



History of the Eighties, Lessons for the Future, Vol. 1

Federal Deposits Insurance Corporation, 1997, 572 pp.

American Finance for the Twenty-first Century

Robert E. Litan, United States Department of Treasury, Nov. 7, 1997, 162 pp.

Asset Securitization—Liquidity and Funds Management, Controller's Handbook.

Washington, D.C. Nov. 1997, 90 pp.

The purpose of this review is to alert the reader to the recent publication of three separate reports by Federal Agencies. All of the reports are potential additions to a reading list in a financial institutions course.

The thesis of the FDIC Report, *Histories for the Eighties, Lessons for the Future*, is that bank failures in the 1980s did not have a short list of causes. Rather they resulted from the concurrence of a number of forces—economic, financial, legislative, supervisory, and managerial—which working together produced a decade of bank crisis.

The first section of the report provided a review of the challenges to the banking industry created by the operating environment in the 1970s. The legislative mandates of the 1980s and 1990s are summarized with special attention paid to the impact these changes had on bank failures. The section concludes with a discussion of the interagency conflicts between FDIC and OCC. In the second section of the study, sectoral and regional crises are considered. The topics covered include: LDC debt, mutual savings banks, the “too big to fail” issue, and the cause of various regional bank crises.

The third section of the study discusses the common elements in the economic environment that characterized the various bank crises and the set of bank behaviors that amplified their impact. The section concludes with an interesting section on fraud and financial misconduct followed by a brief statement on the difficulty the regulatory community has in separating managerial deficiencies and the slack internal control system from fraud.

The final section deals with the behavior and performance of the supervisory agencies during this period and the legal and regulatory constraints they operate under. The thrust of this discussion is to present the thesis that the supervisory function was handicapped by a philosophy that stresses identifying unacceptable levels of risk as observed on the financial reports of the banks. The study suggests that the more appropriate policy would have been to take a proactive view of risk that stressed policies that would help identify and contain risk

as it developed. In a review of the role of the FSLIC was limited in how it could respond to industry problems by severe budget constraints caused by the differentially poor funding it received relative to other Federal Regulatory Agencies. A review of OCC examiners reports for the period indicates that examiners repeatedly reported problems with the internal control systems over lending operations but they were ignored until the late eighties.

It is interesting to note that academic literature has devoted considerable time reflecting on the adverse incentive system created by the flat-rate deposit insurance premiums; an element in the discussion that is not given much creditability by this study. In preparing this report the FDIC has been successful in creating a readable commentary on forces that influenced bank failures in the decade of the eighties.

The stated purpose of *American Finance for the Twenty-first Century* is to discuss the changes in the financial service industry through 2010, and to review the adequacy of existing statutes and regulations. The general thrust of the report is to provide an all encompassing review of the forces influencing the financial system (without covering any topic in depth). This makes the report excellent reading for an undergraduate issues oriented course. One of the pluses to the report are the brief historical summaries of policy issues. The assertion, which I regard as essentially correct, is that today's policy initiatives and regulations are oriented toward preventing a second Great Depression. What is needed is a paradigm shift that builds a policy that seeks to contain failure within boundaries and recognize that markets reward players that embrace change. The report also argues that the financial markets are becoming more complex, and that legislative and regulatory activities that seek to divide the financial world into discrete segments is doomed to failure. This policy should be oriented toward identifying, isolating and disposing of trouble spots that endanger the stability of the whole system.

The report is built around five distinct themes. The study opens with a snapshot view of the financial services industry and its function. The discussion is then broadened to include globalization and a variety of changes in the information system. These forces of change, it is argued, have unleashed a new round of competition that requires a change in the orientation and thrust of our anti-trust efforts. The new policy must monitor the "gatekeepers and keyholders" that control networks and technology. The goal of such a policy should be to prevent a financial meltdown. The concluding section of the study deals with the broad social theme that we need to work to open the financial system to all Americans.

The *OCC Asset Securitization—Liquidity and Funds Management, Controller's Handbook* is divided into three chapters, two of which provide an excellent overview of the structure of the securitization transaction, the mechanics of cash flow, and the risks associated with the securitization activities. Although the discussion on the structure of securitization can be found in a variety of sources, the detail and simplicity with which the process is covered and the example provided—the credit card securitization process—make the discussion a winner for an undergraduate presentation. The discussion of the risk associated with the securitization is simple and much more complete than that found in alternative sources. The third chapter is not of general interest but rather provides a discussion of the examination objectives as they relate to the securitization

process. Other Comptroller's handbooks of possible interest include, capital and dividends and mortgage banking.

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