Luncheon Address

Introduction

John Bovenzi, Director
Division of Resolutions and Receiverships, FDIC

It is my privilege today to introduce our luncheon speaker, Joseph H. Neely, a native of Grenada, Mississippi. He attended the University of Southern Mississippi, where he obtained a Bachelor of Science degree in Business Administration, majoring in Finance. Joe continued his studies as a Graduate Fellow at the University of Southern Mississippi and earned an MBA degree. Joe Neely began his banking career in 1977 with Grenada Sunburst Banking System, serving in the lending area of the bank. In 1980, he joined the Merchants National Bank of Vicksburg, where he served as Senior Vice President. In April of 1992, Joe was appointed Commissioner of the Department of Banking and Consumer Finance for the State of Mississippi. In July of 1995, President Clinton appointed him to the FDIC Board of Directors.

Joe Neely became a member of the Board of Directors of the FDIC on January 29, 1996. I can attest that since coming to the FDIC, Joe has been an active participant in FDIC activities. He takes his responsibilities seriously, regularly asks tough questions to be sure the job is being done right, yet Joe is always approachable and extremely supportive of the staff.

It has been a pleasure to work with someone as dedicated and as sincere as Joe Neely, and when Skip Hove, our original luncheon speaker was called to testify before Congress this morning, Joe was gracious enough to accept a last-minute invitation to fill in. Despite the late notice, I'm sure you will find his comments thoughtful and interesting. Please join me in welcoming FDIC Director Joseph Neely.

Joseph Neely
FDIC Director

Thank you, John.

On behalf of the corporation, let me welcome everyone here. I hope you find that this day and a half is worthwhile to you and worthy of your time and attention, and I hope you are able to take something away from this. I know that to many of you in this room, this is a very personal subject to you and a good bit of your hide, so to speak, is invested in this process that we're reviewing here. Thank you again for coming because without your participation this conference and symposium wouldn't be what it is.

We use military comparisons a lot in making analogies, in making points, and the military a lot of times is very appropriate to use in such situations. I know many times in talking to bankers and as a supervisor, and even as a banker, I always felt that a military perspective pretty much described the proper structure of a bank where the shareholders were like the generals. The shareholders are the ones that staff the army, or they pick the staff they want to carry out the mission. The directors are the strategists and do just that—set strategy and set direction for the bank and if the directors try to do a whole lot more than that, they are probably complicating the issue. If anybody else tries to direct the bank, other than directors, sometimes you can have a problem.

The CEO is more like the field marshal or the director in the field. The CEO leads the bank and says, "we want to go in this direction—let's go over here." Management is like the lieutenants—the management of the bank takes care of the day-to-day operations and makes those decisions and arguably runs the bank. Then the employees are like the ground troops. The employees are the ones that actually take the battle to the enemy, if you will, and carry out the directives of all their supervisors.

In this light, in military affairs there is something called the fog of battle. This refers to uncertainty—the uncertainty of your terrain, the uncertainty of enemy forces you may face, the uncertainty of the adequacy of your own forces, or events over the horizon that may have a bearing on the battle at hand. The art of military leadership consists of bringing order out of all of this chaos, an art that requires one to continually adapt to changes in situations in the field in order to obtain the objectives or obtain the achievements that you seek to achieve.

Please bear with me for a moment or two as I defer to our former Chairman and well-respected Bill Seidman, who is here today. His statement in the FDIC's 1990 annual report, I enjoyed very much. I was telling him earlier today. Going back to the last 10–12 years of FDIC annual reports and reading certain excerpts from the Chairmen as they recapped the year's events and made prophecies about events to come, Bill said in the 1990 report, "Entering 1990 it was clear to everyone associated with the FDIC that it would be a very difficult year for the agency. We would struggle with mounting problems in the banking industry, particularly in real estate portfolios. We would face the prospect of additional losses to the Bank Insurance Fund. We would have our first full year addressing the savings industry problems through the operations of the

Resolution Trust Corporation, and as back-up supervisor of savings associations." But, Chairman Seidman concluded that as the year unfolded, "1990 presented difficulties and challenges far beyond anyone's expectations."

The FDIC and the RTC were truly in the midst of the fog of battle where uncertainty reigned. Years of economic expansion can erase a lot of bad memories. We've heard reference to that this morning—current economic and banking conditions tend to move some of the events so personal to many of us further and further into the past. But, the world is different now than it was then. As time passes, it becomes harder and harder for many people to recall how threatening the banking and thrift crisis of the 80s and early 90s was. Many of you remember, however, because you worked day in and day out to face the crisis and to keep the threat at bay.

One of my favorite sayings is that an organization is in trouble when it has more memories than it has dreams, and that is true. I think it is very important, particularly with some of the events taking place today, that we have to take a very proactive attitude at the FDIC. But you are also equally familiar with the saying, that those of us who do not remember our history are doomed to repeat it.

