President Bush's new plan for dealing with savings and loans

Remarks by

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[Introduction ends something like: "Since he is testifying, we are bringing him live from D. C. Please welcome Bill Seidman." (Begin)]

Hello again from sunny Washington D.C.

To impress you with the frugality of your insurance fund, I'm again saving travel expenses and talking to you by phone.

This year I'm on the horn because Congress requested that I testify yesterday and again tomorrow. Their request of course is my command. Such is the life of your hard working public servant.

I do wish I could have been with you in person today. The good news is you can sleep through the speech and your regulator will never know.

Since I'm present only by voice and spirit, I think it probably is safe for me to talk with your about some real banking issues raised by President Bush's new plan.

Let me start by saying we believe the plan is basically sound, and the President and his new team should be commended for the job they've done. But it's not perfect. So I'll talk about six issue it raises.

First, <u>independence and the President's Plan</u>.

One of the FDIC's greatest challenges throughout the development of a plan for dealing with the thrift problem has been to maintain the independence of your insurer and the banking industry.

Of course, the FDIC -- and its Chairman -- have a significant degree of independence.

These days I can get to work anytime before eight a.m., and I can leave whenever I please after eight p.m.!
[Pause]

A fundamental conclusion of our year-long study on deposit insurance reform was that an independent federal deposit insurer is essential to a cost-effective system.

The deposit insurer must be independent to be able to control its costs and resist undue political pressure.

While generally supporting independence, the President's proposed legislation would make changes to the existing structure of the FDIC that would really limit its independence.

First, the bill would permit the President to appoint and remove, with or without cause, the Chairman and Vice Chairman of the reconstituted FDIC Board of Directors. Now I'm not taking this personally, of course, but it's clear that this new removal authority could put real pressure on the independence of the FDIC.

After all, under the President's plan -- two members of the new five member board -- the Comptroller and the Bank Board Chairman -- report to the Treasury.

Second, the bill would place limits on the FDIC's borrowing authority. We believe it is clearly appropriate to limit the FDIC's ability to issue notes and other debt obligations.

However, the bill -- at OMB's request -- would inhibit our ability to deal with the thrift problem by imposing a complicated formula limiting our authority to issue obligations -- in a way that would jeopardize our ability to handle failed institutions.

We believe a simple provision that we should be able to issue notes or obligations as long as they are covered by our net worth, is sufficient. It will assure that taxpayers don't get hit with any further note liabilities.

Third, the proposed legislation would require the FDIC to submit quarterly reports to both the Treasury Department and to the OMB on our "financial operating plans and forecasts...."

In order to save paper and cut costs -- a most laudable objective -- we believe it should be sufficient to file such reports with the Treasury. And the documents should be the financial reports prepared by the FDIC in the ordinary course of business.

Any help you can give us on these issues will be appreciated.

A second issue I would like to discuss is <u>the appropriateness of the proposed premium increases</u>.

With respect to your bank premium increase, let me make these points:

(1) Without regard to the S&L problem, an increase was necessary. Your fund lost over $4 billion in 1988, and is down to $.83 per insured $100.

(2) No part of the increase goes to pay for the S&L problem.

(3) Given our current estimates, refunds could begin under the new plan in four to five years.

(4) This increase is really a refund by you of past rebates. If those rebates had not been made, the FDIC fund would now be $40 billion -- well over the required $21 billion needed to reach targeted reserve levels. I'm sure that point makes you feel a lot better about the increase!

A third issue is <u>the deposit insurance logo for banks and thrifts</u>.

This issue involves the question of what insurance logo banks and thrifts can have on their front doors after the President's plan is in place.

For the banks, it is a question whether they will retain the FDIC logo that represents many years of generally prudent conduct and a solvent insurance fund.

For the thrifts, it is a question whether they can begin to extract themselves from the tarnished reputation their industry now labors under -- and pays for everyday as it raise funds. If they can use the bank's insurance logo, many thrifts might think they are getting at least something of value in return for their high assessments.

At this point it appears some sort of compromise must be structured.

The proposal in the President's bill provides that the thrift's insurance fund will be called the "Savings Association Insurance Fund", or SAIF, and will be differentiated from the "Bank Insurance Fund", or BIF. Both institutions will display the FDIC logo, but as part of that logo, the institution will have to identify whether it is part of BIF or SAIF.

The first sounds like WIF (If), and the second like -- SAIF -- a Saudi Prince. Give us your suggestions -- perhaps FDIC-banks and FDIC fizzle would do the job.

We need to work on this one with your leadership.

A fourth issue involves the FDIC's plans for disposing of assets acquired as a result of taking over failed thrifts.

Several groups have raised concerns about our plans for asset liquidation operations, particularly real estate. They have asked us to hold our real estate off the market and not sell till the price is right -- whenever that is.

