Second Quarter 1987

The FDIC Quarterly Banking Profile

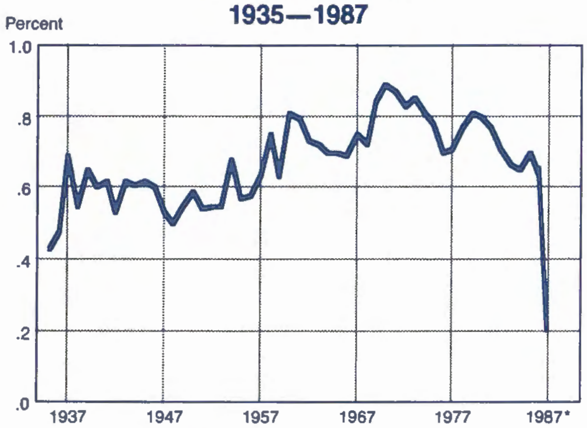
L. William Seidman, Chairman

COMMERCIAL BANKING PERFORMANCE — SECOND QUARTER, 1987

- ***ADDITIONS TO RESERVES BY LARGE BANKS DOMINATE EARNINGS RESULTS***
- ***AGGREGATE INDUSTRY LOSS IN SECOND QUARTER IS $10.6 BILLION***
- ***EARNINGS EXPECTED TO REBOUND IN SECOND HALF***
- ***BANK FAILURES CONTINUE AT RECORD PACE***
- ***BANKS SHOW IMPROVEMENT IN MIDWEST, DECLINE IN SOUTHWEST***

An unprecedented quarterly loan-loss provision of $21.2 billion resulted in a $10.6 billion aggregate second-quarter loss for the commercial banking industry. Most of the loss provision was set aside by the largest banks, and was earmarked for their developing-country (LDC) loans, particularly loans to Brazil. Their actions followed the placement, in the first quarter, of much of their $23.6 billion in Brazilian loans on nonaccrual status, where interest income is not recorded until payment is actually received. The magnitude of the second-quarter loss provision overwhelmed the first quarter's record earnings, giving the industry an aggregate loss of $5.3 billion for the first half of the year. Even though bank earnings are expected to recover in the second half of this year, full-year industry profitability will be at its lowest level since 1934.

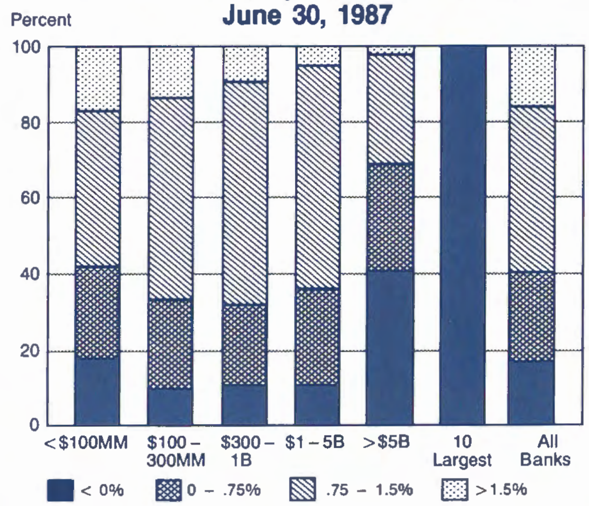
Chart A — Return on Assets at Insured Commercial Banks 1935—1987



*Estimated full-year 1987

Earnings results were mixed at banks with no significant foreign lending exposure. Smaller banks continued to account for a disproportionate share of unprofitable operations and failures, but they showed some encouraging signs in the second quarter. Net charge-offs were well below the level of a year ago, and growth in nonperforming

Chart B — Distribution of Bank Return on Assets Ratios, By Asset Size Groups June 30, 1987



assets slowed considerably. Overall, small banks' net operating income improved, due in large part to lower loan-loss provisioning. Bottom-line net income was lower, however, because of reduced profits from securities sales. Medium-sized banks outside the Southwest continued to perform well, with strong growth in consumer and real estate loans, good asset quality, and wider net interest margins.

