Deposit insurance in the nineties, the FDIC fund year-end 1988, and the future of the "holding company" concept in the 90's.

Remarks By

L. William Seidman

Chairman

Federal Deposit Insurance Corporation

Before

Association of Reserve City Bankers

January 30, 1989

Thank you for inviting me to speak to this most distinguished group of bankers at this crucial time for your industry.

I come to you today a less outspoken regulator since the White House Chief of Staff apparently suggested a painful resolution of the "toaster" controversy. That is where I referred to the proposed depositor fee as a "reverse toaster premium."

The Washington Post reported that a White House aid capsulized Mr. Sununu's view on the matter in the following terms:

"It is true that he [Seidman] would be uncomfortable if the governor [Sununu] did with the toaster what he suggested!"

I knew that being an independent regulator had its risks -- but that is not one I had contemplated.

Today I will briefly review four questions that may be of interest to you. I believe they should be, since much of banking's future depends on the answers.

These questions are:

(1) What is the likely form of deposit insurance in the nineties?

(2) How did the FDIC fund end in 1988?

(3) What is the future of the uniquely American "holding company" concept [in the nineties?]

First, the likely form of deposit insurance [in the nineties].

The FDIC's goal for 1989 is to help design an improved deposit insurance system -- a system that maintains solvency of your insurance fund and helps preserve a strong industry.

We recently released a study, entitled "Deposit Insurance for the Nineties: Meeting the Challenge."

Today I would like to provide you with some ideas and concepts that were brought forward by this process.

Our study concludes that the deposit insurer should operate more like a private insurer.

The insurer needs to be able to control its revenue, limit its costs, decide who receives insurance, and determine when the insured entity is no longer operating in a prudent fashion and no longer deserves coverage.

As for what powers the insurer should have to help control its revenues, we suggested several augmented authorities:

-- The power to adjust premiums, within prescribed limits, to reflect experience and costs on a continuing basis.

-- The power to assess insurance premiums on borrowings that are secured by assets -- assets that otherwise would be available to the insurer in the event of failure.

-- The power to require that institutions obtaining insurance pay an entrance fee sufficient to maintain the ratio between the insurance fund and insured deposits.

-- The power to borrow from both the Treasury Department and the Federal Reserve.

One area where we don't think additional revenues should come from at this point is the assessment of foreign deposits.

While some good arguments support such an assessment, at this point it doesn't make sense.

It is not at all clear that extra revenues would be generated since many foreign deposits could simply be shifted to foreign subsidiaries. Moreover, such an assessment could make American banks less competitive abroad.

And finally, it is not legally clear what the FDIC's responsibility would be if a foreign government took action to the detriment of a foreign branch. Given these uncertainties, let's leave well enough alone.

The insurer also needs to be independent and self-funded. The insurer should report to Congress -- and be accountable to that body -- but not subject to the appropriations process. And to help facilitate the efficient and effective use of its resources, the insurer should have a budget separate from the general federal budget.

While these conclusions should apply to whatever deposit insurance system emerges in the nineties, the problems in the thrift industry and the FSLIC have raised other questions about the system's fundamental structure.

We estimate the costs associated with handling insolvent S & Ls and recapitalizing the FSLIC to range from $80 to $105 billion. We must emphasize, however, that these are our estimates based on our experience with bank failures.

Precise calculations can only be made after the completion of detailed on-site examinations.

Our study presented three alternative restructuring approaches for the FSLIC:

(1) A stand-alone FSLIC, (2) an administrative merger of FSLIC into the FDIC, and (3) a comprehensive reform of the deposit insurance regulatory structure.

We clearly favor the stand-alone option. That is the best way to keep the FDIC and the banks away from the S & L mess, and able to deal with our own problems down the road.

But as the press has reported recently, the Treasury Department is considering proposing an administrative merger of the FSLIC and the FDIC.

It is still not clear if, and how, this merger will be structured -- but I'll briefly describe the way we suggested it could take place.

There would be an administrative merger of FSLIC into FDIC, with a common management and an administrative board over separate FDIC and FSLIC funds.

Two new members would be added to the FDIC Board, including the FHLBB Chairman and an additional director.

In addition to administering the two separate funds, the new FDIC would supervise state-chartered thrifts and state-chartered banks that are not members of the Federal Reserve System. It would also perform all liquidation activities for insured banks and thrifts.

While there may be some merit to this approach from a public policy perspective, as I said, it does carry with it risks for the FDIC and the banking industry.

Turning to the second topic I would like to address -- the condition of the FDIC.

For 1988, the FDIC will show over a 20 percent reduction in its fund, down to less than a $15 billion net worth. This is the first operating loss in our 55 year history.

Last year's loss is the result of the FDIC taking our lumps on 221 bank failures and assistance transactions, with total assets of $54 billion and total depostits of $37 billion. We also booked the estimated cost of handling the problems at MCorp and TAB/NBC, representing another 61 banks, $30 billion in assets, and $23 billion in deposits.
That adds up to the FDIC spending almost $7 billion dollars in 1988 to handle over $84 billion in assets.

In fact, the FDIC booked the cost of handling more problem bank assets in 1988, than the FDIC handled in total during its first fifty years!

While we expect to make a profit in 1989 -- just barely -- changes are necessary to ensure sound future operations.

My third topic involves the future of our unique holding company structure.

The bank holding company structure as it stands today is not one of my favorite animals. Holding companies were created to get around certain artificial barriers, such as geographic and product restrictions. Now, don't get me wrong. I'm not in favor of those restrictions. But, unfortunately, the formation of bank holding companies resulted in the Bank Holding Company Act. That Act has restricted banks from offering more services, and from being owned by most sources of capital in the U.S.

While some bankers might like being protected from the Perlmans or Ichans of the world, the holding company format is not efficient. No other country has such a structure. Even the Japanese, who have traditionally tried to follow the American model, are now looking hard at the European universal banking examples.

So it was not all bad that holding companies took some hard hits last year. The FDIC's handling of First Republic made clear that the FDIC stands behind banks, not bank holding companies.

Already we have seen the cost of bank holding company debt rise compared to direct bank financing.

We have also found that holding companies have not proven to be the "source of strength" they were once held out as.

Our experience shows that when banks in a multi-bank holding company get in trouble, the holding company doesn't always support its troubled banks with its healthy bank subsidiaries.

The FDIC is seeking new legislation to help us deal with this problem.

The insurer must have the power to require all federally insured institutions owned by a common parent to indemnify the insurer against any losses resulting from the failure of an affiliated bank.

A holding company should not have the ability to lay-off on the insurer the cost of its troubled banks, and leave the holding company free and clear with its healthy institutions.

This is just another example of the fact that the holding company structure is becoming less relevant.

And as the line between banking and commerce erodes further, the importance of this structure will fade into the background. Already, with the help of the troubled thrift deals of last year, this line between banking and commerce looks more like Swiss cheese than the Berlin Wall.

And as you can see, there are many interesting -- and tough -- issues out there these days.

Answers to these issues are not always easy to find.

Everyone wishes for a crystal ball. Unfortunately -- like the philosopher's stone and the alchemist's formula -- they are hard to come by.

But my personal crystal ball would suggest that, if the recommendations in our recent report on deposit insurance reform are largely accepted and put in place, our federal system of deposit insurance will weather the storm.

But asking questions, or even peering deep into a crystal ball for answers, is not enough.

We all need to act.

As Dante pointed out regarding difficult issues, "The hottest place in hell is reserved for those, who in time of great moral crisis, maintain their neutrality."

Let's work together -- taking action -- to make sure we all survive as part of a more competitive and efficient financial system.

Thank you.