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President Wolfensohn - Briefings Books for Presidents Meetings - Meeting Materials  
Press Clippings - Photographs - Mr Ed Furash - April 26, 1996

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### A. CLASSIFICATION

- ☒ Meeting Material
- ☐ Trips
- ☐ Speeches

- ☐ Annual Meetings
- ☐ Corporate Management
- ☐ Communications with Staff

- ☐ Phone Logs
- ☐ Calendar
- ☒ Press Clippings/Photos

- ☐ JDW Transcripts
- ☐ Social Events
- ☐ Other

### B. SUBJECT: Meeting with MR. ED FURASH

VENUE: E1227 (OFFICE)

CONTACT: DIANE SHOTWELL @ 331-8400 / 331-8399 (FAX)

TITLE/COMPANY: ED FURASH, CHAIRMAN, FURASH & CO. (CONSULTANTS TO THE FINANCIAL SERVICES INDUSTRY)

IN ATTENDANCE: JDW, FURASH & R. FRANK (TBC)

CAT: PERSONAL/BUSINESS

DATE: 04/26/96

Edward Furash article/brief for meeting includes interview of Furash by Jeffrey Marshall, USBanker, November 1995

### C. VPU

#### Corporate

- ☐ CTR
- ☐ EXT
- ☐ LEG
- ☐ MPS
- ☐ OED
- ☐ SEC/Board
- ☐ TRE

#### Regional

- ☐ AFR
- ☐ EAP
- ☐ ECA
- ☐ LAC
- ☐ MNA
- ☐ SAS

#### Central

- ☐ CFS
- ☐ DEC
- ☐ ESD
- ☐ FPD
- ☐ FPR
- ☐ HRO

#### Affiliates

- ☐ GEF
- ☐ ICSID
- ☐ IFC
- ☐ Inspection Panel
- ☐ Kennedy Center
- ☐ MIGA

### D. EXTERNAL PARTNER

- ☐ IMF
- ☐ UN
- ☐ MDB/Other IO
- ☐ NGO
- ☐ Private Sector

- ☐ Part I
- ☐ Part II
- ☐ Other

### E. COMMENTS:

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# Firebrand In Navy And Gray

*Noted Washington consultant  
Edward E. Furash talks about  
the future of the banking  
system and his frustrations  
with the current framework.*

**by Jeffrey Marshall**

**Edward Furash thinks banks must help foster prosperity.**

Listen to Edward E. Furash, chairman of the Washington consulting firm of Furash & Co., and you sense that beneath the buttoned-down, soft-spoken exterior of this 60-year-old grandfather beats the heart of a revolutionary. If he had his druthers, Furash would take a broadsword to much of today's financial system—starting with the overall regulatory framework for banking, which he suggests has long outlived its usefulness. "We should recognize that the emperor has no clothes," he says, and institute changes with one fundamental goal: to increase economic prosperity.

Furash, a talkative former banker educated at Harvard and the Wharton School, set up his firm in 1980 and has a raft of big-bank clients. He holds some provocative ideas, which he freely shares: Institute private deposit insurance and scale back the government's portion; allow banks to sell asset-backed securities directly to the public; goad the states into creating charters that would foster new products and new thinking. He discussed these subjects and a lot more during a lengthy interview in his downtown Washington office, at one point walking to a flip-chart easel and sketching out his thoughts. Some excerpts:

**USB:** *The thing that has gotten everybody's attention lately is consolidation. Do you think it's important for the U.S. to have megabanks that can compete, in terms of size, with banks in Europe or Japan?*

**Furash:** I think it's important for the country to compete on a multinational or an international scale, but whether that requires megabanks or not is a different issue. If you say that you have to be that large in order to accept extremely small margins and high-risk credits or investment strategies to compete with multinational banks that are basically price-cutters, such as the Japanese or the Germans, then you have to be very large in order to be funded in a way that you can do that. I'm not convinced that size per se is the only solution to international competitiveness. It has to do with the price of the dollar, capital and the fact that technology makes smaller organizations more powerful.