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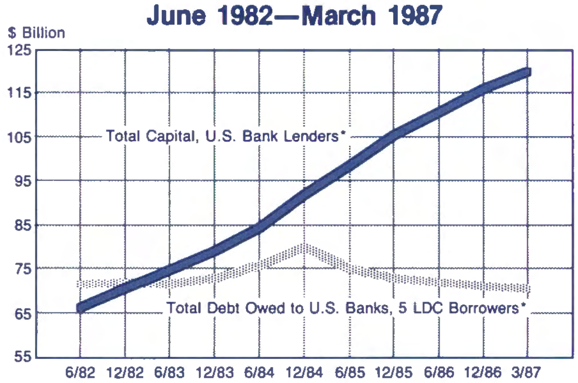
The ten largest banks in the second quarter set aside $12 billion for reserves against anticipated future losses, producing an aggregate $9.7 billion loss for these banks in the quarter. Their combined equity capital fell by $9.6 billion, but this did not reduce their primary capital, since all of the $9.6 billion went into loss reserves, and transfers from equity to reserves have no effect on primary capital levels. Total capital of banks with foreign lending exposure continued to increase relative to their loans to troubled foreign borrowers.

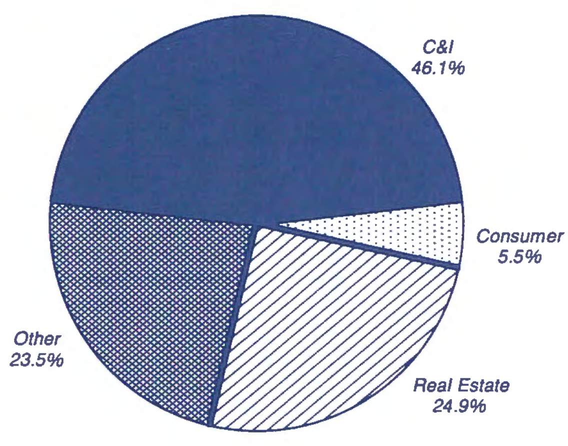
Chart C — Total Capital and Exposure to Five Major LDC Debtors June 1982—March 1987



*Data represent total capital (Equity + Reserves + Subordinated Debt) of U.S. banks with significant foreign lending exposure, and the amount owed them by Argentina, Brazil, Chile, Mexico, and Venezuela.

Domestic loan problems continue to plague banks west of the Mississippi. In the West and Southwest regions, the sharp decline in oil prices in late 1985 and early 1986 is still being felt in higher levels of charge-offs and nonperforming loans, particularly in real estate and commercial and industrial loans. At banks in the Midwest region, charge-offs remained high, but they were lower than a year earlier, and the level of nonperforming assets was down. A year earlier in the Midwest, both nonperforming loans and net charge-offs were still increasing.

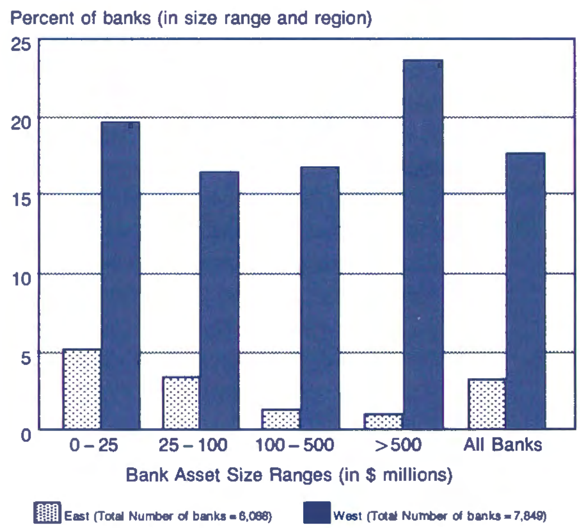
Chart D — Composition of Nonperforming Loans* June 30, 1987



*Nonperforming loans include: Loans 90 days or more past-due, renegotiated loans, and nonaccrual loans.

