SYMPOSIUM: THE DIRECTION OF NEW JERSEY BANKING*

"CONGRESS AND BANKING REFORM I"

*Honorable Marge Roukema***

I. Introduction

I first want to commend the Seton Hall Legislative Bureau and the Seton Hall University School of Law for holding this symposium on the future of New Jersey banking. If, as they say, timing is everything, it is a great testimony to the Legislative Bureau that this conference is scheduled for today, since Congress, just before the 1991 Thanksgiving adjournment, completed its long awaited war on banking reform.

---

* The Seton Hall Legislative Bureau held the Symposium on New Jersey Banking at Seton Hall Law School on December 5, 1991. With emerging trends in the banking industry, many exciting, yet perplexing, changes will occur for New Jersey banks. These changes will affect not only banks and their officials, but also banking organizations, regulators, legislators, attorneys specializing in banking law and everyday consumers. The purpose of this Symposium was to address issues that are of vital concern to New Jersey's banking industry and its citizens. Topics discussed at the Symposium included Super Community Banking, the effect of the savings and loan bailout, mortgage banking, and current legislative trends at the state and federal level.

Symposium participants included: The Honorable Marge Roukema, Republican U.S. Representative, New Jersey, 5th Congressional District; Dennis R. Casale, Esq., Jamieson, Moore, Peskin & Spicer, P.C.; E. Robert Levy, Esq., Levy & Lybeck, P.C.; Raymond Lyons, Esq., Connell, Foley & Geiser, P.C.; New Jersey Assemblyman Joseph Roberts, Assembly Financial Institutions Committee; Thomas K. Sipple, C.F.O., Chemical Bank New Jersey; and Michael F. Spicer, Esq., Jamieson, Moore, Peskin & Spicer, P.C.

** The Honorable Marge Roukema was elected to the House of Representatives in 1980. Mrs. Roukema serves on the House Banking Committee where she sits as Vice-Chairman of the Housing Subcommittee. As a senior Member of the Banking Committee, she has authored several proposals to ensure recapitalization of the Savings and Loan insurance fund and require risk-based premiums on commercial banks. In addition to the Banking Committee, Roukema is a Member of the House Education and Labor Committee and the House Select Committee on Hunger. Mrs. Roukema is married to Dr. Richard W. Roukema and is a mother of three children. She resides in Ridgewood, New Jersey.

II. Banking Reform I

As many of you know, on Wednesday morning, November 27, 1991, after literally nine months of consideration, two weeks of Banking Committee and Subcommittee mark-up, consideration of over 180 amendments and forty-eight hours of non-stop deliberation, discussion and tough bargaining with the Senate, we were able to pass and send to President Bush a modified version of banking reform.[1] The process was somewhat beset with disharmony in both the House and the Senate; therefore, the passage of the banking reforms was a major accomplishment for legislators.

The circuitous route of this legislation was set against the backdrop of a weakening economy. The House twice rejected previous versions of banking reform,[2] and the Senate passed its version in the dead of night, by voice vote, with less than twenty Senators on the floor when the bill was called up. This is not surprising if you understand the recent disasters that have befallen financial institutions in this country. One must be mindful of the fact that many Members of Congress are, as I am, full-fledged, battle-scarred, veterans of the Savings and Loan wars.[3]

---

1 S. 543, 102d Cong., 1st Sess. (1991). *See* H.R. REP. No. 407, 102d Cong., 1st Sess. (1991). The comprehensive banking overhaul measure (S. 543) that passed Congress November 27, 1991 closely mirrored the financing and regulatory reform provisions of the House and Senate passed versions of the bill. *See also* H.R. 6, 102d Cong., 1st Sess. (1991); H.R. REP. No. 157, 102d Cong., 1st Sess. (1991); S. REP. No. 167, 102d Cong., 1st Sess. (1991).

2 John R. Crawford, *Lawmakers Go To the Wire on Bank Overhaul Bill*, 49 CONG. Q. 3439 (weekly ed., Nov. 23, 1991).

3 *See generally* Thomas A. Rose, *The Resolution Trust Corporation: Its Purpose and Operation* 65-69 *in* RESOLUTION TRUST CORPORATION (Harry D. Dixon, Jr. & Thomas A. Rose eds., Practicing Law Institute, 1990).

