BANKING IN

"INTERESTING TIMES"

Remarks By
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Good morning:

The Chinese have a famous saying: "May you live during interesting times."

I must compliment the Bank Administration Institute for your foresight in planning your annual meeting to occur just as one of the most interesting two-week periods in recent economic history draws to a close.

This is a good moment to take "a visionary look at the future of the banking industry." Why? Because the stresses in the system can indicate where repairs are necessary and where opportunities have been created.

I know this brings to mind the stock markets and the future of the economy, a subject of interest to most of us. I'm happy to say that, so far, we've seen no substantial adverse effect on the banking system from the turmoil.

Since we have more than a normal number of crystal ball gazers eating ground glass than usual, I'll just give you my two market tips:

1. Will Rogers said, "The way to win in the market is to buy good quality stocks and hold them till they go up. If they don't go up, don't buy them.

2. Perhaps more helpful is the most accurate forecasting tool: <u>The Super Bowl</u>: In years when the National League team wins, as the Giants did in 1987, the market finishes higher -- this has <u>always</u> been true. So the market Dow Jones will be above 1900 at the end of 1987 -- <u>prediction not FDIC insured</u>.

3. When the length of ladies skirts go up, the market goes up -- they're going up fast now.

Let me now address the subject for today's banking future, what we can do to improve the outlook?

It seems to me, banking's future depends most importantly on:

° A legislative restructuring of the system designed to provide fair competition and the flexibility to meet changing technology and markets,

and

° Bankers developing the quality customer oriented services needed to meet the challenge of tomorrow's competitive world.

° The performance of the US economy and the markets.

First, restructuring of the laws governing financial institutions.

Evidence of the need for an improved structure is provided by recent economic history. Our economy is in its 59th month of continuous expansion -- the longest sustained period of peace time growth recorded in 133 years. During this period, the annual growth rate for commercial banks has been the lowest of all kinds of financial institutions. The growth rates of credit unions, life insurance companies, mutual funds, securities firms, and finance companies -- have all been higher than banks.

Our banks should mirror the vitality of our economy. It is clear they are not doing so. For an insurer like the FDIC, this is disturbing news because problems in the banking system increase insurance costs.

The FDIC has just completed a study designed to develope recommendations to help change these unfortunate trends. I have some copies with me if you would like them. Let me summarize our conclusions:

We believe banks should be carefully supervised for safety because today banks are special. First, because of deposit insurance, banks borrow, at least indirectly, on the credit of the United States Government. Second, banks are special because any threat to the banking system is a threat to consumer services and savings, the intermediation process, private-sector liquidity, the payments system and, most importantly, the U.S. economy.

Because banks are essential to our economy, regulation by the government is necessary. However, the system also has to prosper to be safe and sound. Bank supervisors cannot order prosperity. It can be achieved only if a fair competitive structure is in place that allows banks to compete and to attract capital.

The objective of any restructuring effort should be to find the least burdensome way for the government to maintain a safe and sound banking system. If the bank itself can be made safe and sound by supervision, then supervision beyond the bank is neither necessary nor desirable. Bank regulation and safety supervision could be focused on the bank -- and on the bank alone.

This leads us to THE PIVOTAL QUESTION: Can a bank be insulated from those who might misuse or abuse it? Can we create a wall around banks that insulates them and makes them safe and sound, even from their owners, affiliates and subs?

We at the FDIC believe that such a "safety wall" can be achieved. This is a real regulatory supervisory wall, created by law, not just a "Chinese wall" that is based on internal paper restraints. Supervising conflicts of interest is the key to a real wall. Based on 54 years of experience, our professional supervisory staff believes that conflicts can be regulated to ensure the safety and soundness of the system.

The tools needed for the "safety wall" are only a logical extension of safeguards that exist today to protect banks from insider abuse and conflicts of interest. These tools are identified in my statement and described in greater detail in the study. THE STUDY CALLS FOR INCREASED REGULATION AND SUPERVISION OF BANKS. A major area of increased regulation is the requirement that the capital of nonbanking subs be excluded from banks' regulatory capital, thus requiring such investment to be excess capital resources.

