S. HRG. 103–109

NOMINATION OF FRANK N. NEWMAN

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

NOMINATION OF FRANK N. NEWMAN, OF CALIFORNIA, TO BE AN UNDER SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE

MAY 7, 1993

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

70–090 CC WASHINGTON : 1993

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-041161-0

183

S. HRG. 103–109

NOMINATION OF FRANK N. NEWMAN

RING

RE THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

NOMINATION OF FRANK N. NEWMAN, OF CALIFORNIA, TO BE AN UNDER SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE

MAY 7, 1993

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

70–090 CC WASHINGTON : 1993

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-041161-0

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

DONALD W. RIEGLE, JR., Michigan, *Chairman*

PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
JIM SASSER, Tennessee
RICHARD C. SHELBY, Alabama
JOHN F. KERRY, Massachusetts
RICHARD H. BRYAN, Nevada
BARBARA BOXER, California
BEN NIGHTHORSE CAMPBELL, Colorado
CAROL MOSELEY-BRAUN, Illinois
PATTY MURRAY, Washington

ALFONSE M. D'AMATO, New York
PHIL GRAMM, Texas
CHRISTOPHER S. BOND, Missouri
CONNIE MACK, Florida
LAUCH FAIRCLOTH, North Carolina
ROBERT F. BENNETT, Utah
WILLIAM V. ROTH, JR., Delaware
PETE V. DOMENICI, New Mexico

STEVEN B. HARRIS, *Staff Director and Chief Counsel*
HOWARD A. MENELL, *Republican Staff Director*
GILLIAN G. GARCIA, *Financial Institutions Specialist*
RAYMOND NATTER, *Republican General Counsel*
EDWARD M. MALAN, *Editor*

CONTENTS

FRIDAY, MAY 7, 1993

NOMINEE

NOMINATION OF FRANK N. NEWMAN TO BE UNDER SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE

FRIDAY, MAY 7, 1993

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:05 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

OPENING STATEMENT OF CHAIRMAN DONALD W. RIEGLE, JR.

The CHAIRMAN. The committee will come to order. Let me welcome all those in attendance this morning.

Today the committee is going to consider the nomination of Frank Newman to be Under Secretary for Domestic Finance at the Department of the Treasury. While this nomination was originally referred to the Finance Committee, I appreciate the fact that Chairman Moynihan has agreed to delay the full Senate vote on Mr. Newman until after our committee has had the opportunity today to hear from him.

Over 50 percent of the time of the Under Secretary for Domestic Finance is devoted to matters within the jurisdiction of this committee. The Under Secretary for Domestic Finance assists the Secretary and Deputy Secretary of the Treasury in banking, finance, and economic matters. These responsibilities include the development of policies and guidance of Treasury Department activities in the areas of monetary affairs, financial institutions policy, management of public debt, and domestic fiscal and economic monetary matters.

Historically, the person that occupies this position has played a very important role in formulating Treasury positions on financial services issues and, obviously, those are a major focus of the interest and responsibility of this committee.

I want to say that Mr. Newman brings very impressive credentials to this position. He graduated magna cum laude in economics from Harvard University and has served as the executive vice president and chief financial officer of Wells Fargo Bank. Most recently, he served as vice chairman of the board and chief financial officer of Bank America Corporation.

It is my intention, of course, to support Mr. Newman. But before we get to that point, we look forward to his remarks to the committee today and responding to questions that the committee has for him.

Before I go ahead and ask you to stand and take the oath and make your opening comments, I am going to call on Senator Faircloth for any comments he has and any other Senator that arrives.

Senator FAIRCLOTH. Mr. Chairman, I don't have any comments at this point.

The CHAIRMAN. Mr. Newman, let me ask you to stand and raise your right hand if you would, please.

[Witness sworn.]

Let me welcome you again. We have had now already a number of occasions to meet and talk on different issues that work is being done on. Let me invite you now to make any opening comments you want to make and then we will go to questions.

TESTIMONY OF FRANK N. NEWMAN OF SAN FRANCISCO, CA

Mr. NEWMAN. Thank you, Mr. Chairman. I have a brief opening statement.

I would like to thank you and Senator Faircloth for giving me this opportunity to appear before you today. Some of the members of the committee were able to fit time into their schedules to meet with me prior to the hearing and I appreciate that opportunity, too. And I look forward to future opportunities for discussion with members I have not yet met personally.

It is a privilege to be considered for service in President Clinton's administration and in the Department of the Treasury under the leadership of Secretary Bentsen. In addition, if confirmed, I hope to work closely and diligently with this committee on issues of mutual concern and opportunity.

I realize that there are sometimes a number of different perspectives represented in the committee. I believe that is one of the strengths of our system of democracy, and I have come to Washington determined to listen carefully and to try to understand and appreciate key different views on issues as I develop my own thoughts on the balance of alternatives.

The primary responsibilities of the Under Secretary for Domestic Finance in this administration will include policy matters regarding financial institutions, Federal debt finance, financial regulation, and capital markets, as well as responsibility for fiscal management, operations supporting Treasury auctions, and other forms of debt issuance. These responsibilities include a range of matters relating to the banking system. And if confirmed, I would look forward to working with the committee on many of them.

In addition, I hope to have some constructive role in the formulation of economic policy. I hope, for example, to improve our understanding of the implications of the flows of funds through the financial system as a result of Government debt and debt financing during periods of both weak and strong economies.

I look forward to working closely with the Federal Reserve and the FDIC in addition to the Congress on programs to assure that the Nation has a strong, safe, and resilient system of financial institutions that can and will constructively and fairly serve the economic and community needs of the Nation.

If confirmed, I will undertake the very challenging responsibilities of the Office of the Under Secretary to the best of my abilities.

Thank you, Mr. Chairman.

I would be pleased to respond to any questions of the committee.

The CHAIRMAN. Before we go to the questions, let me call on Senator D'Amato for any comment he wishes to make at the beginning.

OPENING COMMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. I am pleased to have the opportunity to speak with you and, Mr. Chairman, I have one question as it relates to small business. When my time arrives for it, I would like to pose it to our nominee.

The CHAIRMAN. Very good.

Senator Bond?

OPENING COMMENT OF SENATOR CHRISTOPHER S. BOND

Senator BOND. I will wait until the question period. I am delighted to have you with us, Mr. Newman.

The CHAIRMAN. Let's start out with respect to a discussion on the Government auction market. Earlier this week, the Treasury unveiled plans to cut its sales of 30-year bonds and to stop selling 7-year notes in a bid to cut costs.

What do you think the savings will be from this plan? And what can you tell us about the analysis that was done prior to its announcement and whatever projections have been made that this is based on?

Mr. NEWMAN. Well, the underlying philosophy was to try to develop a strategy that would save expense for the Government over the long term given the fact that historically for the past 40 years at least there has been an upward sloping yield curve. And in general, it's reasonable. Most economists would expect there would continue to be an upward sloping yield curve.

We did not intend to try to find a particular scenario, a particular set of savings or a particular set of interest rate assumptions over the short term. In terms of the budget implications, that's something that OMB and presumably CBO will be working on. But the way in which we address that is not to try to find a specific set of savings, assuming a particular pattern of interest rates over the next 3 years, but rather to develop a strategy which, in a variety of different rate scenarios and over the long term, would be likely to save money.

The CHAIRMAN. Is any of that analysis that's been done there something that you can share with us in any detail? I'm not asking to look at working papers, but can you sort of walk us through a little bit of what the thinking is?

Mr. NEWMAN. A lot of it is, of course, predecisional working papers. But in terms of the underlying approaches and analysis, we would be happy to sit down with you at your convenience, Mr. Chairman.

The CHAIRMAN. Let me talk about the issue of preventing any future problems in either the banking or the thrift industries.

Four years ago, when Treasury Secretary Brady testified before this committee, that was February 22, 1989, he came in and he first presented the Bush administration plan to deal with the problems of the thrift industry. Here are some of the things that he said.

He said, never again should a Federal insurance fund that protects depositors remain insolvent. Never again should insolvent federally insured depository institutions remain open and operate without sufficient private capital risk. And, never again should risky activities be permitted by individual States and be put under the Federal deposit insurance fund.

I am wondering in terms of where we are now, a lot has been done and written and put in legislation, and it has been in place for a period of time. The economy has moved ahead during that period. I am wondering what additional steps if any do you believe should be taken to safeguard the Bank Insurance Fund and the Savings Association Insurance Fund in the future?

Mr. NEWMAN. Mr. Chairman, let me divide them into those two pieces because I think they are very different issues. The Bank Insurance Fund, I believe, is in quite good shape at this point in time. The banking industry is in quite good shape. Issues about the long-term future of the banking industry are a separate set of issues that need to be addressed, and we plan to address them during the course of upcoming months and years.

But in terms of the fundamental health at this point in time, and the degree of risk to the Bank Insurance Fund, that is not a major concern. There are a number of steps that are being taken and should be taken, and we are going to beef them up to assure that they're the kinds of risk that might develop in the banking system. For example, through increased use of swaps and derivatives or increased use of a variety of different mechanisms to deal with interest rate risk.

That those tools are properly and fully examined requires a beefing up of the examination force specialized training to deal with those particular forms of risk. But at the moment, there is no reason to believe that any of them pose any serious risk to the system or to the Bank Insurance Fund.

With respect to the thrift industry, of course, we have a very different situation. The thrift industry, although it is recovering from its very difficult times and recently has been performing far better than before, has still got a number of institutions that are problem institutions and that are very poorly capitalized, and the OTS has on its list for potential conservatorship or receivership.

As you know, Secretary Bentsen has requested funds to complete the RTC and the safe resolution of a number of those institutions. In the meantime, in order to prevent future problems, the OTS has undertaken a number of regulatory steps in concert, basically, with the banking regulators to deal with the avoidance of those kinds of problems in the future, to deal with the avoidance of runaway loan quality problems, runaway interest rate risk, and runaway fraud and mismanagement.