> Title V of the FIRREA legislation which addresses the financing for thrift resolutions is the section which established the RTC, the Oversight Board and the relationship with the FDIC as its exclusive manager. [The [d]uties and purpose[s] of the RTC [are as follows:] (1) To resolve all salvage associations which were/are placed into conservatorship or receivership between January 1, 1989 and August 9, 1992. (2) To manage and dispose of the assets of failed thrifts. (3) To manage and liquidate the Federal Asset Disposition Association. (4) To review and analyze all insolvent institution cases resolved by the FSLIC [Federal Savings and Loan Insurance Corporation] between January 1, 1988, and August 9, 1989 with the view to reducing overall cost. (5) To carry out its duties in a manner which would maximize the net present value from the sale or other disposition of failing institutions, while minimizing the

We were determined to be prudent and deliberative before expanding powers for commercial banks. Therefore, the banking reform proposals that were sent to Congress became legislation that "everyone loved to hate."

That having been said, I strongly object to the editorial condemnation that Congress has been subjected to following the passage of this legislation. The *New York Times*[4] and *The Wall Street Journal*[5] and other national periodicals have been highly critical in accusing Congress of simply throwing money at the problem and caving into special interest groups of one sort or another. These criticisms are unfounded. The legislation establishes a foundation in what I call "Banking Reform I" and sets the stage for more comprehensive reform of financial institutions in the future.

III. Purpose of Banking Reform

In an effort to provide some background to the present banking reforms, the comments of Secretary Brady[6] help to shed

---

> impact of the asset disposition on local real estate markets, and maximizing the preservation of the availability of affordable (low income) housing.

Id. at 69.

See also Financial Institutions Reform, Recovery and Enforcement Act [hereinafter FIRREA], Pub.L. 101-73, 103 Stat. 188 (1989) (amending 12 U.S.C. §§ 1811-1833 (1982)).

4 Stephen Labaton, *Senators Load Banking Bill With Items of Local Interest*, N.Y. TIMES, Nov. 23, 1991, at A1, 35:1.

5 *Vengeance or Growth*, WALL ST. J., Nov. 26, 1991, at A14-15.

6 Nicolas F. Brady became the 68th Secretary of the Treasury on September 15, 1988. Secretary Brady served in the United States Senate from April 20, 1982, through December 27, 1982. During that time, he was a Member of the Armed Services Committee and the Banking, Housing and Urban Affairs Committee. In 1984, President Reagan appointed Mr. Brady Chairman of the President's Commission on Executive, Legislative and Judicial Salaries. He has also served on the President's Commission on Strategic Forces in 1983, the National Bipartisan Commission on Central America in 1983, and the Blue Ribbon Commission on Defense Management in 1985. Most recently, Secretary Brady chaired the Presidential Task Force on Market Mechanisms in 1987.

Secretary Brady's career in the banking industry spans 34 years. He joined Dillion, Read & Co. in New York in 1954, rising to Chairman of the Board. He has been a Director of the NCR Corporation, the Mitre Corporation, and the H.J. Heinz Company, among others. He has also served as trustee of Rockefeller University and a member of the Board of The Economic Club of New York. He is a member of the Council on Foreign Relations, Inc., and a former trustee of the Boys' Club of Newark, New Jersey.

some light on the current state of banking law. These are the remarks of Secretary Brady, when he submitted the Administration's banking proposals back in February 1991:

> A sound, competitive banking system is critical to the Nation's economic vitality and the financial well-being of our citizens. But, the federal safety net has been overextended, and the taxpayers are now exposed to substantial losses through federal deposit insurance. . . In the end, the most effective way to minimize taxpayer exposure is through a strong, competitive, well-capitalized banking system.[7]

I would like to review the fundamentals of the Administration's proposals before addressing the larger questions of reform and where it may lead.

IV. The Four Fundamental Reforms

The Administration set out four fundamental areas in which it felt change was necessary in the area of banking law. The four areas are as follows: (1) Bank Insurance Fund (BIF)[8] Recapitalization; (2) Restoring Competitiveness; (3) Streamlining the Regulatory System; and (4) Basic Deposit Insurance Reform.