Forty-five commercial banks failed or required assistance to avert failure in the second quarter, bringing the total for the first half of this year to 99. At the present pace, total failures for the year will approach 200, surpassing last year's record total (since the inception of the FDIC) of 144. All of the failures in the first half involved banks with less than $300 million in assets. The number of banks on the FDIC's "problem" list increased by 100 in the second quarter, to 1,609 at midyear. All of the gain came from the western half of the country; thė number of "problem" banks in the east declined in the second quarter.

Chart E — Distribution of Problem Banks by Asset Size and Region June 30, 1987



Includes commercial banks on the FDIC "Problem List". East/West separated by Mississippi River.

Commercial bank earnings should recover in the second half, as loan-loss provisioning returns to more normal levels. Small banks will remain vulnerable in some regions, but there are signs that the worst may be over for farm banks in the Midwest. A number of large banks that boosted their reserves in the second quarter should demonstrate outstanding earnings results over the rest of the year. However, several of the largest banks are likely to report a net loss for the full year, and the industry's return on assets is unlikely to surpass 0.25 percent, compared to 0.64 percent for 1986.

Table I. Aggregate Condition and Income Data, FDIC-Insured Commercial Banks
(dollar figures in millions)

	Preliminary 2nd Qtr 1987	1st Qtr 1987	2nd Qtr 1986	% Change 86:2-87:2
Number of banks reporting	13,937	14,073	14,309	-2.6
Total employees (full-time equivalent)	1,626,421	1,554,906	1,581,882	2.8
CONDITION DATA				
Total Assets	$2,912,420	$2,900,594	$2,774,202	5.0
Real estate loans	556,375	556,375	532,084	19.1
Commercial & industrial loans	582,762	585,168	581,163	0.3
Loans to individuals	332,840	328,571	317,888	4.7
Farm loans	30,839	29,225	34,678	-11.1
Other loans and leases	265,166	263,787	269,934	-1.8
Total loans and leases	1,767,982	1,738,834	1,670,875	5.8
LESS: Reserve for losses	47,191	29,674	26,282	79.6
Net loans and leases	1,720,126	1,709,161	1,644,593	4.68
Temporary investments	449,529	449,975	448,814	0.2
Securities over 1 year	375,799	367,035	318,597	18.0
All other assets	366,301	374,422	362,199	1.1
Total liabilities and capital	$2,912,420	$2,900,594	$2,774,202	5.0
Noninterest-bearing deposits	471,831	462,807	469,337	0.5
Interest-bearing deposits	1,792,525	1,778,507	1,678,096	6.8
Other borrowed funds	350,555	348,413	327,618	7.0
Subordinated debt	17,283	17,282	16,137	7.1
All other liabilities	104,901	106,987	107,338	-2.3
Equity capital	175,325	186,597	175,677	-0.2
Primary Capital	218,843	212,883	199,234	9.8
Nonperforming assets	75,443	76,015	56,622	33.2
Loan commitments and letters of credit	766,461	752,626	732,226	4.7
Domestic office assets	2,494,264	2,472,617	2,357,473	5.8
Foreign office assets	418,935	427,976	416,729	0.3
Domestic office deposits	1,928,353	1,908,994,	1,825,741	5.6
Foreign office deposits	335,990	332,320	321,691	4.4
Earning Assets	2,546,121	2,526,174	2,412,003	5.6