The CHAIRMAN. One of the issues that I particularly feel strongly about and that we've acted legislatively to deal with but is still a matter of concern to me, is the degree to which the Federal Government extends the Federal deposit insurance net out over State-authorized activities where they differ from what is in the Federal charter. I think the S&L experience is very clear on that point, but just as a general proposition, why should the Federal Government be providing Federal deposit insurance for activities that an individual State may decide it wants to take on, but not insure itself.

Mr. NEWMAN. In principle, Mr. Chairman, I would agree with your fundamental concern if in fact we are going to provide Federal insurance for an institution that is regulated by State regulators and that operates within a set of laws provided by the States. Then it's essential that we have a Federal regulatory agency, which in this case would be the FDIC, overseeing the regulatory activities of those institutions to make sure that the FDIC is satisfied that the supervision being provided by the State is satisfactory from the point of the insurer.

There may also be circumstances in which the nature of the business done by a given State institution in a particular State is such that it actually warrants a higher premium than other institutions would pay. It's a fundamental principle of insurance. It doesn't necessarily mean that an activity needs to be prohibited in order to have Federal insurance. But if in fact there is grounds to believe that a particular set of activities is higher risk, not unsafe and unsound, but higher risk, then it may warrant a higher premium. That is a matter for the FDIC board to determine, but I personally believe it is something that is worthy of consideration.

The CHAIRMAN. I want to flag it and get it up on the central radar screen with a flashing light for you so that we don't lose track of that one, because I don't want to have a situation arise in the future where there is this sort of spreading out of State-authorized activities that are nevertheless under the umbrella of Federal deposit insurance.

It is very tough for the Federal people and experience, I think, proves this to keep track of all the different things that States may or may not do, and how they may be working in real time.

There is a certain amount of skepticism about Federal deposit insurance anyway, but I think it ought to be limited to those activities which we authorize. If the States want to go beyond that, I think they need a different format in which they do it. And if they want to assume the risk, that's a decision they can make. But I am not enthusiastic about them dumping that risk profile back on the Federal deposit system.

Senator Faircloth?

Senator FAIRCLOTH. Thank you, Mr. Chairman.

Mr. Newman, you mentioned that the FDIC was in good shape. I am delighted to hear that, that you saw no immediate risk. And a few short months ago, there was a great conversation that it was in pretty dire straits, that it had to be boosted, and there were various further increases in taxes or demands from the banks. What's brought it about? How much money is there and how many big banks that might be on the doubtful list could it absorb?

Mr. NEWMAN. In essence, Senator Faircloth, I think the banking system has gone through its very difficult time that occurred during the last recession and dealt with the loan problems that needed to be dealt with during that period of time. It is now coming out of that in better shape.

Capital has been built up. The total amount of capital accumulated in the banking system has been very ample during those past couple of years.

At this point in time, the FDIC lists only ten BIF-insured banks with less than $2 billion in assets on its critically undercapitalized list. That is a relatively low number for it. And it is very unlikely that all of that will turn into losses.

Senator FAIRCLOTH. It lists ten banks with total assets of $2 billion?

Mr. NEWMAN. Yes, Senator.

Senator FAIRCLOTH. On the questionable list?

Mr. NEWMAN. On the critically undercapitalized list.

Senator FAIRCLOTH. What are the assets of the FDIC?

Mr. NEWMAN. The BIF fund itself is about at a break-even, as I understand it. It does have, as you know, a line of credit that it can draw upon. But it has been restoring its reserves, if you will, at a fairly rapid pace.

Senator FAIRCLOTH. Paying back the money that it drew down from the reserves?

Mr. NEWMAN. I guess essentially that's it.

Senator FAIRCLOTH. What would be the net of the FDIC today?

Mr. NEWMAN. I don't know the precise figure, Senator.

Senator FAIRCLOTH. About what?

Mr. NEWMAN. About a break even in its insurance fund itself at this point in time, that there is no net reserve built up, and its process of building toward this 1¼ percent target. But that it has made significant improvement over this past year when it was running at a negative point to get to this current point.

Senator FAIRCLOTH. Senator Bond?

Senator BOND. I'd be happy to defer to our ranking member. He said he had just one question.

Let me ask a couple of questions that we continually visit and revisit around here.

The administration has announced a package of regulatory changes to ease the industry's regulatory burden. Have you had an opportunity to review legislation which might be needed to change some of these burdens? Or do you think that administrative changes will suffice to make a significant impact on what's viewed by many bankers as a very, very excessive burden of regulation?

Mr. NEWMAN. Senator, we share the fundamental concerns about the burden of regulation, really, in two different ways. One is the extent to which over-done regulation has hampered lending needlessly without substantive improvement to safety and soundness. This is particularly so for small- and medium-size businesses. That really has been the principal focus of the President's credit crunch alleviation initiative. And steps are still unfolding in that regard.

The second concern is simply one of inefficiency of overhead, of wasted effort as a result of regulation in large banks and in small banks, although the burden may be disproportionately higher for smaller banks which creates a serious problem for them.

That, too, is something that we are looking at carefully. We are trying through administrative action to relieve as much of the unproductive burden as we possibly can. There will be a second stage at which we get to look at possible legislation.

We understand that a number of Senators and Congressmen have suggested legislative change. We would like to look at it very carefully, item by item, to make sure that we are addressing only those issues which in fact cause needless burden and, in fact, don't really add substantively to safety and soundness.

We have no intention of proposing any sweeping changes which would change the fundamental protections for the financial system.

Senator BOND. We are going to need your leadership and your support for making those changes. And I would suggest that one of the areas about which we hear the most complaints is something that sounds very good. The title "Truth in Savings" sounds like a wonderful objective. No one could quarrel with its objective.

But many of the bankers in my State, particularly smaller banks, say that the way we go about providing this protection is excessively complicated. We would hope that you would take a look and ask, can we achieve the legitimate objectives without all of the excessive hassles and requirements that come with it.

Mr. NEWMAN. Senator, I think that is an excellent example. I would hope that the Treasury and the regulatory bodies would be working actively with this committee on not only corrections of the inadvertent burden that was created in the past, but also as new legislation comes up to get a clear understanding of the regulatory implications of any particular piece of legislation and a particular set of wording.

Because it would be very unproductive for us to have a new piece of legislation that sounds like it is doing something constructive, but leaves the regulators in a situation where they have difficulty implementing it in an effective way. And I think it is our responsibility to come to you and to explain those concerns as you are considering legislation.

Senator BOND. Another area, where we hear a great deal of concern is on the Community Reinvestment Act. Many people have suggested that this has become a paperwork chase where process is emphasized over substance. Even the groups that are supposed to benefit from it express frustration that the CRA has done nothing but kill an unnecessary number of trees because people spend most of their time writing memos rather than making loans in the targeted areas. Do you have any specific ideas on how we might be able to streamline that process?

Mr. NEWMAN. Yes, Senator. I would agree with your overall concern on both sides, both the implementation and the examination of the implementation of the Community Reinvestment Act have not been as effective as they should be to make sure that the services delivered to the communities are what was intended by the law. That's something the regulatory authorities are addressing right now. At the same time, we have created a needless paper burden.

The President the other day commented on an initiative that the regulatory authorities are doing jointly. The Comptroller of the Currency and the OTS, which fall within Treasury in coordination with the Federal Reserve and the FDIC are working to develop more performance-oriented CRA standards. These would not be precise numerical guidelines, but they would be much better defined measures of what is a successful CRA program based on loans actually made rather than trees killed.

Senator BOND. That certainly would seem to make some sense. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bond.

Senator D'Amato?

Senator D'AMATO. Mr. Newman, let me ask you if you have had an opportunity to review the issue of the securitization of small business loans and removing some of the regulatory impediments that now make securitization difficult if not impossible?

Mr. NEWMAN. Senator, we are certainly aware of the initiatives that you have introduced in that regard and other initiatives in the House. We share your fundamental concern that we should be aware of and address any impediments that have inadvertently been set up against small- and medium-size business lending. And as you know, of course, the credit crunch alleviation initiatives were intended to address a lot of that.

The idea of securitization is also one that we think is worthy of serious examination. We very much share that view. We have not yet, in this new administration, reached the point of having delved into it with our analysis. We would be most happy to join with you in doing that to see if we could understand better what impediments might be there and what steps might be taken to remove them with the objective of making it easy for banks to make small business loans.

Senator D'AMATO. I hope you would pursue that, because if we leave it to the regulators, we will be studying this until the cows come home.

I would hope that we could count on you pursuing this in a more vigorous manner than the regulators generally pursue these areas, because there are some problems and we don't want to adversely impact the soundness and safety of the banking system. I understand that.

But we certainly want to keep our eye on the objective of permitting the banks to do the kinds of things that they cannot do now, because a prudent banker in many of these cases is not making small business loans due to the various requirements, restrictions and impediments that are placed upon him. He is much better off buying Government paper.

That's why good, successful, sound businesses today are being denied credit that, under most cases they would have. But prudent business judgments by the bankers act as a bar, preclude this. And I just think this is exactly why we had that initiative that you spoke to and that I spoke very favorably about with respect to the President's initiatives to lift some of the impediments and regulations that impair the flow of credit to the small business community.

I think that the securitization is the answer to a lot of the blockage. It may be similar to open heart surgery in getting some new arteries in there to get that blood to the failing patient. Because right now, the failing patients are the small business community.

If anybody wonders why we are not creating new jobs, it is because there is a lack of capital to the small business community. We keep writing and writing about it. We know that the major businesses in this country, for the most part, are restructuring, and that they're cutting down. I saw Jack Welch of G.E. today on a TV program in a seminar saying that they are going to continue this.

So as the major corporations retrench, we don't even have the growth that we have traditionally had that comes from the small business community. I just wonder when we're going to wake up. I want to try to stress the importance of really moving this forward. And I don't understand why we're not doing it more vigorously.