The first area of banking reform centers around BIF Recapitalization. The BIF is currently at its lowest level in history as a percentage of insured deposits, currently at approximately four billion dollars. It was predicted that BIF could become insolvent by the end of 1991 if bank failures continued at their current rate or if a few additional failures the size of the Bank of New England

---

[7] *Deposit Insurance Reform Before the House Comm. on Banking, Finance & Urban Affairs*, 102d Cong., 1st Sess. (1991). At this hearing in February 1991, Secretary Brady set forth the proposals to initiate banking reform, with great emphasis in the area of deposit insurance. *See also* H.R. 1505, 102d Cong., 1st Sess. (1991) (Treasury Department's proposed banking bill).

[8] FIRREA, Pub. L. No. 101-73, Tit. II § 211, 103 Stat. 188 (1989) (amending 12 U.S.C. §§ 1811-1833 (1982)). Paragraph (5) states in pertinent part:

> (A) Establishment - There is established a fund to be known as the Bank Insurance Fund.
>
> (B) Transfers to Fund - On the date of enactment of FIRREA, the Permanent Insurance Fund shall be dissolved and all assets and liabilities of the Permanent Insurance Fund shall be transferred to the Bank Insurance Fund.
>
> (C) Uses - The Bank Insurance Fund shall be available to the Corporation for use with respect to Bank Insurance Fund members.
>
> (D) Deposits - All amounts assessed against Bank Insurance Fund members by the Corporation shall be deposited into the Bank Insurance Fund.

Id.

failure took place.[9]

Secondly, the Administration argued that nationwide interstate banking and branching would make banking institutions safer through diversification and more efficient through substantially reduced operating costs. Moreover, such banking reform could restore competitiveness in the field.[10] In addition, the Administration felt that commercial and financial firms must be allowed to affiliate, and that banks should be permitted to engage in the full range of financial services, e.g., securities and insurance, as long as it were outside the bank itself and not covered by the federal safety net.[11]

In this regard, a major reform proposal was to permit independent and publicly traded corporations to own banks. The purpose of the proposal was to attract capital quickly into the nation's banking system. Many legislators, including myself, agreed, but had serious misgivings about the social and economic costs. There were grave concerns regarding the potential concentration of economic power and conflicts of interests. In the end, this proposal did not survive.

A third area of reform concentrated on a more efficient regulatory system. The Administration felt that a streamlined, efficient regulatory system would further supplement market discipline and apply prompt, decisive, corrective action to weak and unsound institutions. It recommended far reaching reorganization of regulatory agencies, including the Federal Reserve Banks. These regulatory reforms proved of lesser importance and were ultimately dropped.

The fourth and last area of reform dealt with basic deposit insurance. In addition to higher capital requirements for banks as established by the Basel Accords,[12] the Administration sought

---

9 *See Developments in Banking Law 1990*, 10 ANN. REV. BANKING L. 1, 31-2 (1991) for a discussion of the financial troubles of the Bank of New England.

10 *See generally* Stephen A. Rhodes, *Interstate Banking and Product Line Expansion: Implications From Available Evidence*, 18 LOY. L.A. L. REV. 1115-1164 (1985).

11 *Id.* at 1134-36.

12 International Banking Act of 1978, 12 U.S.C. §§ 3101-3107 (Supp. 1979). *See also* Edward L. Symons, Jr., James J. White, BANKING LAW 723 (2d ed. 1984). [T]he International Banking Act provides the following:

> (1) restriction on interstate deposit taking activities by foreign banks; (2) application of Federal Reserve requirements to foreign branches and agencies; (3) requirement of deposit insurance for branches of foreign

to limit the number of insured accounts each depositor could have, reign in the provisions of deposit insurance coverage, and provide a system of risk-related premiums.