Income	Preliminary 1st Half 87	1st Half 86	% Change	Preliminary 2nd Qtr 87	2nd Qtr 86	% Change
Total interest income	$118,635	$121,588	-2.4	$60,000	$59,251	1.6
Total interest expense	69,893	74,661	-6.4	35,582	35,823	-0.7
Net interest income	48,742	46,927	3.9	24,626	23,427	5.1
Provisions for loan losses	25,332	10,023	152.7	21,233	5,348	397.0
Total noninterest income	19,088	16,962	12.5	9,690	8,543	13.4
Total noninterest expense	46,926	43,584	7.7	23,786	21,926	8.5
Applicable income taxes	2,053	3,125	-34.3	155	1,545	-90.0
Net operating income	-6,481	7,158	N/M	-10,855	3,152	N/M
Securities gains, net	1,130	1,886	-40.1	334	924	-63.9
Extraordinary gains, net	36	146	-75.3	-53	45	N/M
Net Income	-5,315	9,190	N/M	-10,575	4,120	N/M
Net charge-offs	6,913	6,935	-0.3	3,640	3,914	-7.0
Net additions to capital stock	744	391	90.3	704	240	-65.9
Cash dividends on capital stock	4,812	4,016	19.8	2,484	2,012	19.0

Table II. Selected Indicators, FDIC-Insured Commercial Banks

	1981	*1982*	*1983*	*1984*	*1985*	*1986*	*1987**
Return on assets	0.78%	0.71%	0.66%	0.65%	0.70%	0.64%	-0.37%
Return on equity	13.08	12.11	10.70	10.73	11.31	10.18	-6.07
Equity capital to assets	5.83	5.87	6.00	6.15	6.20	6.21	6.01
Primary capital to assets	6.39	6.47	6.59	6.98	6.94	7.03	7.48
Nonperforming assets to assets	N/A	1.85	1.97	1.97	1.87	1.95	2.57
Net charge-offs to loans	0.37	0.56	0.67	0.76	0.84	0.99	0.78
Asset growth rate	9.36	8.12	6.75	7.11	8.86	7.62	4.98
Net operating income growth	7.60	-0.62	-3.69	3.40	6.30	-16.20	N/M
Number of unprofitable banks	741	1,196	1,530	1,891	2,453	2,784	2,243
Number of problem banks	196	326	603	800	1,098	1,457	1,609
Number of failed banks	7	34	45	78	118	144	99

*For 1987, return on assets, return on equity and net charge-off ratios are annualized.
N/A — Not available
N/M — Not meaningful, due to negative earnings in 1987.

Table III. Second Quarter 1987 Bank Data *(Dollar figures in billions, ratios in %)*