And that is what this conference is all about. I was particularly impressed with a comment by Doyle Mitchell this morning. He said that hindsight is 20/20, but only if you look. So, that is what we're doing hopefully this day and a half.

How bad was it? Just how bad was it? Focusing on 1990, the excerpts of the 1990 annual report, Bill Seidman's comments, commercial banks in 1990 earned $16.6 billion for the year. In contrast, commercial banks earned $15.3 billion last quarter of last year. Year-end 1990, there were 1,046 banks on the FDIC problem list. As you well know, this was down from well over 1,500 banks at one time, with over $530 billion in problem bank assets.

At year-end 1997, there were 71 commercial banks on the problem bank list, and they held $5 billion total in problem bank assets. Likewise, at year-end 1997, there were 21 thrifts on the problem thrift list with $2 billion in total problem thrift assets. In 1990, 168 banks failed after three consecutive years of having over 200 banks fail annually and massive failures in the thrift industry. Those 168 banks held about $14.5 billion in assets. That was bad enough. But, in 1991, 124 banks failed and they held assets close to $54 billion. Last year, one commercial bank failed and it had assets of slightly over $27 million. In 1989, 330 thrifts failed with total assets of $136 billion. Last year, no thrift failed and no thrift has failed in the last 21 months—rather staggering given the focus of what we're here about for this day and a half.

Over a 15-year period from 1980 to 1994, a federally insured depository institution failed on an average of every other day. At the height of the crisis, the five-year period 1988 through 1992, a bank or savings institution failed on average every day. On one day, institutions holding one-third of the banking assets in the State of New Hampshire closed—in one day.

Looking at it another way, during the 15 years of crisis that this symposium covers, institutions holding one-fifth of the assets of the banking system—20 percent of the assets of the entire system—either failed or received federal financial assistance just to stay open. During that threatening time, not one person lost a cent in a federally insured account. The FDIC and the RTC managed to liquidate hundreds of billions of dollars in assets and through the hard work and leadership of many people who are participants in this very symposium, and many, many other people working for the sister agencies—the FDIC and the RTC—many people in this room, many people watching this through live remote, many people who have gone on to other careers and many people who have retired. Order was created out of chaos and our objectives were met. We are here today and we'll be here tomorrow to discuss just how that happened and to distill from that experience lessons for the future, should we ever have to face similar prospects again.

The objectives were simple to express but difficult to achieve—to maintain public confidence while restoring financial stability. Stability is a goal, not a given. Either directly or indirectly, everything the sister agencies did was aimed at achieving those objectives, while encouraging market discipline, consistency and cost effectiveness. The FDIC and the RTC were constantly doing things to meet those objectives. Obviously, they met them.

In essence, the strategy of the agencies was to make a bank failure a non-event for an insured depositor. Before the creation of the FDIC, depositors had learned from experience that if they kept their money in a bank, it might not be available when they needed it and they might lose a large portion of it as well. As a general practice between the years 1865 and 1933, depositors of national and state banks were treated in the same way as other creditors. They received funds from the liquidation of the bank's assets after those assets were liquidated. The time taken at the federal level to liquidate a failed bank's assets to pay the depositors and close the books averaged about six years, although in at least one case it took 21 years.

From 1921 through 1930, more than 1,200 banks failed and were liquidated. From those liquidations, depositors at banks chartered by the states received on average 62 percent of their deposits back. Depositors at banks chartered by the federal government received an average of 58 percent of their deposits back. Given the long delays in receiving any money and the significant reduction in deposits that were returned, there is no wonder at all why anxious depositors would withdraw their savings at any hint of a crisis or any hint of a problem, thus triggering bank runs.

With the wave of failures in 1929, it became apparent that the lack of liquidity resulting from the resolution process that was currently in place contributed significantly to the economic problems and consequences in that period of time in the United States.

The FDIC in the 1930s, and the FDIC and RTC in the 80s and 90s, gave insured depositors access to their funds as quickly as possible and uninsured depositors as much of their money as possible as quickly as possible to maintain public confidence in the system and to restore liquidity in the economy. For all insured depositors, this was an absolute guarantee. For the vast majority of depositors in the most recent crisis, the subject of this symposium, this meant virtually no loss of access to their money. Banks may fail, but as far as insured depositors were concerned, the banking system continued to operate without pause.

As circumstances changed in the 80s and 90s however, the agencies changed their way of doing business to follow the strategy of making a bank failure as much of a non-event to depositors as possible. The rising tide of bank failures prompted innovation and creativity. Until 1983, for example, the most typical bank failure resulted in a settlement of deposit insurance by either an FDIC-assisted merger or by a direct payment to the insured depositor—the insured payout where depositors would line up to get their money from the FDIC. Fifty-one of the 123 banks that failed in the 60s and 70s were resolved through a deposit payout. As a general matter, few of the failed banks' assets were passed on to the acquiring institutions in those times.

