Testimony of
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on
Financial Services Modernization Act of 1999
before the
Committee on Banking, Housing, and Urban Affairs United States Senate
10:00 a.m. February 24, 1999
Room 106, Dirksen Senate Office Building

Mr. Chairman, Senator Sarbanes and members of the Committee, I appreciate this opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on the draft Financial Services Modernization Act of 1999 and related issues. I commend you, Mr. Chairman, for acting quickly in the 106th Congress and beginning formal deliberations on how best to strengthen and improve the financial services industry.

The FDIC has been and remains supportive of efforts to modernize the nation's banking and financial systems. Since its creation under the Banking Act of 1933, the FDIC has worked to ensure the safety and soundness of the banking system and to assure depositors that their insured deposits are safe. Consistent with its broad perspective on public-policy issues, this concern for the safety and soundness of insured depository institutions underscores the FDIC's approach to financial modernization.

The financial markets have changed dramatically since the 1930s when many of our nation's laws governing the financial system were written. Improvements in information technology and innovations in financial markets have rendered the current system increasingly obsolete and unable to provide the full range of financial services required by businesses and individual consumers in today's global economy. Modernization of the financial system is not only desirable, but necessary, to enable the financial services industry to meet the challenges that lie ahead.

The FDIC has long held the view that the maintenance of healthy and viable depository institutions requires that these institutions generate sufficient returns to attract new capital in support of normal growth and expansion into new areas. To achieve these goals, insured depository institutions must have the ability to compete on an equitable basis with other business enterprises, and their products and services must be permitted to evolve with the marketplace in a manner consistent with safety and soundness. Equally important, the legitimate needs of consumers must be addressed. As part of any effort to modernize the financial system, the potential effect on small communities, isolated markets, and customers of insured depository institutions must be considered.

The draft bill repeals key Glass-Steagall restrictions and authorizes banks to underwrite municipal revenue bonds directly or in a subsidiary. It also authorizes bank holding companies and other affiliates of banks to engage in a wider range of securities and insurance activities. Qualifying national bank subsidiaries are permitted to engage in expanded principal activities. These represent important steps toward achieving the goals of financial modernization. In addition, we commend you, Mr. Chairman, for including a repeal of the Savings Association Insurance Fund (SAIF) Special Reserve.

Although the draft bill is a positive step toward financial modernization, the FDIC believes it can be improved. First, although the draft bill would eliminate the SAIF Special Reserve, it does not mandate a merger of the SAIF and the Bank Insurance Fund (BIF). Moreover, the undecided issues portion of the draft bill would extend the current disparity in Financing Corporation (FICO) assessment rates for an additional three years, which may have adverse consequences. Second, by imposing a size limitation on the ability of national banks to conduct financial activities as principal in a direct operating subsidiary, the proposed legislation unnecessarily favors the holding company affiliate structure over the bank operating subsidiary structure. Finally, the FDIC has concerns regarding several of the provisions relating to the Community Reinvestment Act.

The Deposit Insurance Funds

The draft bill would eliminate the SAIF Special Reserve, and the FDIC applauds this provision. The Special Reserve was created by the Deposit Insurance Funds Act of 1996 (the Funds Act). Under the Funds Act, on January 1, 1999, the FDIC was required to establish a Special Reserve comprised of SAIF funds above the dollar amount required to meet the 1.25 percent Designated Reserve Ratio (DRR) at year-end 1998. The Special Reserve can only be drawn upon if the reserve ratio of the SAIF is less than 50 percent of the DRR and is expected to remain so for four consecutive quarters.

As required by law, the Special Reserve was established on January 1, 1999. On the basis of September 30, 1998 data, approximately $1 billion was segregated into the Special Reserve, thus lowering the SAIF reserve ratio from 1.39 percent to 1.25 percent. The amount of the SAIF Special Reserve will be adjusted to reflect year-end figures when those figures become available in March 1999.

Ironically, if the SAIF Special Reserve is not eliminated, the Special Reserve could lead to an assessment rate disparity between the BIF and the SAIF, thus recreating the very same circumstances the Funds Act - which levied a $4.5 billion special assessment on SAIF-assessable deposits - was intended to eliminate. As a result of the Special Reserve, unanticipated failures of banks and savings associations, or faster-than-expected growth in insured deposits, could cause the reserve ratio of the SAIF to drop below the DRR. Any drop in the SAIF reserve ratio below the DRR likely would precede the reserve ratio of the BIF falling below 1.25 percent, because the SAIF would be starting at a lower reserve ratio. When a fund's reserve ratio drops below the DRR, the FDIC is required to increase deposit insurance assessments to restore the fund's reserve ratio to the DRR. Thus, the FDIC most likely would be required to raise SAIF assessments before instituting a comparable increase in BIF rates, recreating a rate disparity between the two funds. This disparity in assessment rates could arise even though the actual amount of funds available to support the SAIF, which would include the Special Reserve, might exceed the amount of funds necessary to meet the DRR.