		Asset Size Distribution						Geographic Distribution					
								EAST			WEST		
	All Banks	Less than $100 Million	$100-300 Million	$300-1,000 Million	$1-5 Billion	Greater than $5 Billion	Ten Largest Banks	Northeast Region	Southeast Region	Central Region	Midwest Region	Southwest Region	West Region
Number of banks reporting	13,937	11,212	1,864	523	255	73	10	1,081	1,929	3,078	3,288	3,010	1,551
Total assets	$2,912.0	$399.3	$300.7	$264.9	$548.5	$715.8	$683.3	$1,138.1	$381.4	$462.8	$202.1	$286.2	$441.7
Total deposits	2,264.3	355.4	263.4	219.2	427.7	501.4	497.2	832.1	306.1	372.6	157.5	233.7	362.2
% total banks	100.0%	80.4%	13.4%	3.8%	1.8%	0.5%	0.1%	7.8%	13.8%	22.1%	23.6%	21.6%	11.1%
Asset share (%)	100.0	13.7	10.3	9.1	18.8	24.6	23.5	39.1	13.1	15.9	6.9	9.8	15.2
Deposit share (%)	100.0	15.7	11.6	9.7	18.9	22.1	22.0	36.7	13.5	16.5	7.0	10.3	16.0
Number of unprofitable banks	2,354	2,000	209	58	41	36	10	98	185	249	459	951	412
Number of failed banks	45	43	2	0	0	0	0	0	2	2	12	20	9
Performance Ratios *(annualized)*													
Yield on earning assets	9.59%	9.60%	9.51%	9.61%	9.35%	9.51%	10.09%	9.87%	9.78%	9.24%	9.67%	8.88%	9.81%
Cost of funding earning assets	5.67	5.16	5.11	5.12	5.10	5.75	6.97	6.36	5.21	5.35	5.46	5.45	5.07
Net interest margin	3.92	4.442	4.40	4.50	4.24	3.77	3.12	3.52	4.57	3.89	4.20	3.42	4.75
Net noninterest expense to earning assets	2.25	2.80	2.69	2.69	2.38	2.08	1.64	1.95	2.56	2.20	1.91	2.39	2.97
Net operating income to assets	-1.50	0.57	0.67	0.32	0.33	-1.61	-5.67	-2.94	0.83	-0.56	0.10	-1.08	-0.82
Return on assets	-46	0.61	0.71	0.36	0.35	-1.58	-5.60	-2.84	0.88	-0.55	0.13	-1.17	-1.79
Return on equity	-23.43	7.04	9.33	5.04	5.39	-28.97	-123.51	-50.30	12.70	-8.06	1.77	-17.85	-31.36
Net charge-offs to loans and leases	0.85	1.11	0.82	0.99	0.77	0.78	0.82	0.60	0.57	0.54	1.42	2.05	1.08
Condition Ratios													
Loss allowance to loans and leases	2.66%	1.63%	1.53%	1.70%	1.68%	2.84%	4.60%	3.14%	1.43%	2.17%	2.38%	2.81%	3.00%
Nonperforming assets to assets	2.57	2.29	1.94	2.04	1.60	2.38	4.19	2.58	1.12	1.48	2.16	4.97	3.62
Equity capital ratio	6.01	8.69	7.60	7.12	6.40	5.20	3.87	5.30	6.94	6.69	7.46	6.41	5.47
Primary capital ratio	7.48	9.51	8.39	8.01	7.22	6.77	6.63	7.07	7.57	7.85	8.69	7.84	7.27
Net loans and leases to assets	59.08	51.26	56.34	61.45	62.43	61.20	59.03	59.10	60.34	57.47	53.30	54.56	65.20
Net assets repriceable in one year or less to assets	-6.39	-9.82	-8.35	-7.24	-5.96	-6.17	-3.76	-4.79	-9.81	-5.32	-14.53	-8.75	-3.43
Growth Rates *(from year-ago quarter)*													
Assets	5.0%	5.1%	7.5%	10.1%	13.6%	12.2%	-0.1%	7.8%	9.0%	6.0%	4.4%	-2.8%	-0.5%
Earning assets	5.6	5.7	8.3	10.7	14.5	12.9	-0.3	8.7	10.1	6.6	5.2	-3.2	-0.3
Loans and leases	5.6	5.7	8.3	10.7	14.8	12.9	-0.3	8.7	10.1	6.6	5.2	-3.2	-0.3
Loss reserve	79.6	16.7	25.0	34.0	42.2	93.3	165.2	140.1	25.5	64.0	33.7	27.6	66.2
Net charge-offs	7.5	-17.8	0.4	29.6	32.7	-2.0	-19.0	3.1	16.8	-12.5	-28.7	-3.7	-14.1
Nonperforming assets	33.2	3.7	10.1	28.0	29.5	52.6	63.6	74.5	19.1	3.0	-7.4	35.4	14.1
Deposits	5.4	5.3	7.5	9.2	13.0	13.2	2.5	10.0	8.9	6.1	2.9	-3.3	-0.5
Equity capital	-0.2	3.6	7.9	6.3	13.6	3.6	-19.5	-2.0	11.3	0.9	3.5	-9.9	-2.4
Interest income	1.6	-2.8	-0.1	2.3	7.0	9.2	2.9	9.5	3.2	-1.0	-2.9	-13.3	-6.8
Interest expense	-0.7	-8.6	-6.2	-3.8	0.9	7.2	7.0	11.5	-3.0	-5.8	-8.1	-15.1	-13.4
Net interest income	5.1	5.0	8.0	10.5	15.4	12.3	-5.2	6.1	11.4	6.3	4.9	-10.2	-1.4
Loan loss expense	397.0	-14.0	6.4	69.7	116.1	473.1	580.2	903.6	89.1	450.5	44.6	27.8	247.5
Noninterest income	13.4	10.7	9.4	10.0	10.6	16.0	20.8	18.8	13.3	7.1	5.2	10.7	7.6
Noninterest expense	8.5	6.9	8.1	10.5	11.4	19.8	7.1	12.7	8.3	6.2	5.1	-0.4	5.2
Net operating income	N/M	24.9	-5.4	-51.5	- 49.6	N/M	N/M	N/M	4.3	N/M	-81.1	N/M	N/M
Net income	N/M	-3.0	-10.2	-55.0	-52.8	N/M	N/M	N/M	-12.0	N/M	-81.8	N/M	N/M