In 1983, the FDIC pioneered the use of a new technique—the insured deposit transfer—where the agency auctioned a failing bank's insured deposits to a healthy bank. The premium that the acquiring bank paid helped lower the resolution cost. Depositors had an account in a healthy bank as a result—with immediate access to money—usually the next business day after the transaction.

For uninsured depositors, the FDIC developed a methodology for getting an advance dividend into the hands of uninsured depositors as early as possible. This advance dividend was an estimate of what the uninsured depositors would receive if assets were liquidated. Innovation, therefore, made things easier for both the insured and uninsured depositors and provided liquidity for the economy.

Measured by type of transaction, about 74 percent of the resolutions of failed banks in the year 1980 to 1994 were purchase and assumption transactions. About 11 percent were insured deposit transfers, 8 percent were open bank assistance, and a little over 7 percent were deposit payoffs. We saw a slide this morning, the pie chart showing that very thing.

I want to touch on just a few of the other innovations that the agency developed. The most dramatic attempt by the FDIC to pass assets from failed banks quickly back into the private sector was a whole bank transaction, a variation of the P&A—the purchase and assumption. Along with liabilities, almost always both the insured and uninsured deposits and virtually all of the failed bank's assets, were passed to the acquirer for a one-time cash payment. Whole bank transactions kept down the volume of assets that the agency had responsibility to liquidate and therefore preserved the liquidity of the deposit insurance funds and the transactions transferred risk from the agency to the acquirers. Overall, the FDIC completed 202 whole bank transactions from the years 1987 to 1992, almost one-fifth of the total number of transactions during the period.

As the volume of bank failures in the mid- to late-80s increased, the FDIC began to look for ways to pass more of the failed banks' assets to the acquirer. One way of doing this was through a put option. The FDIC and later the RTC would require an acquirer to take assets but gave them an option to return or to put back the assets they did not want to keep. This innovation also conserved liquidity in the insurance fund.

The third innovation in the resolutions process was the creation of asset pools, pioneered by the RTC, which gave investors the flexibility to bid on pools of similar loans at prices set by the agency. Potential acquirers were often reluctant to assume large loan portfolios that did not fit their current business strategies. By selling loan pools separately from the deposit franchise, the resolution options were expanded.

Another wrinkle in the P&A methodology was the loss sharing transaction whereby as many assets as possible were transferred to the acquiring bank and the acquiring bank managed and collected the nonperforming assets. As an incentive to enter the arrangement, the FDIC agreed to absorb a significant portion of the loss on a specified pool of assets with the acquiring bank liable for the remaining portion of the loss. Each of these innovations and others were designed to encourage the private sector to become more involved and to take more of a role in the resolution of failed banks.

In that regard, probably the most innovative method the RTC used for asset disposition was equity partnerships—joining in partnership with private investors who would use their expertise and their efficiencies to recover more value from troubled assets than the agency would have been able to recover. In all, the RTC created 72 such partnerships which had a total asset book value of about $21.4 billion.

The agencies also looked to the private sector for guidance and for additional resources. For example, in 1990 the RTC was holding more than $34 billion in mortgage loans. After a disappointing performance in bulk sales, the RTC turned to the mortgage-backed securities market for assistance in liquidating these mortgage portfolios and establishing its own securitization program. It couldn't have been more successful. The RTC sold approximately $43 billion in mortgage loans through this program—more than 500,000 single-family, multi-family, commercial, home equity and mobile home loans were repackaged and sold as securities.

In all these innovations, and in all others, the FDIC and the RTC exhibited flexibility by changing their ways of doing business to adapt to changing circumstance. They exhibited independent thinking, embracing the new and the untried methods. The FDIC exhibited a desire to apply that flexibility and independent thinking in ways that would preserve the liquidity of the deposit insurance fund and to hold down the cost of bank failures. The agencies made mistakes, and we'll talk about those mistakes, as well as successes, over the next day and a half. But, by the end of the day, the FDIC and the RTC performed their mission—maintaining public confidence and assuring stability. It has been said this morning that it is awfully easy to look back and to criticize. What I always said as a banker and have said since then is that I don't think we ever want to find out what the cost of the alternative might have been.

The agencies didn't manage the failure of institutions—that was simply a means to an end. The end was managing the crisis.