If indeed you worry about jobs, then for God's sakes, get help to the people who will create jobs. Let them have the ability to raise capital so they can expand. And I am going to give you the same two stories.

The most successful hardware marine operation in Long Island, the most successful, and he can't get credit. The largest gum ball distributor in the United States of America, Ball's Vending, can't get credit.

Now if you have two successful business entrepreneurs whose banks are giving them a difficult time, imagine the marginal operators. You can do all the job stimulation in the world, 50,000, 100,000, 200,000 permanent jobs, 300,000, that you're going to be building bridges and whatnot. That's not going to begin to replicate what the business community, the small business community can do day in and day out.

I don't understand it. That should be your number one thing instead of fooling around with all these kinds of things that don't make any sense. And I found your explanation acceptable, but I'm telling you, I don't understand—you want to help the President? The numbers don't look good, people—for God's sakes, make it possible for the banks to make it more possible.

Now they are not going to rush in and do this. You know the securitization process is going to take some time. They're going to have to learn, they're going to have to standardize. But why not help him? He's going to get the credit. But you want to keep fooling around, delaying it and studying it, what do you have to study? Tomorrow call a meeting. It's Saturday. Call them in and say, guys, let me hear what the impediments are. Tell me what they are. So they'll tell you.

If you can't put together a team to deal with it, then something is wrong and you don't deserve to be there.

Now, you know, we're going to be back at this thing. I promise you we're going to continue to bring it up. Because I haven't heard a satisfactory answer and we're dilly dallying. Really, we are.

Mr. NEWMAN. Senator, we will certainly look into it actively. I should also add it's not specifically a banking issue. In addition to the question of credit availability for small- and medium-sized businesses, we are also going to take a look at capital sources and whether there are any problems there that need to be addressed in terms of small- and medium-sized businesses getting access to capital with which they would then better qualify for loans.

Senator D'AMATO. That's good. But I can tell you something. All your fooling around with community banks doesn't mean anything in comparison to opening up the stream to existing businesses and existing facilities. If you're not going to be able to do this, I mean, you're playing at the margins. You are really playing at the margins. And the issue is so critical that I am not opposed to playing at the margins and doing things that will help by lifting some of the regulatory burdens, et cetera.

But that's not really going to the issue as to why it is that a successful company that's made a profit for 20 consecutive years gets its credit pulled back.

But if you're going to be playing around with community development banks, that sounds great. Empowerment. But it's not going to get credit, sufficient credit, out to America. And that's what we want to do.

I want the President to be successful, but I want to tell you, the longer you wait, the harder it's going to be. Successful businesses, fairly successful, will stagger on instead of being able to really hit their stride and put Americans back to work and do that which they do best, which is provide the goods and services for Americans and, in so doing, expand the economy.

That's the end of my speech. Thank you, Mr. Chairman.

The CHAIRMAN. Senator D'Amato, Mr. Newman, let me just say I am working with Senator D'Amato on a bipartisan basis on this issue of finding the method and the best method within the bounds of safety and soundness to enable this kind of securitization of small business loans.

And we want to press ahead and find an answer that works, and we need the active help of the administration in this area so that we really make this a collaborative effort and that we identify whatever the difficult definitional questions are, that we work them through, and that any other concerns that are there be taken one by one. And I think they can be resolved. So I want to underscore the intention to move in this area, but I want us to do that in tandem. I think it's very important that we work this out in a fashion that can accomplish the objective.

If there are pitfalls that you see, and you come out of the banking sector yourself, your own background, or if there are other questions raised by the regulators, let's get them out, let's take them up. Let's figure out how we can meet any concerns that are there. So I want to ask the cooperation of the administration in that fashion, so that we can proceed on that basis.

Senator D'AMATO. I thank the Chairman.

Mr. NEWMAN. Mr. Chairman, I would be very happy to do that.

Let me also mention with respect to some of the particular problems, Senator D'Amato, that you referred to in your home State, I would be happy to have somebody take a look at that, for example, your specific case of the company on Long Island, to see if the problems in the loan application for that individual company are ones that we have in fact sufficiently addressed in the credit crunch alleviation program or not, or whether there are problems there that we need to be more aware of, and need to more actively address.

Senator D'AMATO. I appreciate that.

I used that by way of, he's going to make it because he's big enough. He may not be able to carry the inventory. He has to go through extraordinary kinds of things to put up the buildings as collateral, but the kinds of things that really shouldn't be done.

And, as Harvey pointed out to me, he said, you know, Senator if I'm struggling, and we're the most successful, imagine those who are not as successful as we are, the difficult time they are having, as it relates to securing credit. That's what I'm concerned about.

And then, when I had the other very successful business, again quartered in Long Island, and I'm aware of the situation because my aunt worked for them for 35 years, but the biggest, and again they're having difficulty obtaining sufficient credit for expansion, even having the bankers say to them, maybe you're expanding too quickly. Imagine that.

In some of these businesses, if you don't expand, your competitors come in and take your market share. So that's how I know it's still continuing, because these situations have been raised to me, with me, just several weeks ago, so it's there, it's still there. But I appreciate the offer.

The CHAIRMAN. Let me move through what I want to do today, in the time that we have.

I've got a series of policy areas, all of which are important, some of which are in play at the present time, some of which need attention, and I want to make sure we've got some good, solid benchmark starting points with respect to policy perspectives by you and by the administration, as really sort of take hold here and start down the tracks. So I'm going to move, we've crafted these questions to cover the whole waterfront here, and I want to take you through them as readily as I can.

I want to talk, first, about loan loss reserves.

At the present time, the ratio of loan loss reserves to non-performing assets shows quite a variation among commercial banks across the country. In particular, regulators are permitting money center banks to hold comparatively low loan loss reserves, in the 40 percent range, compared to something closer to the 80 percent plus range of other banks. And lower reserves permit these banks to retain higher leverage ratios.

The question I want to pose is, is there a logical justification for this, or is this a kind of implicit forbearance that may be going on here? And would you favor a more systematic approach to loan loss reserves for all banks, regardless of their size?

Mr. NEWMAN. Mr. Chairman, let me take that in pieces.

First of all, if I may, I'd like to refer back to a question asked by Senator Faircloth, about the FDIC, the BIF fund.

Upon further reflection, I realize that I should probably not be speculating without getting the facts.

As you know, my responsibilities do not include membership on the Board of the FDIC, and I don't have the figures at my fingertips. But I would like to find out more specific facts, and submit them for you and Senator Faircloth.

The CHAIRMAN. Very good.

Mr. NEWMAN. On this particular question, there are a couple of issues that come to mind.

The first is that non-performing assets nowadays have taken on a different character than they did previously. A large number of the assets are now other real estate properties owned, rather than loans, and the way the accounting works, the loan loss reserve is not used to support any potential future losses that might occur on real estate owned.

That is a direct hit to the earnings account, and thus to the equity account. So in trying to evaluate the appropriate loan loss reserve, one really needs to separate out the real estate which, in earlier years, was a much smaller proportion of the problems than it is right now from the loans. The loans being the portion that really is applicable to the reserve.

Unfortunately, however, I don't know of any meaningful way to do a standard comparison from one bank to another bank. And I believe there is no substitute for careful specific examination on a bank by bank basis.

The composition of the loan portfolios that may be on a non-performing status vary so much from one bank to another, that I think it's almost impossible to make a broad statement. Certainly, the kinds of disparities you mention raise questions that I think the examiners need to look into. And those questions ought to be studied carefully.

But each bank should be examined properly on its own. Its own reserves should be examined based on the particular nature of its loan portfolio, it's problem loans, its regional economy, the diversification of its loans, the degree of classification by internal and external examiners. And some of the improvements that Gene Ludwig is instituting at the OCC I think will help in this regard. But that's the proper way to look at it.

The CHAIRMAN. Even if you put in this caveat about real estate holdings, and perhaps in effect taking properties back from people who defaulted on loans, I assume, to the extent that problem is out there, that's kind of out there for a lot of banks, maybe for some more than others, who really went overboard in that respect.

But if these numbers are right, and if you see the money center banks with such a significantly lower loan loss reserve in comparison to other banks, that wouldn't, to my mind at least, initially at least, sufficiently explain that. Why should there be, if these numbers are correct, variations that extreme?

Mr. NEWMAN. The problem, Mr. Chairman, I think, is in the degree of loss potential that might be in any non-accrual loan.

For example, if a loan is well secured, as to 80 percent of its principal, and 20 percent is in doubt, and is actually classified as doubtful, the regulations require that that entire loan be put on a non-performing status, even though the examiner might agree that the first 80 percent is basically secure and without substantial risk.

Therefore, when you go inside the bank and examine it carefully, using all the loan particulars, the internal examiner and the Federal regulatory examiner, can identify the fact that this is a case where 80 percent is pretty safe and 20 percent is really at risk.

When you see it reported in a public figure, the entire hundred percent is placed on the non-performing list, and there isn't sufficient detailed information available to make a larger judgment.

In another case, it might be that 70 percent of the loan is at risk, and only 30 percent is pretty safe, but again that requires going into the individual portfolio to make that judgment.

The CHAIRMAN. Let me tell you what my concern is. And I want you to take a look at it and let me know if I have any basis for concern.

I think there are a lot of reasons why logic would say that if a big bank gets into trouble, that it's very hard to deal with. We have no good answers. It's sort of like the bank that makes a huge loan to somebody and finally is trapped in the relationship and really can't get out readily, because there's no workable answers.

And I've seen situations and have heard of situations where good loans by banks, just to use the illustrated example, have been closed out because the bank has had to continue to stay with an impaired loan that's so big that they can't wash it through. So the good borrower has been hurt to support the impaired borrower. It's one of these perverse things that happens.

But I'm concerned about whether, over a period of time, there may have been a policy in place to bend over backward for the money center banks who may in fact have been in greater difficulty, and that there may be an implicit sort of forbearance policy that is sort of a double standard. Now to the extent there is, maybe there's some powerful argument for it in the name of systemic risk or something else.