V. Evaluation and Impact of Banking Reforms in New Jersey

Although the present bill is significant, it is not a complete reform. Clearly, Congress did not meet all of the Administration's goals. In this respect, both sides played to a draw. Congress failed to address regulatory restructuring, and it did not agree on ways to open new business ventures for banks. Regrettably, Congress failed to pass interstate banking and branching provisions; and, on bank powers, it actually solidified existing authority for some banks. In my opinion, this was our most grievous failure. Congress should have passed interstate banking and branching as a minimal reform. However, this issue pitted money-centered banks against regional banks and independent banks in more rural states. These divided interests led to fractured support for the banking reforms. However, there were some strides made in the area of BIF recapitalization.

Congress managed to recapitalize the BIF by authorizing the Federal Deposit Insurance Corporation (FDIC) to borrow up to thirty billion dollars from the Treasury[13] and to engage in short-term borrowing from the Federal Financing Bank with funds secured by assets taken over from failed banks.[14]

Although the process appeared rather counterproductive, this action was more responsible than the delays incurred during the late 1980s in recapitalizing the Savings and Loan insurance fund.[15] With the present banking reform, Congress moved in concert with the Administration following the Treasury Department's definition of the problem. In the process, Congress did initiate serveral important reforms which included:

(1) the Roukema amendments which authorized (a) risk-based

> banks doing a retail banking business; (4) application of the nonbank activity restrictions of the Bank Holding Company Act to foreign banks that operate branches or agencies and; (5) availability of Federal Reserve discount window access to foreign bank agencies and branches.

Id.

[13] *See* S. 543, § 101; *see also* 12 U.S.C. §§ 1811-1833 (1982).

[14] *See* S. 543, § 102.

[15] *See* FIRREA, § 101 which states in pertinent part:

premiums to be assessed on the basis of their capital base and (b) an evaluation of loan portfolios;[16]

(2) a limitation on pass-through deposit insurance for pension funds only to the highest capitalized banks;[17]

(3) a limitation on brokered deposits only to the highest capitalized banks;[18]

(4) a comprehensive list of "early intervention" actions that regulators could take as an institution's capital began to fall;[19]

(5) a requirement that the regulator assume control of a bank when its capital level falls to 2%;[20]

(6) a prohibition on the FDIC from covering foreign deposits after 1992;[21]

(7) an attempt to address the "too-big-to-fail" conundrum by prohibiting the FDIC from paying off deposits over

---

The purposes of this Act are as follows:

(1) To promote, through regulatory reform, a safe and stable system of affordable housing finance.

(2) To improve the supervision of savings associations by strengthening capital, accounting, and other supervisory standards.

(3) To curtail investments and other activities of saving associations that pose unacceptable risks to the Federal deposit insurance fund.

(4) To promote the independence of the Federal Deposit Insurance Corporation from the institutions the deposits of which it insures, by providing an independent board of directors, adequate funding, and appropriate powers.

(5) To put the Federal deposit insurance fund on sound financial footing.

(6) To establish an Office of Thrift Supervision in the Department of the Treasury, under general oversight of the Secretary of the Treasury.

(7) To establish a new corporation, to be known as the Resolution Trust Corporation, to contain, manage, and resolve failed savings associations.

(8) To provide funds from public and private sources to deal expeditiously with failed depository institutions.

(9) To strengthen the enforcement powers of Federal regulators of depository institutions.

(10) To strengthen the civil sanctions and criminal penalties for defrauding or otherwise damaging depository institutions and their depositors.

Id.

16 *See* S. 543, § 212.

17 *Id.* § 210.

18 *Id.* § 211.

19 *Id.* §§ 202-08.

20 *Id.* § 205.

21 *Id.* §§ 601-36.

$100,000 after 1994 and authorize a restriction on the amount of loans the Federal Reserve could make to a failing institution;[22] and

(8) new regulations on the operation of foreign banks and branches in this country.[23]

With regard to restricting the number of insured accounts a depositor can have, Congress rejected restrictions beyond current law.[24] In my opinion, this decision was justifiable since the cost to the taxpayer is more appropriately restricted by regulatory reform and capital requirements. In addition, restrictions at this time would trigger an outflow of funds from commercial banks and precipitate a "run" on the banks. Such a restriction would, in turn, contribute to the collapse of many banks.