Differences in deposit insurance assessment rates among institutions should reflect differences in risks posed to the insurance funds, not artificial distinctions, such as those that existed before the passage of the Funds Act. Higher assessment rates for SAIF-insured deposits resulted in the shifting of deposits from the SAIF to the BIF and other inefficiencies that were detrimental to virtually all parties. Such market distortions have an economic cost as institutions devote resources to countering artificial statutory distinctions. Thus, the FDIC strongly endorses the elimination of the Special Reserve as outlined in the draft bill.

Although elimination of the SAIF Special Reserve would mitigate the incentive for deposit shifting, one of the undecided issues raised by the Committee - a three-year extension of the disparity in FICO rates paid on BIF- and SAIF-assessable deposits - would exacerbate this problem. The FDIC hopes that the FICO provision is left out of any legislation reported out of the Committee. The FDIC supports equalizing the FICO rates as of January 1, 2000, as provided under current law.

The Funds Act provided for the payment of interest on bonds issued by the Financing Corporation, which amounts to approximately $780 million per year, to be paid by all institutions that are covered by FDIC insurance. Initially, the FICO obligation was to be split between BIF and SAIF deposits such that the rate on SAIF deposits was five times the rate on BIF deposits. The rates were to be equalized no later than January 1, 2000. The annual FICO assessment rate is currently 6.10 basis points for SAIF-assessable deposits and 1.22 basis points for BIF-assessable deposits. It is scheduled to go to approximately 2.2 basis points for BIF- and SAIF-assessable deposits as of January 1, 2000.

SAIF members have expected the current FICO rate differential to be short-lived. If the Congress extends the rate differential for another three years, some SAIF members may begin to doubt if the rates will ever be equalized. The FICO obligation extends for another 20 years. Faced with the possibility of a persistent rate differential, holders of SAIF-insured deposits may feel it is in their best interest to try and shift deposits to the BIF. As we have discussed above, this would result in the very inefficiencies that the Funds Act was intended to eliminate. Therefore, the FDIC believes that the FICO rates paid on BIF- and SAIF-assessable deposits should be equalized next January, as provided by current law.

Although the Special Reserve and FICO payments are recent creations, much of the draft bill deals with modernizing laws that have become outdated with the passage of time. However, there is one relic of the statutory framework established after the Great Depression that the draft bill does not address - two separate deposit insurance funds.

The arguments for a merger of the BIF and the SAIF are persuasive, the timing is optimal, and the administrative and logical steps required to bring a merger about are not complicated or difficult.

The FDIC was established in 1933 and the Federal Savings and Loan Insurance Corporation (FSLIC) was established in 1934. Throughout its history, the FDIC has insured some savings institutions, notably state-chartered savings banks, but for the most part it has insured commercial banks. The FSLIC insured savings-and-loan associations (S&Ls). The SAIF was established in 1989, in the aftermath of the savings-and-loan crisis of the 1980s and the insolvency of the FSLIC, to succeed the FSLIC fund and the FDIC fund was renamed the BIF. Both funds were put under the management of the FDIC.

In the 1930s, there were substantial differences between commercial banks and S&Ls. In general, S&Ls were mutual institutions that primarily offered savings accounts and home mortgages for consumers. Because their charters permitted limited activities, they were not allowed to offer checking accounts, consumer loans, or commercial loans. Indeed, their loans were virtually all long-term, fixed-rate residential mortgages. Commercial banks, on the other hand, served mostly commercial customers. More than two-thirds of bank deposits were demand deposits and banks made very few residential mortgages. Thus, there were significant differences in the institutions insured by the FDIC and the FSLIC when the agencies were created.

Over time, the distinctions between banks and thrifts have become blurred. Each has entered what was once the other's domain. On the asset side, the portfolios of all but the largest banks often look very similar to the portfolios of thrift institutions. Both offer essentially an identical array of deposit accounts. From the point of view of the insured depositor, there is virtually no difference between banks and thrifts.