REGIONS: Northeast — Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Puerto Rico, Rhode Island, Vermont

Southeast — Alabama, Florida, Georgia, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia

Central — Illinois, Indiana, Kentucky, Michigan, Ohio, Wisconsin

Midwest — Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota

Southwest — Arkansas, Louisiana, New Mexico, Oklahoma, Texas

West — Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, Oregon, Pacific Islands, Utah, Washington, Wyoming

N/M — Not meaningful, due to negative earnings in 1987.

Table IV. First Half 1987 Bank Data *(Dollar figures in billions, ratios in %)*

		Asset Size Distribution						Geographic Distribution					
								EAST			WEST		
	All Banks	Less than $100 Million	$100-300 Million	$300-1,000 Million	$1-5 Billion	Greater than $5 Billion	Ten Largest Banks	Northeast Region	Southeast Region	Central Region	Midwest Region	Southwest Region	West Region
Number of unprofitable banks	2,243	1,951	174	53	26	29	10	95	195	184	446	941	382
Number of failed banks	99	94	5	0	0	0	0	1	4	6	20	53	15
Performance ratios *(annualized)*													
Yield on earning assets	9.34%	9.56%	9.45%	9.49%	9.17%	9.21%	9.79%	9.59%	9.55%	9.11%	9.57%	8.83%	9.63%
Cost of funding earning assets	5.50	5.17	5.09	5.06	5.00	5.53	6.69	6.11	5.11	5.29	5.41	5.43	4.99
Net interest margin	3.84	4.39	4.35	4.42	4.17	3.67	3.10	3.48	4.44	3.82	4.16	3.40	4.64
Net noninterest expense to earning assets	2.19	2.79	2.65	2.63	2.33	1.96	1.67	1.88	2.52	2.14	1.93	2.33	2.95
Net operating income to assets	−0.45	0.59	0.71	0.52	0.55	−0.49	−2.65	−1.17	0.90	0.14	0.42	−0.54	−0.68
Return on assets	−0.37	0.68	0.80	0.60	0.62	−0.42	−2.55	−1.06	0.97	0.20	0.49	−0.48	−0.63
Return on equity	−6.07	7.92	10.68	8.38	9.70	−7.71	−54.50	−18.60	14.27	2.87	6.72	−7.36	−11.01
Net charge-offs to loans and leases	0.78	0.97	0.74	0.90	0.69	0.77	0.81	0.58	0.52	0.49	1.42	1.78	1.03
Growth Rates *(from first half of 1986)*													
Net charge-offs	0.1	−11.7	8.4	36.2	22.9	5.0	−6.0	10.5	14.7	−12.7	−18.0	3.7	−4.4
Interest income	−2.4	−2.5	−1.3	0.5	4.1	3.4	−2.3	3.8	0.5	−3.8	−5.5	−16.3	−7.0
Interest expense	−6.4	−7.6	−7.3	−6.3	−3.3	−0.5	−2.4	2.0	−6.1	−9.0	−9.9	−18.3	−15.2
Net interest income	3.9	−4.3	−6.9	9.6	14.7	9.9	−2.3	7.0	9.5	4.6	1.0	−12.9	3.7
Loan loss expense	152.7	−11.1	7.2	34.5	62.1	174.1	383.3	433.8	42.5	175.3	5.8	−6.8	97.2
Noninterest income	12.5	11.2	9.8	13.0	10.5	19.0	16.9	15.4	12.7	10.7	19.4	5.8	7.5
Noninterest expense	7.7	6.9	7.9	10.7	10.7	16.5	9.9	11.9	8.1	5.9	6.2	−2.9	7.1
Net operating income	N/M	10.5	−0.0	−23.0	−16.7	N/M	N/M	N/M	1.1	−82.2	−13.2	N/M	N/M
Net income	N/M	−5.3	−6.8	−25.2	−17.9	N/M	N/M	N/M	−3.1	−77.5	−31.2	N/M	N/M

N/M — Not meaningful, due to negative earnings in 1987.

