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FEDERAL DEPOSIT INSURANCE CORPORATION

"The health of the FDIC"

Remarks by

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Good day, ladies and gentlemen. I am most pleased to be able to speak to you again.

I'm not going to talk to you today about the usual FDIC problems -- the RTC and land "dumping", capital standards and the Comptroller, or the RTC Oversight Board and turf.

These issues sadly tend to remind me of Woody Allen's prophetic words at a graduation ceremony:

"Graduates, more than any other time in history, mankind faces a crossroads. One path leads to despair and utter hopelessness. The other to total extinction. Let us pray we have the wisdom to choose correctly!"

That brings to mind W.C. Fields who, when asked to choose between two sinful evils, replied: "For variety I usually select the one I haven't tried before."

Actually I'm here to remind you this marks my fourth anniversary at the FDIC and the 110th anniversary of Thomas Edison's demonstration of the incandescent electric lamp.

Edison is one of my favorites. When introduced in a long-winded introduction emphasizing his invention of the talking machine, Edison rose and said: "I thank the gentleman for his kind remarks. But, I must insist on a correction. God invented the talking machine. I only invented the first one that can be shut off..."

So I'll keep it short.

First, as is my custom, I'll report on the health of your FDIC.

So far, 1989 has been a much better year than 1988 for the FDIC -- at least with respect to our financial report card.

In the first six months of 1989, we returned to making a profit. Our insurance fund -- what we now fondly refer to as BIF -- grew by $171 million to a net worth of $14.2 billion. We estimate that we could break even in 1989.

The main reason for this improvement is: 1989's failures are much less costly than last year's and many '89 failures were reserved for in '88. At first blush the failure rates over the last two years appear relatively close. By the end of third-quarter 1988, 186 banks had failed or received assistance. By that same time this year, 163 banks had failed or received assistance.

However, financially in 1988 we booked the estimated cost of handling several large problems -- MCorp, TAB, and NBC -- even though they failed in 1989. That means the number of failures the FDIC must really "pay" for thus far in 1989 is more like 119, not 163. Fortunately, we do not expect any really large bank problems to hit our books for rest of the year -- if of course no events occur that we haven't foreseen.

Until recently we had been very successful in shrinking our asset portfolio, mostly through the increased use of "whole" bank sales where assets are kept with the private sector. However, the book value of our assets in liquidation has increased 12 percent in the first half of this year -- up to $10.4 billion.

Most of this increase resulted from a lower success rate with our "whole" bank transactions, particularly in Texas. Maybe we've saturated the market.

We need to do better because our cash is down. We have been able to keep our liquid assets fairly stable at over 70 percent of total assets for most of the year, but we expect that ratio to drop to about 55 to 60 percent by year-end. As you know, the FDIC's continued liquidity has been a key to our ability to meet the record problems we have seen over the last few years. This is an area that we are giving special attention.

All in all 1989 certainly will not be our best year.

And, from a nonfinancial view point, your [friendly] old FDIC will never by the same. It's now the RTC, SAIF, BIF, Old FSLIC, and FADA -- with appropriated funds and OMB reviews.

This new status reminds me of what Max Kauffman once said about marriage: "I never knew what real happiness was until I got married. And by then it was too late."

Ah, for the good old days of obscurity and independence!

Let's talk about your future -- particularly about the future of the dual banking system. Some important developments can be discerned in this area. As a defender of dual banking, we find these developments disquieting.

First, the Treasury Department has been mandated by Congress in the new legislation to study a range of issues related to the future of deposit insurance and the financial system.

for those of us in the business this process brings to mind the old saying, "Never play leapfrog with a unicorn."

Let me remind you of some issues to be addressed in the study that relate to the dual banking system:

-- incentives for market discipline (A) limiting each depositor to 1 insured account per institution; (B) reducing the amount insured, or providing for a graduated decrease in the percentage of the amounts deposited; (C) combining Federal with private insurance; and (D) ensuring that on the closing of any insured institution, the appropriate Federal insurance fund will honor only its explicit liabilities, and will never make good any losses on deposits not explicitly covered by Federal deposit insurance. That's really the "Too Big To Fail" issue.