But I want to understand whether we've got, really, a dual standard going, and whether we may well have been, or be in a situation where some banks are being given a more favorable treatment in this respect than other banks are.

Mr. NEWMAN. Mr. Chairman, I will look into that for sure.

Most of the banks that you're referring to are examined by the OCC, which, as you know, is part of the Treasury, and I'll work with Gene Ludwig on that matter.

Some of them are Federal Reserve examined, and I will get the Federal Reserve to look at that exact issue.

I do share your concern that we do need to be particularly careful about the risk in large banks. We don't want to fall into the too-big-to-fail trap, and end up sort of inadvertently protecting shareholders of large banks. That's not proper at all.

On the other hand, we do need to make sure that we are sufficiently and properly examining large banks, and have procedures in place to prevent systemic risk to the banking system.

The CHAIRMAN. I would appreciate that. Let me go on to the issue of regulatory consolidation.

I think you are aware of views I've expressed before, the need to consolidate the various bank regulatory agencies into a single, independent Federal regulator. I want to just read you a few statements in support of the concept. And then I want to ask you what your view is and what you think might be ahead.

But just to give you an idea of the range of outside opinion and experts that have spoken on this issue, here's a quote from Bill Seidman, former FDIC Chairman well-known to you. He says:

> The financial institutions regulatory system is complex, inefficient, outmoded, and archaic. It needs to be reformed with a single independent Federal regulator.

And then he parenthetically added:

> Do not bother to ask regulators about it. Their turf is their only message.

All that is a quote. That's Seidman.

Here's one from the former Chairman of this committee, Senator William Proxmire, who has said:

> Our banking and financial system is undergoing rapid technological change, where new and complex practices are introduced almost daily. Bank regulators cannot possibly stay on top of this constantly changing financial system if they must spend most of their time fighting turf wars.

That's a quote from him.

Here's John Samner, who is the Chairman of the Chicago Mercantile Exchange, again a direct quote:

> No one quarrels with the fact that regulation really isn't meeting the needs of the financial services industry. The current system is an expensive morass of duplication and inefficiency. Regulatory reform is necessary if the United States is going to stay competitive in the global market. Reform is long overdue.

Then finally, from still a different perspective, David Mullins, serving of course as Vice Chairman of the Federal Reserve Board, says this. He says:

> The current structure is costly and cumbersome, and tends not to lead to decisive actions when needed. There is no question that we need to move to a more streamlined system.

And there are lots of other quotes like this.

But I'm struck by the fact that I think there has emerged a consensus by a number of people experienced in dealing with these issues, who say it's time for some regulatory consolidation and, I think for the most part, people would argue with independence, as well. I certainly would argue for the independent side of it. But let me ask your views. How might we best undertake a consolidation and streamlining of our regulatory apparatus?

Mr. NEWMAN. The first thing that occurs to me, Mr. Chairman as you go through this list is, I have a lot of work ahead of me. This is clearly one that needs to be studied carefully. And I would certainly agree with you, that if one started from scratch, this is not the structure one would develop.

The real questions are, what's the best way to move from here, how can we do something that is less duplicative, and make the transition, any transition that we might want to make, in a smooth way which is not disruptive to the regulatory operations themselves.

The first step we're taking, as you know, is to try to eliminate the duplicative activities in the individual banks, as long as we do have multiple regulators. There's some fundamental division of labor that makes sense.

The FDIC, for example, historically has examined several thousand of the smallest banks in the country, and has developed a lot of expertise at dealing with issues in the smaller banks. The Comptroller of the Currency deals with some of the smaller banks, but mostly larger banks. The Federal Reserve fundamentally puts its thrust on bank holding companies. And the OTS specializes in thrift. There's some logical division of labor, but we do end up with overlap.

We are working actively now amongst the four regulators to try to minimize that overlap. There's no reason why, once a professional examination has been conducted by an appropriate Federal agency, in accordance with the agreed-upon regulatory standards, that we then need to have another regulatory agency come in. It's a waste of resources of Government employees, and it's a waste of resources at the bank itself.

In the case of a large bank, it's a significant nuisance. In the case of a small bank, it may be a very serious piece of overhead for them to have to deal with multiple regulators. So we are taking steps, again as you know, to minimize that overlap to make sure that the multiple examiners come in only when there's a very good reason to do so.

The next step of looking at what might make sense, in terms of our regulatory reform, and we would be happy to work with you, Mr. Chairman.

The CHAIRMAN. Well, let me tell you what I'd like to do in this area because we want to move ahead in this area, and there's a strong desire on the House side, as well, to move in this area. And I think the time has come to do it. Now, it's never simple because when you try to take and uproot organizations or fold organizations together, there's a very powerful sort of self-protective instinct that arises to try to stop that from happening.

But I think for a lot of reasons, that kind of thoughtful rational consolidation makes sense. And frankly, the pinch on resources is so great that we can't afford inefficiencies that cost money, as well as create, I think, undue burden because of this overlap and tension out with financial institutions who are having to contend with folks coming in and out of the door, one after the other, and at the same time, and so forth.

I'm respectful of the fact that the administration has got two big central issues right now that it's got to concentrate on: the economic job growth issue and the health care reform issue.

And so I expect that other issues that are in a secondary status will have to be sort of time-phased in later. I think that's wise and necessary.

But within a period of 6 months from today, I think we ought to have, some time in that time frame, from you, a judgment, as an administration, as to what ought to be done here, and not just have us all yield to the inertia of business as usual. And I think there will be an appropriate period of time in which issues like this can be dealt with in an orderly way without interfering with these major lines of initiative that the administration is having to pursue right at this time.

So I'm going to look for a recommendation from the administration over that time frame, and I do want to move ahead in this area. And I would like us to do this in concert. I would like us to think about how that's to be done.

These are never simple matters, and maybe it's taken in stages over time, in terms of some degree of consolidation in phase one. And maybe over a longer period of time, a second phase of consolidation, and so forth. But I think we're at a time when it's proper for us to ask those questions and to get those answers.

So let me just leave it at that, with that declaration of intention and desire to want to work with you on it.

Let me raise a different issue, and this is the issue of interstate banking and the question of just concentration of banking resources. And you've come out of a couple of pretty good-sized banking operations, so you've had a chance to see and understand the dynamics of large bank entities. That consolidation process is moving ahead.

I'm not sure how many people really understand how far it's gotten, but let me just put a couple of examples out for some context.

Bank America now owns more than 30 percent of the banking assets in four different States. California being one, but Nevada, Arizona, and Washington being the other three.

I think it's fair to say that most people think that if any single entity owns more than 20 percent of the banking assets in an area, that that starts to create at least the potential for undue market power. Now that's an arguable proposition as to where that figure is; maybe it's at 20 percent, maybe it's higher than that.

I think that when it gets up into the range of 30 percent or higher, it starts to raise real questions about concentration.

I would be interested in knowing your views about the degree of concentration in local banking markets that would be a matter of concern to you, and are there any safeguards that we need to think about to make sure that, as we move toward a more consolidated industry, that we don't, in effect, end up with a sort of a market dominance of firms that become so large and so powerful that it really starts to tip the process the other way.

I'd just add one other thought to it, to indicate why the concern is something that is worthy of some thought.

There are three States that have experienced especially sharp decreases in commercial and industrial lending are Nevada, Arizona, and Connecticut.

Now there are multiple factors at work here, but those are among the States with the most concentrated banking markets. And so you start to wonder if there's a cross relationship between the degree of concentration and the drying up of loans in those categories.

It raises the question in my mind, if there's any connection between the concentration issue and aspects of the credit crunch. I mean, if you start to see patterns like that emerge.

When you're riding these important trend line changes sometimes, you don't really see where they may be taking you, or what the effects may be until you've ridden them long enough, and then you've got a basis of time in which to look back and say, well, you know, that's interesting. We used to be here, and now we're here.

But I'd like you to react to what I've just laid out.

Mr. NEWMAN. Well, Mr. Chairman, I'd certainly agree that the fundamental issue is making sure that we have competitive markets for the offering of financial services in all the markets of the country is extremely important. The degree of difficulty in measuring it is also formidable.

The markets, themselves, are often characterized by individual sub-markets within a State, for example. And the particular States you mentioned, I see the question, and I think some study needs to be made to see the extent to which regional problems in those States and some of the particular institutions who have had difficulties there may have led to some of the results.

There is a process that the regulatory authorities go through—the Federal Reserve, the OCC, and the Justice Department—in reviewing applications for acquisitions and for mergers, where they look, as I'm sure you know, at individual communities, trying to determine whether or not there would still be a sufficiently competitive market and sufficient competition from the perspective of the consumer of financial services in these markets. And there is still some uncertainty as to how to measure it.

For example, it is no longer sufficient to look purely at banking. One needs to look at the thrift industry. A depositor, for example, could go to a credit union, or he could go to an S&L. As a matter of fact, it's now particularly complicated by the fact that a depositor, instead of making a deposit, can make an investment in a money market mutual fund, many of which are now readily available in lots of different parts of the country, not only by local facilities, but by mail, which makes that a difficult measurement.

The Justice Department and the Federal Reserve, I know, have done fair amount of work on trying to understand the local markets for small business loans, and all the different players who might offer small business loans.

Not commercial banks, but commercial finance companies and the sellers of equipment often do a lot of financing for small businesses, and they are attempting to take a look at that total source.

One of the things that I think would be very useful for us to do, and is on my list, if confirmed, to pursue, is to work more closely with the Justice Department on the mechanisms for examining the local effects of competition in the financial services industry in its broadest sense, to try to develop, a little bit better, the means for determining whether or not something has reached a point where it is no longer sufficiently competitive.

The CHAIRMAN. No, I want to just ask one follow-up question, and then I want to yield to Senator Murray.

But, you've severed your relationship with Bank America so you're free of any relationship with them. That's correct, is it not?

Mr. NEWMAN. I have resigned as an officer and director. I still have some stock left, which I am intending to sell promptly after confirmation.