One of my most memorable experiences concerning the FDIC was as a state supervisor when I worked very closely with a regional director who was retiring. We called a bank board in, and we had a problem situation and were preparing for a very intense meeting. We broke for lunch before we sat down with this bank board. He was leaving after about a 30-year career with the FDIC and I really wanted to pick his brain because I knew I was possibly going to end up on the FDIC Board. I respected him a lot. I asked him, “after your 25–30 year career with this corporation, what do you leave here with? What reflections?” We were on the 19th floor of the office building—that gives away the region—doesn’t it. He looked out the window and was in a very pensive and reflective mood, and there was some fellow walking across the parking lot to a bank that was across the parking lot. He said, “you know Joe, I think I leave here with one major overriding thought—that fellow right there (and I looked out the window and thought maybe it was somebody he knew), that fellow right there has no idea how close we came. That fellow right there is going to his bank to make a deposit or make a withdrawal with total, absolute, unquestioned confidence in the banking system and the deposit insurance system and the protection of his deposits. That fellow right there has no idea that the absolute financial underpinnings of this industry were under siege. That fellow has no idea that at any given time in the war room, information would come in and we would sit around and say, we can’t do it—we don’t have the resources—we don’t have the people—we don’t have the money—we don’t have the logistics—we can’t handle this. But we did. We had people making decisions well above their level of authority. We had people making decisions well above their delegations of responsibility. We had people working weekends away from home, weeks and months at a time. We had people making decisions at 3:00 a.m., learning how to eat pizza for breakfast. We had people who were doing things they probably weren’t commissioned or authorized to do, but they just did the right thing and moved on to the next challenge.”

Teddy Roosevelt once said that there are three things you can do—the best thing obviously you can do is the right thing. The next best thing you can do is the wrong thing. The worst thing you can do is to just do nothing. One of the dangers, I think, is to run in place. We need to be extremely cautious about that.

One of the things the FDIC didn’t do during the period covered by this symposium was that it didn’t run in place. People made decisions, the right decision or the wrong decision. They followed their heart. They followed their instincts, and they said that we just want to protect that gentleman walking across that parking lot because we’re not sure—we’re scared to think about how close we may be right now. We don’t have time to think about it. Let’s make the decision and try to do the right thing, and let’s just move on.

Another personal experience, if you’ll allow me, was when John Bovenzi talked to me about making this talk. I said to John that I came to the FDIC in January of 1996—I’ve been here two and a half years, approximately. I wasn’t here during this period. Skip Hove was here and I feel a little bit in awe of many of you who were here and fought the battle. I said, I don’t feel like I need to get up there and try to give the impression that I was here during that period of time, so I won’t. I’ll talk about where I was during that period of time.

During that period of time, many times on a Monday, I’d go to the bank, totally minding my own business, trying to maybe do the right thing every now and then. Little did I know that on Wednesday, I might be in some motel room or hotel room in a neighboring city with reservations having been made under some clandestine name or purpose. I was going through the proper clearances to be allowed to go into a room where a transaction was about to take place unlike any in America. I had the opportunity to go in and witness a bid meeting on several occasions, and to see the process work. Again, on Monday having no idea until I got the call that I might be in Baton Rouge, Louisiana, Jackson, Mississippi, or somewhere else. On Wednesday, knowing that I probably would go ahead and check into that hotel and spend the next 48 hours with my people trying to put together a bid presentation. No other business, no other entity, no other assets are transferred under such circumstances. As a banker, I was so in awe of watching the system work. What was even more impressive, as a community banker from Mississippi, bidding on what was at the time, in the scheme of things, an insignificant pool of assets or a relatively small institution, I was made to feel like that was the only transaction taking place at the time.

I was always impressed with the innovation, the creativity, the ingenuity and the imagination of the people I was dealing with. No deal was too ridiculous to consider because the issues at hand and the job at hand were too important.

And, on Friday, we would cross our fingers not knowing if we wanted to win or lose, because we knew we had to open on Monday, exactly one week from the time I got that first phone call. We were in a new market, in a new bank, with an acquired customer base that we didn't know. We didn't know a single one of them, wondering if we could retain those deposits, employees, and customers.

The second part of that is that I was there after the FDIC/RTC left. You went on to your next assignment and I was there with my new customers. Not only were all the bankers in awe and proud to watch the system work, but you can't imagine the gratification of sitting down with formerly uninsured depositors, fairly unsophisticated people in many circumstances, who had been tremendous beneficiaries of the system and for the first time were realizing it. To sit there and work with these people and make the introductions and try to get them to stay with your institution, and then watch them come to the appreciation of what had just transpired and how they had benefited as a result. Benefited from a unique system that doesn't exist anywhere else. It was quite a rewarding experience.

So, I wasn't here at the FDIC at that time, but I certainly saw it from a different perspective.

The seasoned military officers will tell you that the true enemy on the battlefield is uncertainty. In resolving the failures of the 80s and the 90s, the FDIC and the RTC were often in unknown territory, unsure of what would happen next, how their plans would be disrupted, but by keeping their eyes on the objective, their eyes on the goal, and their eyes on the mission, they overcame uncertainty. Perhaps, that is the greatest lesson we can take away from this whole experience.

Thank you.