Not only have the banking and thrift industries become more similar over time, but the composition of who holds SAIF-insured deposits has changed as well. The name Savings Association Insurance Fund connotes a fund that insures savings associations. When it was established, this was indeed the case. Virtually all SAIF-insured deposits were held by SAIF-member thrifts. However, over the last decade, this has changed dramatically. As of September 30, 1998, commercial banks (35.1 percent) and BIF-member savings banks (8.1 percent) held over 40 percent of all deposits insured by the SAIF. Indeed, two of the five largest holders of SAIF-insured deposits are First Union National Bank and NationsBank N.A. The name Savings Association Insurance Fund has become a misnomer. The SAIF has become a true hybrid fund.

If the only problem with having two insurance funds is that one is misnamed, there would be little reason to merge the funds. However, there are substantive reasons why the two funds should be merged. First, as we have previously stated, the BIF and the SAIF provide an identical product - deposit insurance. Yet, as long as there are two deposit insurance funds, whose assessment rates are determined independently, the prospect of a premium differential exists. When an identical product is offered at two different prices, consumers - in this case, banks and thrifts that pay deposit insurance assessments - naturally gravitate to the lower price. This phenomenon was observed before the passage of the Funds Act when some SAIF-insured institutions successfully shifted deposits to BIF insurance. Despite moratoriums, entrance and exit fees, and bans on deposit shifting, market forces ultimately prevailed. Inefficiency and waste were introduced as institutions expended time and money trying to circumvent restrictions that prohibited them from purchasing deposit insurance at the lowest price. Although the Funds Act led to the elimination of the disparity in deposit insurance assessment rates that then existed between the BIF and the SAIF, a merged fund would guarantee that such a disparity would not recur in the future. It would have a single assessment rate schedule whose rates would be set solely on the basis of the risks that institutions pose to the single fund. The prospect of different prices for identical deposit insurance coverage would be eliminated.

Second, a merger of the funds would help mitigate the increased concentrations of risk facing both the SAIF and the BIF. Since its inception, the SAIF has insured far fewer, and more geographically concentrated, institutions than the BIF has insured. Consequently, the SAIF has faced greater long-term structural risks and has been subject to proportionately greater losses from the failure of a single member. Although interstate merger activity may have reduced the geographic concentration of SAIF deposits somewhat, recent merger activity has increased the relative size of the largest members of either fund. As of midyear 1990, the three largest holders of SAIF-insured deposits held 8.7 percent of these deposits, and the three largest holders of BIF-insured deposits held 5 percent of these deposits. As of September 30, 1998, that figure was 13.3 percent for the SAIF and 10.1 percent for the BIF. In a combined insurance fund, the three largest institutions would hold 9.3 percent of insured deposits.

Finally, a merger of the funds also would result in lower administrative costs to the FDIC and to approximately 900 institutions that hold both BIF- and SAIF-insured deposits (Oakar deposits) that must be tracked and assessed separately. Although these costs may not be large in absolute dollars, they represent wasted funds.

In summary, the BIF and the SAIF both are capitalized fully, with identical assessment rate schedules, and the members of both funds are healthy and profitable. Upon elimination of the SAIF Special Reserve, the reserve ratio of the SAIF would be restored to reflect its true level, and the BIF and the SAIF would have comparable reserve ratios. A merger of the two funds under these circumstances would not result in a material dilution of either fund, and would strengthen the deposit insurance system. This is an excellent time to merge the funds and eliminate a weakness in the federal deposit insurance system. It would be unfortunate if the Congress, while modernizing the rest of our statutes governing the financial services industry, left the anachronism of two deposit insurance funds in place.

Permissible Activities and Corporate Structure

The draft bill would repeal key Glass-Steagall restrictions that inhibit member-bank affiliations with securities underwriters. In addition, qualifying bank holding companies and their nonbank subsidiaries could conduct a wide range of financial activities, including the full range of insurance and securities activities. The new test for permissible activities would be "financial in nature or incidental to such financial activities." The draft bill lists many permissible activities for qualifying bank holding companies, and permits the Federal Reserve Board, in coordination with the Secretary of the Treasury, to determine other permissible activities.

To qualify for the expanded list of financial activities, a bank holding company would have to meet certain requirements. All subsidiary depository institutions would have to be well-capitalized and well-managed. If the holding company does not maintain its well-capitalized and well-managed status, it could be required to divest a depository institution subsidiary or cease a new activity, if the holding company fails to correct the deficiency. However, the draft bill would not require that all insured depository institutions have a satisfactory Community Reinvestment Act (CRA) rating at the time the bank holding company declares that it wishes to engage in the new permissible activities. Banking organizations that choose to conduct new financial activities should serve all of the members of their communities. Thus, the FDIC favors the approach taken in H.R. 10 that would require a satisfactory CRA rating.