The CHAIRMAN. Let's just take that case, then. I mean, in a professional sense, the separation has taken place here, so I want to use this as an example, because it's a relevant example here.

If Bank America, for example, has more than 30 percent of the bank assets in California, a huge State, big part of the country, and the adjacent States, or nearly adjacent, not in each and every case, but Nevada, Arizona and the State of Washington, you can start to look at a map, and you can see a pretty large concentrated economic force.

I don't know who else, would there be another bank that would be above 20 percent in that general market area?

Mr. NEWMAN. I'm not sure where Wells Fargo is in California. Wells Fargo is a substantial player in California. And there are a couple of banks in—Senator Murray might know better than I do—in the State of Washington that are fairly large, including a large mutual.

The CHAIRMAN. I'm told that Bank America has 41 percent of California now. And leaving aside, for the moment, the question of adjacent States, let's, if that figure's accurate, and I'm told it is, I don't know where the line is, but I start to have a concern about concentration of that degree.

Now you're shaking your head. You think that number's not right?

Mr. NEWMAN. Mr. Chairman, I think the problem is exactly what measure is used for what purpose.

In many of the categories of lending, for example, home mortgages, my recollection is that Bank America had about a 6 percent market share in California.

The CHAIRMAN. You see, maybe that's part of the problem. In other words, I mean that may start to illustrate the issue of concentration of assets and where they're going.

You know, I don't know, there may well be a profile as a banking conglomerate gets larger and larger, it may, by its character, trend off into the kinds of loans that's causing Senator D'Amato heartburn and it may end up with home mortgages being down to a rather modest fraction, given the scale of the total business that apparently that institution does in the State.

Mr. NEWMAN. I see what you're saying, Mr. Chairman. Although, again, I think we need to look at those figures very carefully.

My recollection of some of the consumer loan figures are in the 12 percent range, 15 percent at the highest. The small business lending market is very competitive.

Now there are these other credit crunch issues we were talking about before. The market is very competitive.

The deposit share market also needs to be measured with respect to all these different other alternatives that consumers have.

I very much agree with your fundamental concern. I don't want to, in any way, treat it lightly.

I just do believe that we need to do some homework, and it is something that is definitely now on my list, to try to figure out how to do these measures to determine whether in fact we are slipping into a situation where step-by-step, we are getting into markets that don't deliver sufficiently competitive services to the consumer.

The CHAIRMAN. Just as a matter of, you know, sort of banking practice and theory. I mean, you've lived most of your life there.

If a single financial institution, say, in banking, were to have say 50 percent of the banking assets, either in the country or, say, in a big State like California, which is as big, itself, as several States put together, doesn't that sound like an awful lot of concentration?

Mr. NEWMAN. Yes, it does, Mr. Chairman.

Even in some of the other industrialized countries, where there are only a relatively small number of banks, like in Canada, where there are only a handful of banks, and Great Britain, where there are a relatively small number of banks, nobody has anything like 50 percent of the market.

And that, I agree, would raise very substantial questions. Even in an individual market, a sub-market, if a single institution actually has 50 percent of the market in a particular community, a particular county, or whatever the local measure is, I would agree, that would raise lots of questions.

Again, one needs to look at all the sources of providing of funds. But it clearly raises serious questions.

The CHAIRMAN. Well, if the data that I have is right, and this is based on banking assets, so you're right that it can vary from category to category of investment activity, if the numbers I have are right, the Bank America is now up to 41 percent in California—I mean, 41 percent isn't 50 percent, but it's a pretty significant percentage.

I don't just mean to zero in on the company that you've left, and I don't want to leave that impression, but it happens to be a very relevant illustration of the point I want to try to make here. And that is that I think, as we move down this road toward consolidation, there are some very real questions that are now posed to us about what constitutes an undue share of assets in a given market.

I have to tell you, you know, and I'm open to reason and argument on this issue, but by instinct, when I see an institution, say, crossing the 40 percent mark, or even probably crossing the 35 percent market and heading up, I'm asking myself the question, you know, does that start to create a kind of market condition that, you know, is disturbing in certain ways?

Mr. NEWMAN. Mr. Chairman, again, I do agree. The measurement problem though, remains a significant problem.

To use another example with an institution I didn't have any affiliation with, look at a bank like Chemical Bank, or Chase Manhattan Bank in New York. If we simply take their total assets, a lot of their assets are loans to corporations that are located outside the State of New York. And in fact, a lot of them are loans outside of the United States.

So when one tries to make a measure of what is their share of the market in New York, it's necessary to separate out all the rest of those things.

Sharing your fundamental concern, it's here on my list, Mr. Chairman, to actively pursue that issue.

The CHAIRMAN. I'm going to give you one fact, and I'm not going to ask for any comment, because I want to go to Senator Murray, but I'm told that in Nevada right now, three banks control 84 percent of the assets in the State.

I'm not sure how they're divvied up, the 84 percent, but I think it's another measure of concentration in a State outside of California, a smaller State, obviously, but I think it helps to illustrate the point I'm making.

Senator Murray?

OPENING STATEMENT OF SENATOR PATTY MURRAY

Senator MURRAY. Thank you, Mr. Chairman, and thank you, Mr. Newman, for appearing today.

I want to change the focus for a few minutes here.

I appreciate how much work you've done, even before your confirmation, on the very tricky question of RTC funding. And I'm curious if you can give me, in as much detail as possible, your perspective or the administration's views on what occurred in the House Banking Committee yesterday, when they did their mark-up on the RTC Fund.

Mr. NEWMAN. Fine, Senator Murray.

The detailed document, of course, will be available very shortly, I'm sure, and it did turn out to be a longer document than we'd originally envisioned, so it's going to take some careful study. But I think there are a couple of key points that came out of it.

One is that the total amount of funds authorized does now basically consist of approximately $18 billion, which results from changing the expiration date on a previously authorized $25 billion, of which seven had been previously utilized for the RTC, plus another $16 billion, which we made available for the SAIF, to resolve institutions with a whole set of restrictions to provide some orderly mechanism for making sure that the industry was paying its proper fair share of the losses, but not to the point where it would essentially destroy the industry.

The total of those two amounts obviously is $34 billion. As you know, Secretary Bentsen had originally asked for $45 billion. That was revised to $42 billion after we were delivered the GAO's latest results from their on-going audit.

As Secretary Bentsen mentioned, at that point in time, nobody knows for sure what the exact amount of funds that will be required are going to be. It all depends on your estimate of market conditions, of interest rates, of local markets.

It turns out that California, for example, has some very large S&L's in it, and California has a very difficult economic environment at the moment. And depending on how optimistic or how pessimistic one is, more or less funds could be used.

I believe that this $34 billion was based on some projections that we would acknowledge and did acknowledge, right from the very beginning, are well within in the range of likelihood.

It's just that Secretary Bentsen had suggested that it would be wise to authorize some additional funds to allow for the possibility that interest rates might rise, that market conditions might be more difficult, and that those funds would not be expended unless necessary.

In this particular case, the amount of funds that the House Banking Committee approved yesterday is a smaller amount, but within the range that Secretary Bentsen initially indicated was a reasonable range. It just doesn't allow as much room as he had requested for possible market deterioration over time.

The underlying concept of not spending the money unless it is necessary to be spent, is preserved, as was originally requested and in the Banking Committee mark-up yesterday.

Senator MURRAY. Would the administration be satisfied with the $34 billion?

Mr. NEWMAN. Well, we would feel that it didn't give as much protection against this possibility of adverse market conditions. As long as the Congress understood that there was no way to guarantee that the entire job absolutely could be done for the $34 billion, we would believe that there is a good chance that it could be done for the $34 billion.

Senator MURRAY. But you feel that $34 billion is an adequate amount, knowing what you do at this time?

Mr. NEWMAN. When Secretary Bentsen presented his testimony to you earlier, and requested the $45 billion, our best estimate, he indicated at the time, a need for $32 billion, and an additional $13 billion of room for possible adverse market conditions.

Now our best estimate is $29 billion. If in fact there were $34 billion available, it would allow $5 billion, rather than $13 billion, for the possibility of adverse market conditions. And that of course is a judgment that needs to be made.

Senator MURRAY. In the several months that's gone down, do you see that going down again in the next several months?

Mr. NEWMAN. Senator, I wish I could predict that for you. I hope that that's the case, but I think the uncertainty about the economy is sufficient. At the moment, the latest statistics we've seen, as I'm sure you're very much aware, are still not showing a robust recovery. Unemployment again was flat. At this particular point in time, I think the degree of uncertainty must be faced.

Senator MURRAY. If we give the RTC more money than they need, is there truly incentive for them to get the best dollar value they possibly can?

Mr. NEWMAN. We believe, Senator, that a number of mechanisms are in place to assure that. And that none of the money would be spent unless in fact it was necessary.

The funds are actually never delivered from the Treasury to the RTC or to the SAIF unless they are demonstrated to be necessary.

There is a set of reforms, as you know, Secretary Bentsen proposed to you, and they are all now being very actively put in place under the direction of Deputy Secretary Altman, who, as you know, is the acting CEO of the RTC. It's an extremely active program to get those reforms in operation as rapidly as possible. A number of those steps have already been implemented.

Senator MURRAY. Has that contributed in the decline of how much you need?

Mr. NEWMAN. The truth is, I think it's too early to say that. It does give us a much higher degree of confidence that whatever funds will be requested from the Treasury will be funds that in fact are necessary.

Senator MURRAY. OK. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Murray.

I want to put into the record, a statement from Senator Moseley-Braun, who has to go over and manage a bill on the floor, but she's very interested in this, and so we'll make her statement a part of the record, without objection.

I want to make sure, for the record, in our last exchange that I understood you to say that the administration would give us their view and recommendation on regulatory consolidation some time in the next 6 months?

Mr. NEWMAN. Mr. Chairman, I have a very clear note here on my pad in that regard, and we will do our best.