The FDIC's present position is as it has been in the past -- that all real estate will be for sale.

Importantly, we will try and sell these properties at current fair market values, and will <u>not</u> engage in dumping. If we can't obtain today's fair price, we'll hold on.

No sales will be made on a "whatever we can get basis."

We believe government subsidized holding of properties off the market for higher prices actually can be detrimental to the real estate market and local economy. Large amounts of property overhanging the real estate market, under asset maintenance agreements, creates uncertainty and delays return to true private sector management.

No one knows when the government might open the flood gates.

The way the private sector can make rational economic decisions is to get property back into private hands as promptly as possible. However, unfortunately, even with such a policy, sales will take years.

Incidently, the FDIC is moving to make the sale of real estate easier by now accepting terms. That includes all cash bids. So come in and see us. We'll have lots for sale.

The fifth issue involves the dual banking system and its relationship to the President's plan for federal deposit insurance. The issue is: why should the federal government insure institutions that are allowed by the states to do all sorts of things that the Feds won't allow federally chartered institutions.

There is a growing feeling that deposit insurance should be limited to thrifts engaged in traditional activities as defined by statute. Thus, many have said, let's limit the kinds of activities that the states can permit through the dual banking system.

That means residential real estate and consumer financing -- not basic commercial banking, and certainly no less wind mills or fish farms.

Instead of that drastic limitation on the dual banking system, I'd like to give you the FDIC's thoughts.

It is appropriate for the federal insurer to limit what can be done by our insured institutions since the insurer is backed by the credit of the Government.

Thus, thrifts, and indeed banks, should ideally limit themselves to traditional activities within the insured institutions.

However, nontraditional activities should be permitted, outside the bank or thrift in a separate subsidiary (or affiliate of a holding company).

By using excess capital to fund that separate unit, and enforcing a system of tough supervisory firewalls between the insured and uninsured entities, the traditional bank or thrift would remain safe. If the riskier affiliate did well, the insured entity would reap the benefits. If the affiliate failed, that cost would not spread to the deposit insurer.

This is the key to keeping the industry healthy, and the insurer safe.

Of course, the problem with this approach has been the Fed's unwillingness to permit many nontraditional activities to take place outside the banks in subsidiaries or affiliates.

The Fed's famous Reg Y proposal that attempts to extend this power to subs of state banks owned by holding companies becomes a key issue here. Our plan can't work if the Fed's Reg Y positions is upheld.

Bankers are united as never before in opposition to the Fed's position on this issue.

With the way things are going on the Hill, you and we can't afford to lose this one.

You have written my friend Chairman Greenspan some great letters -- with quite colorful language. Don't stop!

Sixth, will the FDIC's new responsibilities for overseeing and controlling over 200 insolvent thrifts seriously impair our main responsibility of supervising state nonmember banks?

At its height, this task will utilize as many as 1500 regulators at any one time.

Regulators from the OCC, the Fed, and the FSLIC are part of this effort, together with the FDIC's own people. At the point of greatest demand on human resources, we expect about 750 of our 2000 employed supervisory people will be on this new assignment.

However, it is important to note that this very significant use of FDIC personnel will only be for a short period -- probably two to three months. After that, no more than a few regulators will remain in each institution.

There is no doubt that this will put a strain on our resources, but with help from the state supervisors, the job can be done. All banks that are in trouble will be handled with no change in operations.

In accordance with previous plans, we are in the market for 150 additional supervisory personnel to increase our totals to over 2200.

You can rest assured that the FDIC will have the bulk of its supervisory personnel on their prime mission -- supervising banks.

History certainly is confirming what we always suspects: better supervision can reduce insurance costs. That means under the President's program of variable insurance rates, lower costs to the good banks.

Let me close by saying I am very pleased that Comptroller Clarke is proposing to change the OCC's bank closing standards to apply equity capital, rather than primary
capital, to determine insolvency. This is a sound step in the right direction. It will reduce deposit insurance costs by closing institutions earlier than now can be done.

Incidently, Bob Clarke is the best comptroller this county has seen in a long while. We and you are luck to have him stay on in the new administration.

Well, I'm at a point in this speech that reminds me of a story that one of the presidential candidates recently told me about his experience during the campaign.

He had just finished a long and rambling six issue speech like this one. Afterwards a woman came up to the speaker's table to shake his hand.

She said, "I liked your speech. But it seems to me you missed several excellent opportunities."

The candidate asked, "Several excellent opportunities to do what?"

"To end your speech," she replied.

Not to be accused of missing good opportunities, I'd like to say thank you for asking me to speak.

Once more, I'm sorry I couldn't have been with you in person. I wish you a successful and interesting convention.

Thank you.