FDIC bank supervisors and bank directors have effectively safeguarded banks from conflicts of interest over the last 50 years. Inherent in our banking system is the conflict that exists when directors of a bank are also borrowers of the bank. Potential conflicts also can exist in the relationship between a bank holding company and its subs or affiliates. In both cases, history shows us that supervision has been effective in preventing such conflicts from jeopardizing the system.

While our supervision seeks to protect every bank, we know that no system is foolproof. Our goal must be to keep the overall system safe and sound. Our experience teaches us that when the rules are reasonable the great majority of bankers will follow the rules. Thus, the supervisory challenge in creating a safety and soundness wall is to identify and restrain the small percentage who will abuse the system. The view of our supervisory staff is that with the right tools they will find most of the small number of abusers. Thus, they will be able to preserve the system's safety and limit the cost of failures.

With a better supervisory "wall" in place, direct banking regulatory and supervisory authority over bank owners and nonbanking subs and affiliates is largely unnecessary. A wall would permit the dismantling of banking laws that regulate the activities of nonbanking subs and affiliates -- namely, Glass-Steagall and the activity restrictions of the Bank Holding Company Act -- and allow for functional supervision of those nonbanking entities.

This proposal permits nonbanking activities to be undertaken either in bank subs or holding company affiliates. There are approximately 4,500 banks that are not in holding companies. Such companies should <u>not be forced to establish a holding company</u> in order to affiliate with nonbanking entities. Furthermore, there are advantages if the bank conducts business thru a sub rather than an affiliate of a holding company. Earnings of a bank sub's business flow to the bank. "It's heads I win, tails you lose." If the bank runs into financial difficulty, the sub can be sold to raise capital for the bank. If the sub runs into difficulty, under our proposal its failure will not impair the capital of the bank.

Congress also should reassess what activities should be considered "banking" and thus be allowed inside the bank. The FDIC believes that at least mutual funds, commercial paper, securitization and municipal revenue bonds are "banking" and should be permitted within the bank.

To summarize, the existing governmental framework for banking mandates inefficiency and reduces competitiveness. Government's presence should be modernized so that banks can provide more and better services to customers, at lower costs. <u>Bank supervision should be strengthened and nonbanking supervision reduced</u>.

Bankers, regulators, the Congress and the President, must come together to ensure a new structure is put in place.

The second requirement for banking to enjoy the future is the development of customer-oriented services needed for future success.

Winston Churchill said "It is no use saying we are doing our best, you have got to succeed in doing what's necessary."

This is a subject you will be focusing on tomorrow. Let me give you a few comments--which I hope will be useful. Much of what I say comes from a new book--<u>Competitors Handbook</u>, which I wrote. It will soon be out. Naturally, I believe it has some useful information for helping to insure that your vision of the future is a pleasant one.

Please consider whether the following <u>Competitors Handbook</u> guidance for setting a strategy can be useful in your situation.

(1) Commit first and foremost to <u>customer-oriented</u> quality service.

The Latin motto over my dean's office at Arizona State University--sine emptore, nullum negatium--without a customer you don't have a business, is as sound as any university latin I've been able to locate.

(2) Know your facts--your costs, your markets, and your people.

The most important thing I learned in three years at Harvard Law School was, "get the facts, without them, you are helpless."

(3) Build on strength where you find it:

•Your experience

•Your geography

•Your employees

•Your capital

•Your reputation

•Your customers

•Your desire to win

(4) Find a niche or specialize--don't try to be in all markets in all ways. Why do bankers so consistently ignore this advice which is so well accepted in most of American industry? Perhaps because they have just begun to fully adjust to the new competitive conditions created by technological and market changes.

(5) Reward innovation--try something new on a regular basis. Encourage ideas, reward the good ones, and never penalize those who try for creativity but don't succeed.

(6) Work as a team -- use the team approach to decision- making. The team approach takes time because it encourages discussion and controversy. It will, however, develop a strategy based on the commitment of those who participated in its development. Remember the team needs to be rewarded for accomplishment -- not just a few top people.

All of you know more about running banks than the old Dean does, but I hope that these ideas on developing a strategy will be useful to your planning for the future. On thing is certain, strategic planning will be a necessity for your vision of the future to be a pleasant one.

Thank you for the chance to talk with you about these most important subjects.