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[FSLIC Recapitalization].

An Address ~~By~~

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Washington, D.C.

Before the

American Bankers Association
Leadership Conference

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It is a pleasure to be here at the ABA Leadership Conference. The agenda items are most timely given recent developments in Congress and elsewhere.

This evening I would like to discuss two main topics. The first one concerns the status of the FSLIC recapitalization proposals and the implications for you and your deposit insurance fund. Then, in the time remaining, I will touch on some issues relating to the industry restructuring proposals which will be presented and discussed at this conference.

FSLIC - Related Issues

Everyone in this room should be vitally concerned about how the current funding problems at the FSLIC are resolved. This issue impacts all of us -- not just the thrift industry.

As Chairman of the FDIC, let me state my agency's position on the possible merger of the insurance funds. We don't favor a merger. What we do want is for the Congress to pass a good recapitalization bill that will solve FSLIC's funding crisis. Time is getting short.

As you all know, the Congress currently is considering legislation to ease the FSLIC's plight. I cannot emphasize enough how disappointed I am that the dollar amount initially targeted to recapitalize the FSLIC has been cut in both houses of Congress. I also am very concerned about specific provisions in the House recapitalization bill -- H.R. 27.

To be perfectly blunt, we -- the FDIC and other regulators of depository institutions -- have some very serious concerns regarding the current House bill. It simply poses too many severe regulatory problems to be workable in its present form.

First, the House bill provides the lowest dollar volume of relief -- only a $5 billion aggregate limit over a two-year period. I fear that this will not provide sufficient flexibility to cope with the situation. Yes, it can be argued that this is a start -- but we need a permanent solution to the underlying problems facing the FSLIC.

Title II of the House bill, unlike the Senate version, contains a number of provisions that not only make the bill unworkable -- but it can only be described as creating a supervisory "nightmare." Let me cite a few brief examples.

- It would legislate industry accounting practices - in some cases insisting on Generally Accepted Accounting Standards - in others, deviating from them. Thrifts would be allowed to recognize loan fee income and define capital using liberal accounting conventions not sanctioned by the accounting profession. Regulatory discretion would be eliminated in some areas. As an accountant by training, I must say I dislike setting accounting practices by statute. Financial reporting does not belong in the political arena.

- Further, it would mandate "capital forebearance" to what, in many cases, are insolvent thrift institutions. Again, removing the discretion of the professional supervisors to determine when and what type of forbearance is in the industry's and FSLIC's best interest.

- It fails to address the compelling need for experienced staff nor does it grant relief from OMB oversight under the Antideficiency Act. In recent House hearings Chairman Dingell recognized the difficulty of functioning under such constraints stating, in part, that the FSLIC has "the full sympathy and support of this committee ... the fact that they don't give you enough examiners and the fact that they don't let you pay them enough is a national disgrace and jeopardizes the security of our financial system."

- Perhaps most importantly, provisions of Title II would effectively emasculate the supervisory process over the affected depository institutions. Panels of independent arbiters would be set up to review -- read "second guess" -- the decisions of the supervisory agency regarding loan classifications and asset values if they are disputed by the regulated thrift. Further, a cumbersome appeals process would be mandated. The last thing the S&L industry needs right now is ineffective supervision.

- It would also set up a similar review and appeals process for individual borrowers who have grievances against a thrift. As a lender, how would you like to defend each and every credit judgment?

Such provisions are both disturbing and nonproductive. They only serve to obfuscate the problem, erecting new barriers to a permanent solution. The sheer weight of the administrative burden these provisions would impose make the House bill unworkable and counterproductive.

It was Milton Friedman who once said "The government solution to a problem is usually as bad as the problem." I think you will agree that the current House bill does little to help the FSLIC situation and may well fit Mr. Friedman's unfavorable characterization.

If the House version were to prevail, I frankly believe that any hope of developing a viable FSLIC Recapitalization Plan would be doomed. If that happens we all will then have to face even more difficult choices. We will need to look at other -- more radical -- alternatives such as a merger of the deposit insurance funds and/or a taxpayer "bailout."

I ask you -- just for a couple of minutes -- to put yourselves in the shoes of the CEO of a healthy, well-run thrift institution. Yes, there are healthy thrifts -- quite a few of them really -- and yes, even commercial bankers can let their thoughts wander a moment. Now ask yourself -- How will the House bill help my thrift? Who is protected by such provisions? Do I really want the ability to thwart the supervisory process? I feel confident that your answer, and the answer of most thrift executives, would be a resounding -- NO!