The draft bill would expressly authorize expanded activities as principal for a subsidiary of a national bank that is not part of a holding company, provided that the bank and its subsidiaries had consolidated assets of $1 billion or less. Any activity classified as "financial in nature or incidental to such financial activities" would be permissible, with limited exceptions. In addition, the bank must be well-capitalized and well-managed. Finally, approval from the Comptroller of the Currency is required.

The draft bill would require that investments in a national bank subsidiary engaged as principal in financial activities be deducted from regulatory capital. The draft bill also applies the anti-tying provisions of the Bank Holding Company Act Amendments of 1970 and Section 23B of the Federal Reserve Act to the relationship between a national bank and its principal activities subsidiaries. As in the case of a holding company, at the time the bank first acquires control or an interest in a subsidiary, the bank is not required to have a satisfactory CRA rating.

Although allowing national banks with assets under $1 billion to conduct some activities in bank subsidiaries is a step forward, the FDIC still has concerns about the imposition of a size criterion for national banks to conduct expanded financial activities as principal in a direct subsidiary. There is no valid reason to treat national banks differently on the basis of size or holding company affiliation. As discussed below, the FDIC believes that all national banks, regardless of size, should have the freedom to choose what organizational structure is appropriate for the conduct of expanded principal activities.

The FDIC has gone on record as supporting the repeal of the Glass-Steagall restrictions and the expansion of permissible financial activities, subject to proper safeguards to protect the safety and soundness of insured depository institutions and the federal deposit insurance funds. These provisions advance the goals of financial modernization, consistent with safety and soundness. However, there is no reason to withhold from all banks, regardless of size or holding company affiliation, the option of conducting the full range of expanded financial activities, including activities conducted as principal, through bank subsidiaries.

The question as to whether new activities for financial institutions should be authorized for direct subsidiaries of banks or be conducted only in nonbank subsidiaries of bank holding companies has emerged as one of the more critical issues to be decided in the current debate over financial modernization. Aside from its competitive implications, the resolution of this issue is particularly important because, to a large extent, it will determine the future legal and operational structure of diversified financial service providers in the United States.

The FDIC has studied this issue closely for a long time. It is our judgment that both national and state-chartered banks, regardless of size or holding company affiliation, should have the freedom to choose the corporate structure that best suits their business needs for conducting permissible nonbank activities. However, it is essential that certain safeguards be in place to protect the bank, the safety and soundness of the banking system, consumers, and the taxpayer. The necessary safeguards include: (1) applying principles such as those contained in Sections 23A and 23B of the Federal Reserve Act to transactions between a bank and its operating subsidiary, with the appropriate principles to be determined by the federal banking agencies; (2) requiring that the bank's investment in the operating subsidiary be deducted from regulatory capital; (3) requiring that after this deduction, the bank be well-capitalized; and (4) requiring that the corporate separateness of the bank be protected. In addition, the adoption of real-time reporting requirements should be considered for intracompany transactions under certain conditions, analogous to SEC requirements. The draft bill does not specifically require that a bank holding company engaging in expanded activities ensure the corporate separateness of its affiliates. The FDIC strongly believes that the maintenance of corporate separateness is vitally important and that the draft bill should be revised to include a provision requiring corporate separateness. With these safeguards in place, we see no compelling public-policy reason to mandate a particular organizational form.

From a safety-and-soundness perspective, both the bank operating subsidiary and the holding company affiliate structures can provide adequate protection to the insured depository institution from the direct and indirect effects of losses in nonbank subsidiaries or affiliates. Some have argued otherwise - that the bank holding company structure provides greater safety-and-soundness protection than does the operating subsidiary structure. As the deposit insurer, we have examined this issue closely and we disagree. Indeed, from the standpoint of benefits that accrue to the insured depository institution, or to the deposit insurer in the case of a bank failure, there are advantages to a direct subsidiary relationship with the bank. The properly insulated operating subsidiary structure and the holding company structure can provide similar safety-and-soundness protection when the bank is sound and the affiliate/subsidiary is financially troubled. However, when it is the bank that is financially troubled and the affiliate/subsidiary is sound, the value of the subsidiary serves to directly reduce the exposure of the FDIC. If the firm is a nonbank subsidiary of the parent holding company, none of these values is available to insured bank subsidiaries, or to the FDIC if the bank should fail. Thus, the subsidiary structure can provide superior safety-and-soundness protection. Appendix A to this testimony contains an in-depth analysis of this issue.