The bill, itself, should not be confused with a salutory piece of legislation that was promulgated only to appease powerful special interest groups. These banking reforms take full aim at many of the banking industry's most serious problems.

The provisions of the bill indicate that Congress has made more than a half-hearted attempt to rein in the divisive interests that exist in the banking industry and in many of its institutions. First, the bill will permit the FDIC to borrow up to seventy billion dollars to replenish the BIF and requires the FDIC to build reserves of at least $1.25 per $100.[25] The banking industry must repay these borrowings within fifteen years through increased premium assessments.[26] To accomplish this, banks could be facing the spectre of paying upwards of $0.30 for each $100 of deposits.[27] Second, the FDIC is required by 1994 to implement a system of risk-based premiums based on the full range of risks faced by each institution.[28] For many investors, premiums may decline, but for others who have more speculative portfolios, their premiums will increase greatly.[29]

---

22 *Id.* §§ 201-234.

23 *Id.* § 602.

24 12 U.S.C. § 1821(a)(1982) which states in pertinent part: "(1) The Corporation shall insure the deposits of all insured depository institutions as provided in this chapter. The maximum amount of the insured deposit of any depositor shall be $100,000." *Id.*

25 *See* S. 543, § 101.

26 *Id.*

27 *Id.*

28 *Id.* § 213.

29 *Id.*

Third, the legislation imposes a system of capital levels which will force many banks to redefine their asset-liability management and raise capital or sell assets.[30] Fourth, all insured institutions must undergo an annual, on-site examination by the primary federal regulator.[31] State examinations, however, can be substituted every other year.[32] In addition, insured institutions with assets of more than $150 million will be required to obtain an outside audit of internal controls and compliance with regulations.[33] Fifth, within one year, all banks will be required to report off-balance sheet items on financial statements and to disclose fair market value of all assets to the extent possible.[34] Sixth, the bill permits only well-capitalized banks to accept brokered deposits and allows only those institutions to offer pass-through insurance for pension funds.[35] Seventh, the bill prohibits banks from underwriting insurance.[36] This provision represents a roll-back for state-chartered institutions. Eighth, the bill prohibits state-chartered banks from engaging as a principal in direct equity investment and real estate developments.[37] Finally, the bill includes a "truth-in-savings measure" which requires banks to give full disclosure of the terms and conditions of savings accounts.[38]

VI. Summary and Conclusion

My perspective is that this represents, as already stated, "Banking Reform I." The reform is not complete, and I would like to believe that 1992 would see the birth of "Banking Reform II." And, while I never like to make predictions, let me attempt to assess what the next logical step should be.

Additional reforms all depend on the President and the Congressional leadership and their willingness to pursue renewed legislation in the midst of 1992 election-year politics. It also depends on a badly divided industry and how serious it is about going through another violent confrontation on such issues as

---

30 *Id.* § 202.
31 *Id.* § 204.
32 *Id.*
33 *Id.* § 203.
34 *Id.* § 225.
35 *Id.* § 210.
36 *Id.* § 707.
37 *Id.* § 215.
38 *Id.* § 504.

interstate banking and branching and the expansion of banks into the securities and insurance fields. The hope, of course, would be that a compromise could be worked out and common ground found; however, these issues are far from easily resolved.

The industries involved— banking, securities, insurance, and real estate— will not readily agree to new powers as long as there is no common ground on the definition of "fire walls" which, in my opinion, are essential for any expansion of powers of commercial banks. There seems to be a movement toward the "core bank concept." Yet, at present, the core bank concept is only an academic exercise. Its purpose, however, is to define the separation of powers between the banks that provide insured deposits and the investment banks.

In conclusion, I must acknowledge that Congress is attempting to do all of this during a deepening recession and a prolonged credit crunch. I would submit that these reforms are necessary, and they do not unduly exacerbate the credit crunch. The Savings and Loan debacle taught us that we need exacting regulation and strong capital requirements. There are no quick fixes. It will take time to work out our banking problems. This is neither pessimistic nor optimistic. It is a realistic outline of what must be done to ensure healthy growth for the financial industry here in New Jersey, across the nation, and in a competitive global economy.