I think there's a size at which technology, like the gun in the Old West, makes everybody pretty equal, if you're smart about how you apply it. And I think the real issue is the capacity to absorb risk. What size does is make a lot of things affordable, and gives the capacity to do



Photos: Adam Avel/Gamma Liaison

things, especially in the capital markets. And what size does is enable you to take risk that you could not take in a smaller organization, simply because of the ability to spread it. But many international banking functions can be done off-balance sheet, as investment bankers do.

**USB:** *Where do you come down on the shakeout of the industry over time? Do you see a place for a good regional bank, somewhere between the megabanks and the community institutions?*

**Furash:** Yes, but it's unfortunate that we're all used to talking about size as a way to measure these things. What's really important in domestic competition is efficiency and depth of market share, which usually creates it. A \$100-million bank in a small town that has 35% to 40% of the market and can buy most of the technology or anything else it needs is an oligopolist in that market. The whole banking structure is turning into an oligopoly in which four or five institutions dominate any particular geographic-based market—anything from a town to a county to a state or a region, to the whole country.

Our projection is that 300 organizations will have about 85% of whatever banks do. Now, banks are doing less and less; they're down to about 25% of financial services as we've been able to measure it.

**USB:** *What kind of time line are you referring to?*

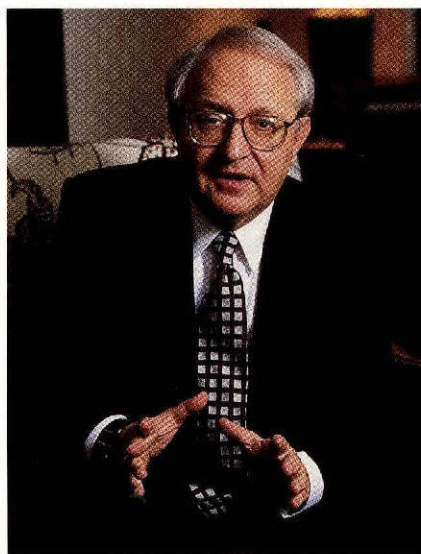
**Furash:** Within three years. We all know the factors that are driving the consolidation of the industry, especially economies of scale in manufacturing. Most of those businesses are turning into commodity businesses. The fragmentation of intermediation has made it relatively difficult, it not impossible, for most banks to get sufficient net interest margin, relative to their capital structure, to earn what they used to earn.

The industry is caught in a difficult transition period. It has this very expensive distribution system, and the consumer is increasingly saying,

"I don't care about it." And yet the industry can't walk away, because of old myths about what it means. Politicians demand that you put branches in places to serve the poor. Their model of how you serve the poor is based on that and not on what kind of service the poor really need.

**USB:** *The American banking industry is clearly trying to alter its delivery system...*

**Furash:** Everyone is saying, "I've got to cut my costs." And all the analysts are pushing this dramatically. The problem is that the industry can't save its way to salvation. What happens is time after time, when banks cut their costs severely—and sometimes too severely—they also



unhinge their capacity to generate revenue. The net effect is that they've cut their costs and raised fees, but the organization isn't functioning well. It's often demoralized, inward-focused and not able to serve the customer.

So what's driving the mergers? Never underestimate vision. Some bankers have a basic geopolitical concept still. In the old days, you made money by taking old products to new markets. That model doesn't work any more. But some people haven't given it up: It's one of the Gothic myths of the business. And

everybody says, "I'll make money by deepening my market share," which is absolutely correct, but only if you bring down your cost structure. So in-market mergers became the vogue for a period of time. And that is very important: We have markets in this country that are grossly overbanked. We have an industry with chronic overcapacity.

The second thing that is driving mergers is the need to substitute fee income for net interest margin, or to be able to absorb more risk in that margin. And that makes them say, "I've got to be a lot bigger to generate my margin." Let's look at the investment management business, which is probably going to be the most rapidly growing and important business in financial services for the

***I think there's a size at which technology, like the gun in the Old West, makes everybody pretty equal, if you're smart about how you apply it.***

next 30 years. You have to be enormously large, and many banks that started down the path of proprietary mutual funds found they couldn't get critical mass to make money. So we're going to see a revisiting of that in terms of how we make money.