The FDIC certainly has had experience where the placement of an activity in a holding company affiliate has raised the cost of a resolution. For example, in many instances in the 1980s and early 1990s, data processing activities were conducted in a holding company affiliate. This gave the holding company bankruptcy trustee considerable leverage to extract fees from the bank receivership that the holding company would not have received had the data processing activities been conducted in the bank.

From a public-policy perspective, however, not all decisions should be dictated by savings to the deposit insurance fund at the time of bank failure. For example, there may be legitimate business reasons to place a data processing unit that is serving a number of different sister companies in a separate holding company affiliate. Similarly, it may be less expensive for a holding company to raise capital - thus benefiting insured banks - if nonbank activities are placed in holding company affiliates, rather than in bank subsidiaries where the entire net worth of the subsidiaries would be subordinated to depositors and the insurance fund. Thus, despite the fact that the bank subsidiary mode of organization provides certain advantages at the time of bank failure, we believe it is important that banks have a choice of organizational structure.

In addition to safety-and-soundness issues, some have argued that banks have a lower net marginal cost of funds than nonbanks because of a perceived federal subsidy from deposit insurance and access to the payments system and the Federal Reserve discount window. Further, it is argued that the ability of institutions to pass a net subsidy from the federal safety net is easier under a bank subsidiary structure than under the holding company structure. Thus, the argument continues, activities conducted in bank subsidiaries are subsidized, resulting in an expansion of the federal safety net. For well-capitalized banks, the evidence shows that if a net marginal funding advantage exists at all, it is very small.

Setting aside the issue of whether a marginal safety-net subsidy exists and its magnitude, it is useful to consider the channels through which banks may have an opportunity to transfer a subsidy beyond the parent bank. First, banks could transfer the subsidy through capital infusions to their direct subsidiary, or by routing dividends through their holding company to an affiliate. Second, banks could extend loans or engage in the purchase or sale of assets at terms that favor their subsidiary units. Yet, in practice, regulatory safeguards for operating subsidiaries, such as those discussed above, and existing safeguards for affiliates, such as Sections 23A and 23B of the Federal Reserve Act, would inhibit a bank from passing any net marginal subsidy either to a direct subsidiary or to an affiliate of the holding company.

Banking and Commerce

The financial modernization debate also encompasses the issue of whether banking organizations should be allowed to affiliate with commercial enterprises. Both the benefits and risks of mixing banking and commerce have been debated for many years. Although there is no hard evidence that combinations of banking and commerce are harmful, there is no hard evidence that they are beneficial, either. Nevertheless, foreign and domestic marketplace developments suggest that combinations involving banking and commerce are becoming more numerous. Appendix B to this testimony discusses the mixing of banking and commerce in the United States in more detail.

The FDIC supports a cautious easing of the restrictions on the mixing of banking and commerce, consistent with safety-and-soundness considerations, for the following reasons. First, there has never been an absolute prohibition on the mixing of banking and commerce in the United States, as discussed in Appendix B. Second, it is important that U.S. financial organizations not be placed at a competitive disadvantage in the domestic and global financial markets.

Attempting to completely arrest the mixing of banking and commerce would ignore recent developments in the domestic and global financial markets. One such development is the 1998 merger of Daimler-Benz, Germany's biggest industrial group, with Chrysler Corporation to form DaimlerChrysler. Germany's Deutsche Bank owns slightly more than one-fifth of the stock of the former Daimler-Benz and was active in the merger discussions. Soon after the merger was consummated, DaimlerChrysler announced it would combine its global services operations, such as automobile leasing and finance, information technology, real estate, and telecommunications, into one financial services provider called DaimlerChrysler Services AG. According to news reports, this entity, which will be headquartered in Berlin, will be the fourth-largest provider of financial services in the world outside the banking and insurance sectors. The emergence of financial powerhouses such as DaimlerChrysler Services AG underscores the need for policy makers to fashion and adopt a more realistic approach to the mixing of banking and commerce in the United States.

Nevertheless, we recognize that U.S. banking organizations have had limited experience in affiliating with commercial enterprises. Therefore, we believe that we should proceed cautiously in order to allow banks time to adjust to a new competitive environment and to allow regulators and others to assess the actual benefits and risks of permitting banking and commerce to mix.