Yet, if a permanent solution is not found you will face the prospect of having to pay to support the continued operation of what is really a small percentage of unprofitable and not very well-managed thrifts. As a responsible thrift executive, you would be left with no real choice -- even though you may wish to support the S&L industry, you also owe it to your firm, to your shareholders and yes, to your customers to look for reasonable alternatives.

One such alternative is to leave the system by converting to an FDIC insured institution. The "exit fee" in the House bill, imposing a penalty equal to two years' assessment payable over a two-year period, is not sufficient to prevent conversions of healthy S&L's to FDIC insured status. If you do the calculations, you will quickly find that a healthy S&L can recover the exit penalty in about three years' time because of the substantially lower premiums charged for FDIC insurance. It would seem that, under the current House bill, healthy thrifts that do qualify for FDIC insurance coverage are almost being encouraged to leave the FSLIC system.

If large numbers of the FSLIC fund's healthiest members move to the FDIC, there will be less likelihood of ever restoring the FSLIC fund. No insurance system can long survive if the weakest members are all that remain. We will all be hurt -- all insured depository institutions _and_ the American public -- if this should come to pass.

I firmly believe that the time has come for the two industries -- commercial banks and thrift institutions -- to cooperate and work together to solve these problems. I ask you to begin to think of banks and S&Ls as common institutions -- common in the sense that they are the insured depository system and have many common interests, not the least of which is the maintenance of a safe and sound financial system.

I would suggest that we work together as one industry with insurance funds, to create the kind of level playing field and the kind of competitive powers which will allow both to survive and prosper. What that form may be in the long run, the industries will have to work out. Maybe it is a common governing Board for regulatory purposes or maybe it is some interrelationship between the insurance funds. I think that has to be an industry question. It seems increasingly clear to me, however, that if the banking industry will think of itself as the broader industry of insured depository institutions, you will find that you have much more in common than you have to quarrel about -- and much greater ability to get things done in the political warfare on Capitol Hill.

Restructuring Issues

Although we all must be concerned about addressing the problems facing the FSLIC, there are other longer-term issues that also need attention. During this conference several industry restructuring proposals will be presented. As the lead-off speaker, I resisted the temptation to return from the mountain with an engraved tablet providing THE answer. Instead, I would like to offer some observations that may prove useful as you listen to the various proposals.

First, let me make a point that I think is very important in serious discussions of banking reform. Deposit insurance, in combination with a responsive Federal Reserve discount policy, has gone far in eliminating systemic risk in the banking system. Specifically, I am referring to the risk of a loss of public confidence that would result in a serious contraction in our economy.

The existence of a federal safety net means individual banks can be allowed to make a wider range of business judgments, including the chance to make mistakes. On balance, the cost of these mistakes to the industry and to the government will be more than offset by increased efficiency and benefits to bank customers; that is, the public at large.

In crafting reform, care must be taken to strike that very delicate balance between an enlighted regulatory approach that promotes maximium individual flexibility and the need to ensure the safety and soundness of the system.

As you review the various proposals, ask what balance each one strikes. When you do that, remember banks are not operating in a vacuum. Proposals that seem logical but place tier upon tier of regulation are costly and thus may be inappropriate in a global economy. Consider to what extent each proposal translates to mean more, not less, regulation. What do the proposals mean in the long run to your operating costs and competitive position?

Another key watchword is simplicity. Someone once observed that the simplest things are often the most sophisticated. Several of the restructuring proposals call for a complex tiered system of holding companies. In considering this and other features of the various proposals, ask yourself whether a simpler alternative is available. Too often we make things needlessly complex -- to the detriment of all concerned.

We -- the Congress, regulators, and bankers -- need to carefully consider our long-run objectives.

The key questions that should be answered are:

1. Why should the government be concerned with depository institutions? -- that's the easy one.

2. Given a legitimate governmental concern for safety and soundness, what are the characteristics of appropriate banking activities?

3. Can banks be effectively insulated for safety and soundness purposes from their owners or affiliates or subsidiary organizations?

4. Does bank restructuring have to protect against undue concentration? Are there other acceptable means?

Remember, we should seek to loosen the bonds that currently restrict our industries -- what we dont't need is to create a hangman's noose.

Conclusion

In closing, I would like to stress the urgency of the FSLIC funding crisis. Longer range, we need to restructure the banking industry to make American banks more competitive both at home and abroad. You will have plenty to do to make progress on these issues during your conference. We at the FDIC wish you good luck and offer our support.