The third factor is that banks that have not paid attention to technology are finding it increasingly difficult to play catch-up.

**USB:** *That's certainly been cited in a number of mergers we've seen recently.*

**Furash:** It's true, but it's not a sufficient reason. It's often an excuse for management that hasn't paid attention to the marketplace, since technology is not that expensive. Affordability can be a problem. But the problem is not the cost, either in hardware or in software. The affordability problem is in getting it done.

There's a lack of talent in the industry to get technology implemented, to get the software written properly and installed across massive organizations, and get that installation used through intensive training.

The kinds of products and services that are needed are not excessively complex. Small banks can do everything they need with local area networks, smart PCs and off-the-shelf software. And they can create their own MIS and ability to serve the market, and do micromarketing.

To get change, you have to get at the root cultural problems of the organizations. In most large organizations, particularly banking organizations, everyone can say no and no one can say yes. As long as that's the culture, you just can't get anything done.

The fourth factor driving mergers is lack of revenue. You have to get bigger because you don't have the revenue to drive through the system for the cost structure you have, even though you've cut it down. And if the latest data is correct, and as much as 60% or 70% of transactions are occurring outside the old distribution system, there's a crisis ahead. Because there's a point at which physical branch distribution cannot be reduced any further.

**USB:** *It's still a sales platform.*

**Furash:** And you've got to push people through those stores. Banking has been caught for years on this dilemma of pushing people out of the stores to get the transactions down, which at the same time does something a retailer would never do—not have people come into the store to be sold something.

Two other things are driving mergers, and no one should diminish them. The first of these is fatigue. Sometimes management just gets tired. They don't know what they're going to do for an encore. They haven't paid attention to so many things that were needed. They haven't built database marketing, they haven't built the capacity to really do risk management in a way that uses risk as a competitive advantage. Even if they have done

these things, they often despair of the difficulty in getting it done. So their strategic plan is to sell.

What is required in banking is good, solid meat-and-potatoes activity that you do everyday the same way, and you drive it home day after day. Pounding it home requires grueling tenacity.

The final part driving mergers is the market. All the analysts are speculating in it. A lot of directors simply do not understand their capacity to say no to a merger or often have limited belief in management. Management can't produce a plan going forward that is greater than the present value of what is being offered by someone else. And so the decision is purely financial.

Consolidation is a combination



of all those factors. And I predict, flatly, that after we have the consolidation and the creation of these large organizations, in order to survive they will re-decentralize in order to ensure entrepreneurial activity...

**USB:** *Sort of like an AT&T...*

**Furash:** Exactly right. There are times I worry about whether anyone can run one of these large organizations. Everyone knows you have to create low cost, coupled with a high level of interaction with the customer. That interaction depends on

being big but acting small. You have to remove the naysayers. And I don't want to come across as critical of large organizations, because I'm not. I think this is their nature, but this is what good CEOs who are running them need to do.

**USB:** *Let me ask you specifically about the state of bank telemarketing. My sense is there's a lot of noise, but very little effect.*

**Furash:** That's right. One of the problems with telemarketing in general is how to do it without being annoying. Very few companies have reached that. Your real objective is to get people to become addicted to the way you do it; you have to become a cult. That's the secret of Fidelity and USAA.

The job is to take a brand, put

***What happens is time after time, when banks cut their costs severely—and sometimes too severely—they also unbinge their capacity to generate revenue.***

product behind it, a method for doing business. That makes the telemarketing more comfortable, because then customers want to have it happen. They don't mind it if their bank calls them. Most of it (however) is product-driven, not needs-driven. I've seen in the last year and a half a general decay in the quality of bank telemarketing, of telemarketing in general. Cost-cutting has made telemarketing worse.

**USB:** *I have read that you've argued that states should try to go about creating a strong charter to compete with the national bank charter. Have you seen any of that happening?*

**Furash:** No. The states don't have the gumption to step up and recognize that they have been in the past

***The system today is not really geared to creating prosperity, and we seem to have lost sight of that.***

the source of major innovation in financial services. That's where the NOW account came from, that's where so many things have come from. And what's needed now is for the states to create the type of banking franchise that obviates much of the national regulatory structure.