The CHAIRMAN. Because I don't want to have to go ahead without you, and I want to give you enough time to be able to work this thing through. I'm not trying to make this unduly burdensome, given everything else that's in the works, but I don't want to sidestep on this. I really want to make sure that we get a response so that we can move ahead.

Mr. NEWMAN. I appreciate that, Mr. Chairman, and I think that's a reasonable time frame. I appreciate the fact that you want to work cooperatively. We would very much like to do that, and appreciate that opportunity.

The CHAIRMAN. All right. We'll look to hear from you on that.

This morning, there are some stories that have run in the papers about the future of the banking industry, and different stories have different tones.

But one in the Wall Street Journal today, written by one of the writers that has been writing on financial issues for a good long time, Ken Bacon, who is here this morning, carries the headline— I don't know if you've had a chance to see it. It says "Banking Industry Is In Long Term Fall Despite Current Health, Greenspan Says." And then it's a story that covers remarks and a speech that he made yesterday.

Without trying to read the whole article, the thrust is that while banks are doing better in the present time period because of improved earnings and such, and strengthening their capital base, that as he looks out over the longer horizon, he sees a shrinkage of banks in terms of total financial assets, and perhaps that trend continuing. Have you had a chance to see this piece?

Mr. NEWMAN. Yes, I have, Mr. Chairman.

The CHAIRMAN. I'd like you to react to it. What is your view? I mean, beyond today and looking out, again because you've been in the banking business now for a number of years, when you look out, say, through this decade to the end of the decade, and trying to look beyond, just in terms of your sense for the long term health of the industry, what observations would you make on that?

Mr. NEWMAN. Well, Mr. Chairman, I share some of Mr. Greenspan's fundamental concerns, that we do need to look carefully at what the longer term implications are for the industry as we now know it, as there are changes in the delivery of financial services in the United States.

There have been a number of changes that have sort of been outside of the banking industry during the past several years, such as the money market mutual funds, such as the growth of the commercial paper market, that have changed the role, to some extent, of the banking system in the overall financial system.

We need to look at that carefully to make sure that we are not inadvertently creating a structure which will not be able to serve its proper role over the long run. That, again, is one of our projects. I cannot guarantee you a 6-month time frame on that one, Mr. Chairman but clearly is something we need to look at.

We would look forward to working with you on that, as well as with the Federal Reserve in trying to understand what alternatives might be available to try to ensure that the constraints on the banking system are such that we can feel confident about having a safe and sound banking system, but also a viable banking system that is able to generate sufficient capital to serve the needs of the Nation and the communities.

The CHAIRMAN. There are these two very tough nexus issues, one of course being Federal Deposit Insurance, and what that can mean under extreme adverse conditions. And we've had some very sad recent experience in that area.

But also the cross-connection to monetary policy and the Federal Reserve's ability to influence monetary policy.

Obviously, anybody that wants to get into a form of the banking business without those two connections is free to do so. And isn't that really what's happened.

I know, for example, I just bumped into the fellow who runs the financial services arm of Ford Motor Company, and he was quite happy that a large part of their positive earnings reported for the first quarter of this year came from that subsidiary of Ford Motor Company.

And so there are a lot of people that have moved into the financial services business, sometimes under an operating structure that carries with it deposit insurance and Federal Reserve connections, and sometimes outside of that, completely outside that.

So obviously, if somebody's out there today with private capital who wants to get into the financial services business, they really have a choice, they have many choices. But I mean, they have a fundamental choice, if they want to come in on the side where Federal deposit insurance is present, with all the pluses and minuses that go with that and the Federal Reserve connections, or they can go a different route. And there really is that freedom in our system, isn't there?

Mr. NEWMAN. Yes, I agree. Within the bank holding company structure concept, there's the opportunity for bank holding companies to do some activities which don't involve FDIC insurance. And that needs to be explored further. And clearly, I would very much agree that whatever we do needs to be done having in mind proper protection of the Bank Insurance Fund, and proper premium flow for the Bank Insurance Fund.

One of the interesting side effects of the kinds of examples you were just mentioning is that there are other responsibilities that we have, as a matter of public policy, decided that the banking system should provide. Yet we have not placed those same responsibilities on other forms of institutions that deliver financial services, the CRA being a very notable example.

Banks and thrifts have the responsibility to deliver those services to their local communities, whereas finance companies do not, and money market mutual funds might in fact, draw cash out of a local community. The concept of an individual who could place cash in a bank or in a money market fund, in either case, one has to ask what happens to those funds, and are any of those funds then used for the benefit of the community.

It seems like we need to take a look at the proper role of a variety of different institutions in supporting their communities, in addition to banks per se.

The CHAIRMAN. I've got about seven more areas that I want to cover. I'm only going to cover three of them in the time we have today. I'm going to ask you to respond to the rest for the record. I'll indicate what they are, so that you know and others here who are following the discourse and who would be interested in what the positions would be in these areas, would have some way of knowing what you'll be responding to in writing.

Let me move to three other areas. I want to get into the consumer area.

Last month, during his confirmation hearing, Gene Ludwig assured the committee—and I want to quote him. He said that:

As comptroller, I will work to remove discrimination from our financial system, root and branch.

And he said it with real feeling and I'm convinced that he meant it, because he'd said it to me earlier.

I want to say that I applaud the actions of the OCC earlier this week to put an end to lending discrimination by national banks, and I want to commend the Comptroller here today for that action, because I think it's entirely in keeping and a follow-through to what he said here to us.

I have repeatedly urged the bank regulators to use testers and statistical analyses to do a better job of targeting the exam procedures, because we've got, I think, clearly a real problem out there, and it just can't be tolerated any longer. And I want to commend the administration generally for taking firm steps to make sure that racial discrimination or any other kind of discrimination is confronted and stopped with respect to what's going on in our financial services and within our banking activity.

I would like to ask you for a commitment that's the equivalent of that that we asked for and got from Gene Ludwig, that you're going to hit this discrimination problem head on, and that there won't be any if's, and's, or but's about it.

I want this problem dealt with straight up in this administration from the very first day, and I want to make certain that it's a top priority of yours, and that the Community Reinvestment Act and other tools will be applied to make sure that we're really getting the job done, and getting credit out on a fair basis to everybody in this society.

Mr. NEWMAN. Mr. Chairman, you have my commitment unequivocally. I'm extremely supportive of the concept you mentioned, and extremely supportive of the actions that the OCC is taking and of Mr. Ludwig's program.

I personally abhor discrimination in any of its fashions and believe that we need to do a great deal of work to make sure that there is not on-going discrimination in our financial system.

We need to provide better measures of discrimination, better ways of identifying it, so that we can point out to those institutions who may be, intentionally or unintentionally, falling into patterns of discrimination early on to not only correct situations as they exist, but also to prevent them from getting worse, and in fact to turn the patterns so that we eliminate the discrimination on a broad range.

The CHAIRMAN. I am pleased to hear you say that, and you will have the full support of this committee because we waited long enough. We fought a civil war over these issues and the years go by. We have heard story after story, and the Boston Fed study bears it out as well, of people who go in and who have credit histories as good or better than somebody else and they are turned away with loan applications. And it is part of why the country is in trouble, it is part of why our inner cities have gone into a kind of tailspin.

If the free enterprise system can't work and if we can't get credit into situations where clearly it ought to be going on a fair and impartial basis, then it just sort of cancels out not only the constitutional guarantees of equity and fairness, but our economic system can't work that way.

That's the way to wreck the economic system. As well as behave in a fashion that's a direct violation of the laws of the country and what the country stands for. So we've done a lot of foot shuffling in the past on these issues, quite frankly, and a lot of blindness, I think, to the problems.

That's one of the reasons that I strongly supported President Clinton, because I felt and feel today that he was determined to be the kind of President who would do something about it and would ask people like you to serve and Gene Ludwig, who would set this right.

So I want to just emphasize again how much I want to see a forceful follow through on this, and anybody that you run into in the banking system that doesn't want to see to it that the system is fair, have them come and see me. Because I would like to chat with them.

Mr. NEWMAN. Fine, Mr. Chairman.

The CHAIRMAN. Back in 1992, the Federal Reserve Bank of New York in their quarterly review reported that the foreign bank share of U.S. commercial banking now, the market share, is higher than the frequently cited 30 percent that we hear, and that Japanese banks alone now account for more than 10 percent of all U.S. banking assets.

I am wondering what your view is as to what accounts for the large share that foreign banks now have of U.S. commercial lending and what competitive advantage does the U.S. give foreign banks here in our market?

Mr. NEWMAN. Well, clearly, there was a dramatic growth in the loans held by foreign banks in the United States. Some of this, I think, has been evened out a little bit by the international adoption of the BIS capital standards. I think that was a great step forward.

It is taking a while for the full effect of that to flush through the system around the world, but I believe you can already see some effects of that including a country such as Japan.

There is also the issue that the cost of capital in countries like Japan, which for a long time have had relatively low inflation, is lower than in the United States and it means that banks in countries such as Japan were able to raise capital to support growth at essentially a lower cost than United States companies.

We also in this country have allowed foreign banks pretty good access to our markets in a variety of ways, including retail banking as well as wholesale banking. There are a number of countries around the world, as I am sure you know very well, where they do not permit the equivalent operation of a U.S. bank in their country, particularly in the retail market and even in the wholesale market there are a number of restrictions in those countries.

The CHAIRMAN. Senator Garn, when he was here, and I pressed very hard legislatively to deal with that problem as it relates to Japan, because that is a very sore subject, and it is wrong the way it is today. I frankly don't see any reason why our Government should give any competitive advantage to a foreign bank over a domestic bank, and I will give you an example.

In terms of the wholesale branches of foreign banks, they're exempt from the CRA requirements while the U.S. wholesale banks are subject to those requirements. I frankly don't see the justification for that.

I think there are other things like that, but I think it's time to take a look at that and see if we shouldn't get our own banks on the same footing that we give foreign banks in this country. That's a separate issue from the barriers we face overseas, where we've got other countries that like the one-way street approach access here and not wanting to give access there to our institutions. So we will press them a different way.