The undecided issues portion of the draft bill contemplates permitting a bank holding company to have a commercial basket limited by a designated percentage of revenues and assets attributable to the commercial activity. The designated percentage would begin at 5 percent for the first two years, and increase by 5 percent every two years until the percentage reaches 25 percent. In general, the FDIC favors a 5 percent commercial basket. An analysis done by FDIC staff in 1997 showed that of 28 large brokerage, insurance and diversified financial services firms, 21 received at least 95 percent of their revenues from financial services. Thus, a 5 percent basket would go a long way toward establishing a two-way street, and unlike grandfathering, a 5 percent basket does not favor those who already have commercial activity over those who do not. However, we are concerned that the contemplated phase-in up to 25 percent, will not give regulators sufficient time or discretion to evaluate marketplace developments. We also believe that it is vitally important that the depository institution subsidiaries of a bank holding company wishing to engage in commercial activities should be well-capitalized and well-managed. Any legislation should incorporate these safeguards.

Community Reinvestment Act Issues

Under the draft bill an insured depository institution is deemed to be in compliance with the Community Reinvestment Act (CRA), for purposes of regulatory applications, if it achieves a satisfactory or outstanding rating at its most recent CRA examination, and has done so during each of its CRA examinations in the immediately preceding 36-month period. Deemed compliance status continues until the next regularly scheduled CRA examination unless substantial verifiable information to the contrary since the last examination is filed with the appropriate federal banking agency. The appropriate agency must determine whether the negative CRA information filed is of a substantial verifiable nature. The burden of proof is on the person filing such information.

Under current practice, an institution's CRA rating represents the on-site evaluation by a regulatory agency of the institution's performance in helping to meet the credit needs of its communities at the time of the examination. However, it may not necessarily reflect an institution's record of performance or current compliance under the CRA in the time period following the most recent examination.

The FDIC does not believe that an agency's ability to conduct an examination or visitation to determine any change in a bank's compliance status should be restricted to the next "regularly" scheduled examination. Any legislation should continue to permit the agencies to take into account the CRA rating assigned at the most recent examination, public comments received, and an institution's current performance.

The undecided issues portion of the draft bill contemplates CRA anti-extortion and anti-bribery provisions. These provisions would provide for fines and imprisonment for financial institution representatives who make payments in any form, other than loans in the ordinary course of business, to any person to influence their testimony before a federal banking agency regarding the institution's CRA compliance. Similarly, it would be illegal for any person to receive such payments. The FDIC does not believe that this provision is necessary on the basis of our recent experience with protested applications and resultant CRA agreements.

Moreover, the FDIC is concerned that this provision may have the unintended consequence of discouraging legitimate partnerships between financial institutions and community organizations. Any concern that making legitimate loans or grants to community organizations or other protestants may give the "appearance" of influencing them inappropriately may have a chilling effect on these legitimate activities. Finally, we would note that the level of protest activity is relatively small. For example, out of a total of over 28,000 applications subject to the CRA submitted by FDIC-supervised banks since 1987, only 97 have involved CRA protests. Although the FDIC is not a party to these private agreements, protestants and applicants entered into private CRA agreements in only a handful of the 97 cases, to the best of our knowledge. Private CRA agreements typically include provisions such as: multi-year pledges of loans and lending commitments; investments; development of new and expanded products and services; outreach, marketing, and advertising; consumer education; and homeownership counseling.

Regulatory Authority

Under Section 10(b)(4) of the Federal Deposit Insurance Act, the FDIC has the authority to examine all affiliates of any depository institution as may be necessary to disclose fully: (1) the relationship between such depository institution and any such affiliate; and (2) the effect of any such relationship on the depository institution. The FDIC has used this authority sparingly and only after careful analysis. The very fact the authority exists, however, gives the FDIC the leverage to obtain necessary information that might not otherwise be available or forthcoming. The experiences of the 1980s underscore the importance of the insurer's ability to monitor in a timely and effective manner the relationships a depository institution has with its affiliates, especially during a period of major changes in the marketplace and the law. The current version of the draft bill preserves the FDIC's authority to examine any affiliates for insurance purposes to determine the condition of an affiliated insured depository institution. Preservation of all authority to examine affiliates is vitally important to allow the FDIC to discharge its insurance responsibilities.

Concluding Remarks

We have a unique opportunity to achieve financial modernization against the backdrop of a prosperous economy. This favorable environment will better enable institutions to accommodate the necessary changes. Rather than miss this opportunity, we should use it to its best advantage. Mr. Chairman and members of the Committee, the FDIC stands ready to work with you in this important endeavor.

Last Updated 06/25/1999