The states understood it when they could create jobs by putting in credit card exemptions. But what's now needed are charters that are for financial services companies, entities that allow banks to market non-insured deposits. Under state blue sky laws, they could offer the opportunity for banks to sell asset-backed securities to residents of the state. But there's very little desire for experimentation on the state level. They're still fixated on the competition with the national regulators.

We have lost the capacity of the financial services industry, and banking in particular, to fulfill what I consider its basic function, which is to create prosperity. We've got to grow the pie, and banking has always been a traditional mechanism for growing the pie. When we needed to fund canals, we started banks.... The system today is not really geared to creating prosperity, and we seem to have lost sight of that.

**USB:** *But hasn't Wall Street really taken over the function of creating capital?*

**Furash:** Wall Street has taken over some of that function, but that function seems to have been funneled to financial transactions rather than job creation. And that's a major difference. I think banks are a much better way to get job creation. All of the reregulation or deregulation or changes up on Capitol Hill should have one primary objective: creating

prosperity in the country by expanding the economic pie. We can't solve anything unless we do that, and we're not doing it. And the current role of Wall Street is insufficient to infuse money at a grass-roots level.

**USB:** *How does any of this get back to community reinvestment and CRA, the way it's evolved?*

**Furash:** The way it's evolved was based on a theory that if you take money from a community, you ought to put it back to work in that community. And that was always a false assumption, because frankly, most of the time it *was* being put back to work where it was used best.

You don't use CRA to prosecute people for rank discrimination. That's a different issue, and should be dealt with (strongly). If people are redlining, if people are discriminating—nail 'em. But making people put money into a market where you're just saying, "Give it away," you're just inviting lower standards and charlatans to take the money. That has been the history of all these government-sponsored approaches. I'm radical enough to say that I believe totally in vigorous enforcement of antidiscrimination issues, but wonder if CRA does much good other than as a veneer.

**USB:** *I saw something that you'd written about deposit insurance. You're a believer that it should be scaled back, and we should have private insurance. Is that any more tenable, politically, than it has been?*

**Furash:** As a purist, I'd like to go to nothing but private insurance, but it's not politically tenable because the small banks are so very concerned that if they don't have federal insurance, they won't be able to compete. And the large banks are concerned because of the securities industry. But if the purpose of deposit insurance is to protect the nickels and dimes of the little people, I think we ought to say that 90% or better of their money can be protected in a federal or state system in which \$25,000 is the limit. We just made a mistake by going to \$100,000 because it increased the

level of moral hazard.

The way you get away from deposit insurance is first, to reduce the levels, and second, allow banks to offer a lot of uninsured products and let people make a decision on the rate of return they can get. That allows banks to pass insurance along as a separate charge, as opposed to just something everybody does.

**USB:** *A bank could offer an uninsured product for a few hundred basis points more than an uninsured one?*

**Furash:** Right. Just offer an asset-backed deposit. Why are we securitizing all this money when we could take auto loans and sell them to the consumer directly as asset-backed securities by a bank? Why shouldn't a bank be able to take a portfolio of loans and put a guarantee on it?

**USB:** *You wouldn't have Wall Street getting in as a middleman...*

**Furash:** That's right. You wouldn't have the markup. All this happened because banks couldn't offer these kinds of products.

**USB:** *I've never heard of a regulator having to rule on an issue like that, or even addressing it.*

**Furash:** No one's trying.

**USB:** *Is anyone in the industry thinking about those kinds of things?*

**Furash:** No. It's puzzling, because I've probably been offering this idea for five years, and nobody wants to step up because of the cost of going to the regulators and trying to get it through. But if the states would simply enable it.... All it would take is one state.

It's a security, but what stops it? The SEC, which asks, "Is it a security, and do we have to label everything as hazardous to your wealth? Or is it banking product?" That's why we need a wholesale revision of the regulatory system, but no one is willing to tackle it.

Let's hope that getting Congress to focus on banking's urgent role in fostering prosperity—making the pie bigger—will move true restructuring of financial services ahead. ●