NOTES TO USERS

COMPUTATION METHODOLOGY FOR PERFORMANCE AND CONDITION RATIOS

All income figures used in calculating performance ratios represent amounts for that period, annualized (multiplied by the number of periods in a year).

All asset and liability figures used in calculating performance ratios represent average amounts for the period (beginning-of-period amount plus end-of-period amount plus any periods in between, divided by the total number of periods).

All asset and liability figures used in calculating the condition ratios represent amounts as of the end of the quarter.

DEFINITIONS

"Problem" Banks—Federal regulators assign to each financial institution a uniform composite rating, based upon an evaluation of financial and operational criteria. The rating is based on a scale of 1 to 5 in ascending order of supervisory concern. "Problem" banks are those institutions with financial, operational or managerial weaknesses that threaten their continued financial viability. Depending upon the degree of risk and supervisory concern, they are rated either "4" or "5".

Earning Assets—all loans and other investments that earn interest, dividend or fee income.

Yield on Earning Assets—total interest, dividend and fee income earned on loans and investments as a percentage of average earning assets.

Cost of Funding Earning Assets—total interest expense paid on deposits and other borrowed money as a percentage of average earning assets.

Net Interest Margin—the difference between the yield on earning assets and the cost of funding them, i.e., the profit margin a bank earns on its loans and investments.

Net Noninterest Expense—total noninterest expense, excluding the expense of providing for loan losses, less total noninterest income. A measure of banks' overhead costs.

Net Operating Income—income after taxes and before gains (or losses) from securities transactions and from nonrecurring items. The profit earned on banks' regular banking business.

Return on Assets—net income (including securities transactions and nonrecurring items) as a percentage of average total assets. The basic yardstick of bank profitability.

Return on Equity—net income as a percentage of average total equity capital.

Net Charge-offs—total loans and leases charged off (removed from balance sheet because of uncollectibility) during the quarter, less amounts recovered on loans and leases previously charged off.

Nonperforming Assets—the sum of loans past-due 90 days or more, loans in nonaccrual status and noninvestment real estate owned other than bank premises.

Primary Capital—total equity capital plus the allowance for loan and lease losses plus minority interests in consolidated subsidiaries plus qualifying mandatory convertible debt (cannot exceed 20 percent of total primary capital), less intangible assets except purchased mortgage servicing rights.

Net Loans and Leases—total loans and leases less unearned income and the allowance for loan and lease losses.

Net Assets Repriceable in One Year or Less—all assets with interest rates that are repriceable in one year or less plus assets with remaining maturity of one year or less, minus all liabilities that are repriced or due to mature within one year of the reporting date. A positive value indicates that banks' income from assets is more sensitive to movements in interest rates than is the expense of their liabilities, and vice-versa for a negative value.

Temporary Investments—the sum of interest-bearing balances due from depository institutions, federal funds sold and resold, trading-account assets and investment securities with remaining maturities of one year or less.

Loan Loss Expense—the quarterly addition to the loan loss reserve that will keep the balance of the reserve adequate to absorb the quarter's anticipated loan losses.

Additional information regarding bank performance, bank failures and economic issues affecting the banking industry is available in the **Banking and Economic Review,** published by the Office of Research and Strategic Planning, FDIC. Information on legislative issues and changes in state and federal laws and regulations governing banks is contained in the **Regulatory Review,** also published by the Office of Research and Strategic Planning. Single-copy subscriptions are available to the public free of charge. Requests should be mailed to:

Banking and Economic Review or Regulatory Review, Office of Research and Strategic Planning, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429