-- the scope of deposit insurance coverage and its impact on the liability of the insurance fund,

-- alternatives to federal deposit insurance,

Thus, the study will examine ways of reducing deposit insurance levels. Why does this threaten the dual banking system? Because reducing deposit insurance levels would likely put small banks at a competitive disadvantage with large banks in gathering deposits.

Federal deposit insurance was created over 55 years ago largely through the support of small banks. Larger banks opposed deposit insurance at that time. And, in many ways, deposit insurance has been essential to maintaining our decentralized community banking system. It allows smaller institutions to gather deposits on an equal basis with the biggies.

The key to the discussion and resolution of the issue of reducing deposit insurance coverage is the "Too Big To Fail" issue. That is, should certain institutions will be considered "too big" to allow their depositors to suffer losses? No discussion of changes in insurance levels can be complete without resolving this subject. As we know, "too big to fail" is 100 percent deposit insurance. Can we reduce deposit insurance levels for smaller institutions while "Too Big To Fail" has not been repealed? Stay tuned, this will be a big one for the dual banking system.

Perhaps the answer will fit the old congressional saying: "If you thought the problem was bad, wait till you see our solution."

Second, the Comptroller of the Currency has proposed a new capital standard for national banks that would result in lower capital requirements for national banks are required of state banks.

Our calculations indicate that the Comptroller's proposal would reduce minimum capital requirements in the banking system for most banks. I applaud and support Chairman Greenspan's speech to you yesterday on the need for capital in this industry.

Unless a common standard can be agreed to, national banks will gain a competitive advantage over state banks subject to a

higher capital requirement. Failure to resolve this conflict not only reflects badly on us regulators, but even more importantly, it bodes ill for the dual banking system.

Third, as you know, the new S&L legislation already gives the Office of Thrift Supervision, and thus Treasury, authority over both state and federal thrifts.

Some in authority have suggested this pattern be followed for banks. They argue that the insurer should not both supervise and insure financial institutions. The reason given is that the insurer will tend to be too tough a regulator -- requiring excess capital and excess supervision. If in fact this is the way of the future, Treasury through the Comptroller would be the federal regulators of state banks. Since the Comptroller is the charterer and promoter of national banks, this is not an encouraging development for state banks. Presumably the difference between the two would slowly expire.

Nothing in recent history indicates that the record of insurer-led supervision has been too conservative. In fact, perhaps it has been too liberal.

Fourth, the Fed is still playing around with controlling subsidiaries of state banks in holding companies despite its loss in the AMBAC case.

The Fed's Reg Y would extend its jurisdiction to subsidiaries of state-chartered banks -- the traditional domain of state regulators and the FDIC.

On this issue a state banker recently sent a letter to the Fed that stated: "For one thing, [the Fed's proposal] would put my bank at a substantial disadvantage to state banks that are not members of bank holding companies".

"Also, keep in mind that your grand plan may backfire in that state banks may be forced to fold the subsidiary operations now existing into the bank, therefore, increasing the risk to the banks as opposed to the way things are now where the subsidiary insulates the bank."

Both perceptive observations.

The last public action by the Fed in this area was its receipt of comments to its proposed regulations and a public hearing on the issue last April. Nothing since. Hopefully, the Fed will allow this issue to fade away.

But until they do, it's another dual banking system negative.

Well, those are areas where the dual banking system faces challenges.

One final point -- perhaps the most important with respect to my concern for the future of the dual banking system. It relates to the FDIC Board, which currently has 4 members. Two of our members are now from Treasury -- the Comptroller and the Director of OTS -- and then there are two independents, C.C. Hope and myself. We have an opening now for a fifth member. The Country needs an independent banker dedicated to the dual banking system in that position.

I hope you will all get together, agree on a candidate, and recommend him to the President. It's so important for your health that I'm confident my hopes will be fulfilled since your record on agreement has improved substantially under Doan Ogilvie's leadership.

Speaking for myself, I look forward to working with the ABA and bankers across the country to insure dual banking is part of your future.

Thank you.