But I would like to make sure that we are looking to see that we are not creating an unfair advantage for foreign banks in this country that is really not justified. And I would say the CRA sort of sticks out like a sore thumb.

Let me ask you a question with respect to—I want to ask you one other question with respect to Government securities legislation that we passed in the aftermath of the problems of Solomon Brothers to try to improve the Government Securities Act. Are you confident that the reforms that have already been undertaken by Treasury will prevent another Solomon-type problem on the Treasury market?

Mr. NEWMAN. We believe that the reforms that have been put in place are significant improvements and that the market is now running very effectively. And that proper mechanisms are in place both with respect to Treasury and the SEC and the Federal Reserve Bank of New York to monitor things.

However, we do think it's important that this new piece of legislation which would restore Treasury's rulemaking authority be put in place. Because, at the moment, we're sitting in a situation where, should an unanticipated problem arise, we do not have the authority to install the new rules that might be called for. And it is very important that we have that authority available at any given point in time.

The CHAIRMAN. I agree with that.

Has the private sector taken steps to improve the dissemination of information about secondary market trading in Government securities?

Mr. NEWMAN. Yes. The private sector has taken steps and we have taken steps with respect to the private sector, for example, by now permitting a broader range of dealers, not just primary dealers, to bid on a number of auctions. We are also doing confirmation of customer orders directly with customers to make sure that what is represented about those customers is correct.

The CHAIRMAN. I am going to ask you, for the record, to respond to the following issues. I will not ask you to do it here now.

One of them is fair trade in financial services. This is the legislation I referred to, to really deal with these market impediments that our institutions face in foreign markets. I am also going to ask you to respond to a question on the future of the Federal Home Loan Bank system.

Also, I want you to talk a little bit more about interest rate risk and also the question of home equity loans, what you see in that area in the risk sense. And I may have one other that I won't be able to cite right here and now.

Finally, let me ask you this: I appreciate the time you're giving and the insight you're sharing with us in the course of this discussion. Some have expressed the concern, you know, that you are going to bring the big bankers' perspective because you have been associated now with big banks for at least the last 20 years. You are the executive vice president and chief financial officer of Wells Fargo Bank, which is a substantial organization. And, of course, vice chairman of the board and chief financial officer of Bank of America.

So, how do you address the question to those who raise that concern, who may be in smaller institutions or represent smaller institutions around the country that they are going to get the same level of consideration and concern in your thinking as big institutions like the ones that you have been part of before?

Mr. NEWMAN. Mr. Chairman, you and I just happen to know each other a little bit in some of our conversations, and I hope we will do much more of that. But from my perspective, I want to be here. I could have stayed in San Francisco in a pretty good job and continued on working for a large bank. Here is an opportunity for me to do something which is genuine public service in an administration that I think has tremendous potential under the leadership of President Clinton and Secretary Bentsen where I can contribute in a meaningful way to a variety of issues that relate to our financial system. They are things that I feel very strongly about.

I believe that we should have a viable banking system for this country in all its dimensions: community banks, small banks, medium-size banks, large banks. There's a whole variety of financial services for consumers that is an important part of this Nation. I don't particularly plan to favor any one portion over any other portion. We already talked about discrimination. It is something I believe very strongly, as you do, about. And that is one of the reasons I am here.

I believe in the CRA. I believe that we need to do more for our inner cities and poor rural areas that are suffering from a variety of economic problems where delivery of financial services in a special way may be very important to solving a lot of the problems there, or at least helping to deal with a number of the problems in those particular areas.

I think it is important that we find ways to support the needs of communities in a variety of different ways through the banking system. I don't think we're necessarily at the end of that issue. And as times change, we need to have flexibility in terms of meeting the new needs of our communities. Small communities, big communities, also retail banking, large banks, small banks.

I come genuinely with no bias other than to have a successful, fair financial system over time, and I would be honored to contribute to that.

The CHAIRMAN. Thank you. I appreciate that. And I accept your statement and I believe what you have said. So I am enthusiastic about the fact that you have come to serve and that you are willing to take this job on. I think it is hard to decide to leave San Francisco. The ever-present threat of an earthquake notwithstanding, it's a lovely place to be.

But to take on the responsibilities of public service, I think, requires a special dedication and I appreciate what you've said about your feelings in that area and what you've said previously. We want to move along and get you in this job as quickly as we can and work with you in getting it done and done well.

Mr. NEWMAN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

The committee stands in recess.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

[Prepared statements and response to written questions supplied for the record follow:]

STATEMENT OF SENATOR CAROL MOSELEY-BRAUN

Mr. Chairman, I am pleased to be here this morning as the committee considers the nomination of Mr. Frank Newman to be Under Secretary of the Treasury for Domestic Finance. I have had the opportunity to talk to Mr. Newman about his nomination, and about a number of current financial issues. I have no doubt that he will make an excellent Under Secretary of the Treasury, and I strongly support his confirmation to that post.

The Under Secretary for Domestic Finance is the point person for a number of issues that are critical to our economic future. The Under Secretary must cope with problems like the credit crunch, regulatory burden, regulatory consolidation, access to capital for distressed communities, and many others that I will not take the time to detail now.

These issues are often considered to be esoteric, and not to involve real people. Nothing could be further from the truth. These issues are vital to people's lives. How they are resolved will help determine how many Americans will be able to access the American dream of a good job and home ownership.

I know Frank Newman to be a person who share's the President's vision for our future. I know he intends to "put people first" at the Treasury Department. I am confident that he understands the great public responsibility he is undertaking, and I am sure he will do a great job.

STATEMENT OF FRANK N. NEWMAN, NOMINEE TO BE UNDER SECRETARY FOR DOMESTIC FINANCE OF THE DEPARTMENT OF THE TREASURY

Mr. Chairman, distinguished members of the committee, it is genuinely an honor and a pleasure to appear before you today. Some of you were able to fit time in your schedules to meet with me prior to this hearing and I appreciated the opportunity to talk with you. I look forward to future opportunities for discussion with members I have not yet met personally.

It is a privilege to be considered for service in President Clinton's administration, and in the Department of the Treasury, under the leadership of Secretary Bentsen. In addition, if confirmed, I hope to work closely and diligently with this committee on issues of mutual concern and opportunity. I realize that there are sometimes a number of different perspectives represented in the committee; I believe that is one of the strengths of our system of democracy, and I have come to Washington determined to listen carefully, and to try to understand and appreciate key different views on issues, as I develop my own thoughts on the balance of alternatives.

The primary responsibilities of the Under Secretary for Domestic Finance in this administration will include policy matters regarding Financial Institutions, Federal Debt Finance, Financial Regulation, and Capital Markets, as well as responsibility for Fiscal Management operations supporting Treasury auctions and other forms of debt issuance. These key responsibilities include a range of matters relating to the banking system, and, if confirmed, I would look forward to working with the committee on many of them.

In addition, I hope to have some constructive role in the formulation of economic policy. I hope, for example, to improve our understanding of the implications of the flows of funds through the financial system as a result of Government debt and deficit financing during periods of both weak and strong economies.

I look forward to working closely with the Federal Reserve and the FDIC, in addition to the Congress, on programs to assure that the Nation has a strong, safe, and resilient system of financial institutions that can and will constructively and fairly serve the economic and community needs of the nation.

If confirmed, I will undertake the very challenging responsibilities of the office of the Under Secretary to the best of my abilities. Thank you, Mr. Chairman. I would be pleased to respond to any questions of the committee.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name:	Newman (LAST)	Frank (FIRST)	Neil (OTHER)

Position to which nominated: Under Secretary for Domestic Finance, Department of the Treasury

Date of nomination: 3/22/93

Date of birth: 4/20/42 (DAY/MO/YR)

Place of birth: Quincy, MA

Marital status: Married but living apart.
Full name of spouse: Mo Newman

Name and ages of children: Daniel, age 23

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Thayer Academy	1955-59	Diploma	6/59
Harvard College	1959-63	AB	6/63

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

Magna Cum Laude, Economics, Harvard College
Alfred P. Sloan Scholarsnip, Harvard College

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable, and other organizations.

Organization	Office held (if any)	Dates
Harvard Club of San Francisco	Director	1985-
Japan Society of Northern California	Director	1987-
San Francisco Municipal Improvement Railway Corp.	Director	1980-86 (approx.)

Employment record: List below all positions held since college, including the title or description of job, names of employment, location of work, and dates of inclusive employment.

Analyst, Corporation for Economic and Industrial Research Inc. (CEIR), Cambridge, MA, 1963-1966

Manager, Consulting Practice, Peat Marwick Livingston and Co., Boston, MA, 1966-69

Vice President, Transaction Technology Inc (a subsidiary of Citicorp), Cambridge, MA, 1969-73

Executive Vice President and Chief Financial Officer, Wells Fargo Bank, San Francisco, CA, 6/73 - 10/86

Vice Chairman of the Board and Chief Financial Officer, BankAmerica Corporation, San Francisco, CA, 10/86- 2/93 (currently on leave of absence pending appointment. As of 2/1/93, I have resigned from my position as director and vice chairman.)

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

None

Published writings: List the title, publishers and dates of books, articles, reports or other published materials you have written.

None

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

None

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

6-88	Friends of Diane Feinstein	$1,000
4-89	Feinstein for Governor (primary)	$1,000
10-89	Bradley for Senate	$1,000
11-89	Feinstein for Governor (general election)	$1,000
1989	Bank of America Federal Election Fund	$1,710
7-90	Feinstein for Governor	$1,000
1990	Bank of America Federal Election Fund	$2,052
6-91	Feinstein for Senate	$1,000

6-92	Hsieh for Supervisor	$500
6-92	Kaufmann for Supervisor	$500
6-92	Lazarus for Supervisor	$500
6-92	Kennedy for Supervisor	$500
1992	Bank of America Federal Election Fund	$2,000

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

See attached biography

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm association, or organization if you are confirmed by the Senate.

