bank regulatory agencies is designed for this purpose.

The FDIC is amending its capital forbearance program. We plan to expand the program beyond agricultural and energy banks. Capital forbearance will be available to all banks whose problems stem from external economic events -- not just agricultural and energy banks. We will place less emphasis on specific capital ratio levels and more on viability in determining eligibility requirements. In other words, the 4% capital requirement will be waived if the bank has a viable plan for the future. We also are reevaluating the feasibility of a net worth certificate program for commercial banks. Again our objective is to do what we can to keep well run, viable institutions in business.

History shows that banks, big or small, who adapt, prosper. Small banks have survived and prospered under the pressure of new entry. In California, for example, with the largest branching network in the country, there are 337 independent unit banks serving local communities. And, California is among the leading states each year to grant new bank charters.

In New York when large, money center banks attempted to penetrate local communities in upstate New York after state branching laws were liberalized in the early 1970's, community bankers survived and prospered.