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December 17, 1990

Mr. Roger B. Porter
Assistant to the President for
Economic and Domestic Policy
The White House
Washington, D.C. 20500

Dear Roger:

As we approach 1991, reform of our nation's banking system is rapidly rising to the top of the nation's domestic agenda. There is no question that action will be taken - but what kind?

On one hand, we could enact a series of partial reforms to solve parts of the problem. But analysis suggests that such half-steps will ultimately worsen the crisis in our financial system, force a higher taxpayer bank bailout, prolong the recession, and leave the banking system too weak to finance recovery.

Or, instead of half-steps, we can commit to taking the whole journey. We can proactively reform the banking system and its regulation fundamentally - thereby enabling the banking system to heal itself - and support recovery - without massive taxpayer assistance.

The enclosed report describes the needed reforms and their rationale. It is the product of a long-term, Firm-funded effort by McKinsey & Company to understand the condition of the banking industry and to offer suggestions, in the public interest, for improvement.

The leader of this effort, Lowell Bryan, is the author of Breaking Up The Bank and one of the first observers to accurately predict the size and severity of the S&L debacle. He has authored this fundamental reform and restructuring plan. Its key features are:

¶ Prevent insured depositories from taking further excessive credit risk by restructuring banks into insured "core" banks, with low-risk assets and liabilities, and separate, uninsured, market-regulated affiliates that would carry higher risk assets and liabilities.

¶ Prevent insured depositories from paying more for deposits than they should by pegging interest rates on insured deposits to floating Treasury rates, thereby preventing disintermediation.

¶ Ensure that new regulations work with market forces, rather than against them, by reforming the Bank Holding Company Act, the Glass-Steagall Act, and the McFadden Act.

¶ Allow banks that have not yet failed to recapitalize themselves using a combination of private investment and aid from the Bank Insurance Fund - with the extra BIF funds coming not from taxpayer assistance, but rather through the sale of FDIC preferred stock.

By adopting this kind of comprehensive reform package, we can restore the capacity of the banking system to make economic loans; reduce the severity of the recession; bolster public confidence; build a solid platform for the recovery of a safe, competitive, and profitable banking system; and avoid a taxpayer bailout of the BIF. The choice of how far to go is ours to make, now.

If you have any questions about our suggested reforms, feel free to contact either Lowell directly at (212) 446-8810 or me at (202) 662-3100. We welcome your comments.

Sincerely,

Greg Wilson

Gregory P. Wilson

Enclosure

Best wishes for the New Year