   Yes

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firms, association or organization.

   No

3. Has anybody made you a commitment to a job after you leave government?

   No

4. Do you expect to serve the full term for which you have been appointed?

   NA

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

   None, other than B of A pension interest as noted in my SF 278.

2. List any investments, obligation, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

   I currently own stock in two banking companies -- Bank of America and Wells Fargo. In addition, pursuant to Bank of America compensation plan, I received restricted stock. Following confirmation all holdings of stocks and vested restricted stock will be divested; all non-vested restricted stock will be forfeited.

3. Describe any business relationship, dealing, or financial transaction (other than taxpaying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

   None

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

   None

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

   See answer to question #2.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

   I have served as Vice Chairman of the Board and Chief Financial Officer of BankAmerica Corporation (BAC) since October 6, 1986. Since that time, I am not aware that I personally have been the subject of any investigation for the possible violation of criminal statute.

   BAC, the Bank of America NT&SA, and its affiliates and subsidiaries, like many corporate entities, have been involved in many suits in the normal course of business during the years that I served as a director and senior officer of BAC. Some of these suits named all the directors of BAC, and I may have been served in that capacity.

   From time to time, BAC and the Bank of America NT&SA, its affiliates and subsidiaries, and their employees, because of the nature of their commercial banking and financial services business, have been the subject to informal and formal investigations by, and inquiries from, federal, state, and local authorities regarding various aspects of its business, some of which, such as regulatory investigations, could result in criminal charges. I do not recall BAC, the Bank or their affiliates or subsidiaries ever having been subjected to a criminal indictment or criminal filing during the period in which I served as a director and senior officer of BAC.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

NA

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM FRANK N. NEWMAN

Q.1. Fair Trade in Financial Services—This committee fashioned and the Senate has passed on several occasions a bill entitled the Fair Trade in Financial Services Act. The legislation is designed to give Treasury negotiators new leverage to end discrimination against U.S. financial firms in certain markets such as Japan and Korea. It would, in essence, move the U.S. from a policy of unconditional national treatment to a policy of reciprocal national treatment on these matters. When Treasury Secretary Bentsen was asked about the legislation at his own confirmation he said: "The touchstone of our trade policy, including international negotiations on financial services, is that we must demand reciprocity." Do you agree with that? If so, will you work with this Committee to get the Fair Trade in Financial Services bill enacted this year?

A.1. U.S. markets for financial services are quite open to financial firms based in other countries. I agree that it is only fair that other nations open their markets similarly to American financial firms. As noted, Secretary Bentsen has made a clear statement making reciprocity an important trade policy objective. I would be pleased to work with the Committee on fair trade in financial services, consistent with the administration's overall trade policy and negotiations.

Q.2. Interest Rate Rise—The FDIC Improvement Act required the Federal banking agencies to formulate safeguards against interest rate risk. Are the safeguards currently proposed by the regulators adequate? If not, how should they be strengthened? Do many banks or thrifts have excessive exposure to interest rate risk now? If so, what danger does this pose to the Bank Insurance Fund?

A.2. The Federal bank and thrift regulatory agencies have done substantial in-depth work on interest rate risk, including publishing for comment detailed regulations to go into effect later this year.

The management of interest rate risk is an extremely important function for financial institutions and for examination by the regulatory authorities. For some institutions, particularly large banks and others utilizing a variety of modern financial instruments, this process can be very challenging, and calls for very well qualified and well trained examiners, regardless of the models and computations that are used. This entire area will receive additional regulatory attention over upcoming months and years.

At this time, the regulatory authorities have indicated to me that they see no evidence of excessive interest rate risk in either the bank or thrift industry, overall. The model used by the Office of Thrift Supervision estimates that some thrifts may have levels of interest rate risk, relative to their, capital bases, that could call for corrective action. These thrifts are being specifically examined to determine appropriate actions. In addition, rates have been relatively stable and relatively low for some time now, and continued regulatory attention is called for and planned, in light of potential increases in the volatility of rates in the future.

Q.3. Disclosure—The FDIC Improvement Act sought to increase market discipline on federally insured depository institutions. But to facilitate market discipline, timely and accurate information on the condition of these institutions is needed.

A.3. Financial institutions in the U.S. provide very substantial amounts of information to the public, and with greater frequency than in many other nations with well developed financial systems. Nonetheless, as changes occur, I agree that it is appropriate to consider how public reporting of data might be improved, and we will give specific attention to that issue. If the committee has any particular areas of concern, we would be happy to give them special attention.

The issues regarding public disclosure of CAMEL ratings are extraordinarily difficult. I believe that the ratings alone, separated from the context of the full examination reports, can be extremely misleading, and even dangerous. At the same time, public disclosure of confidential examinations would be highly inappropriate, could significantly interfere with the effectiveness of the examinations themselves, and might well impede corrective actions. I believe that we should strive to avoid intentional or inadvertent disclosure of CAMEL ratings, as risk-based FDIC premiums are implemented, and continue the efforts to have banks provide adequate and timely factual information to the public, for analysis by depositors, investors, and private-sector rating agencies.

Q.4. Federal Home Loan Bank System—What do you envision to be the future role of the Federal Home Loan Bank System? [For example, some people would argue that they may have outlived their role in providing liquidity to the system.] To what extent have Fannie Mae and Freddie Mac cut into their function?

A.4. In the Housing and Community Development Act of 1993, Congress asked the Treasury to comment on studies that it had requested on the Federal Home Loan Bank System. These studies, which should be submitted to Congress in June of 1993, are being drafted by (1) the Congressional Budget Office, (2) the Federal Housing Finance Board, (3) the General Accounting Office, and (4) the Secretary of Housing and Urban Development. Other studies are also being written by Freddie Mac, Fannie Mae, and the Federal Home Loan Bank System.

When these studies are completed, Treasury will analyze them and develop a set of recommendations.

It would also be more appropriate for me to comment on the future role of the FHLBank System and the extent to which Fannie Mae and Freddie Mac affect the FHLBank System's function at that time.

Q.5. SLMA—It has been reported that the Clinton administration is seeking to have student loans made by the Federal Government directly rather than through banks as is currently done. From a financial services viewpoint, what effect would this policy change have on financial institutions which originate student loans, consumers (students/parents) who obtain student loans from banks and on SALLIE MAE, the GSE with primary responsibility for the student loan market?

A.5. The Clinton administration has proposed a new approach to student loans, in which funds would be extended directly from the Federal Government, rather than through banks, with a GSE guarantee structure. We believe that this approach will provide more cost-effective funding for student tuitions. The proposal envisions a transition program so that any disruption to the existing process can be held to a minimum, for students, parents, and schools. Financial institutions that have been making guaranteed student loans will lose that business, which is a relatively small component of total bank lending. Although I believe that it is extremely important that we do not needlessly and artificially prevent financial institutions from undertaking profitable, capital-enhancing business activities, I do not believe that the Government has an obligation to provide specific business opportunities to banks and thrifts, with taxpayer-guaranteed lending programs.

The proposal also envisions a transition process for SLMA, to be conducted with due attention to taxpayer risks, and SLMA has indicated its interest in pursuing other business activities as the Government-guaranteed program winds down.

Q.6. Future Problems—Would you please give us your best assessment of any future problems that you believe may lie ahead in the banking and thrift industries? Do you believe the banking regulators currently have the ability to adequately regulate trading of derivative instruments by banks? How concerned are you about home equity loans?

A.6. Clearly, one of the responsibilities of the Treasury Department, in coordination with the regulatory agencies, is to continually re-look at changing industry characteristics so as to be prepared with appropriate examination approaches and emphasis. This administration takes that responsibility seriously and is already instituting appropriate actions.

One such area does deal with derivative financial instruments, which are legitimate modern financial tools, but which call for highly specialized examinations in the largest and most complex banks, and considerable vigilance when they are used increasingly at smaller institutions. Appropriate program enhancements are being planned at the regulatory agencies.

Home equity loans, in and of themselves, need not be a cause of major concern. Two fundamental principles do need emphasis with respect to them, however: sound underwriting practices and careful examination of rapidly growing portfolios.

Although I believe the banking industry is fundamentally safe and sound at this time, longer-term issues appropriate range of services demanded by their customers in efficient, profitable, capital-enhancing ways. It is essential that we look ahead at these issues, so that our Nation can have financial institutions that are capable of serving the economic and community needs of a growing and changing society.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR FAIRCLOTH FROM FRANK N. NEWMAN

Q.1. Bank Insurance Fund (BIF) of the FDIC

A.1.

- BIF had an accounting deficit balance of $7 billion at year-end 1991.
- During 1992, BIF had net income of $6.9 billion.
- The year-end 1992 deficit balance was approximately million.
- The accounting deficit is a result of $10.9 billion of reserves established for estimated costs of future bank failures, beyond actual losses incurred to date.
- The BIF has not used any of the $30 billion authorized to be borrowed from the Treasury to cover operating deficits and does not anticipate using it during 1993.
- At year-end 1992, BIF had working capital borrowing from the Federal Financing Bank (FFB) of $10.2 billion. BIF also had assets in the form of net receivables from bank resolutions, amounting to $27.8 billion ($53.4 billion gross less a 48 percent reserve). That is, BIF expects to realize $27.8 billion of cash from sales of assets, $10.2 billion of which can be used to repay the working capital borrowed from the FFB.
- As of March, 1993, only 10 BIF-insured banks, totaling less than $2 billion in assets, are on the FDIC's critically under-capitalized list.
- Current conditions do not indicate any expectation of cost to the taxpayer from support of the BIF. I believe that it is extremely important that Government policies promote a banking system that safe, sound, and successful, so that no taxpayer costs will ever be needed for BIF, while still permitting banks to undertake responsible lending and other services in support of the economy and the communities which they serve.

O

ISBN 0-16-041161-0

9 780160 411618 90000