FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

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SAVINGS BANKS DOING WELL, BUT SOME STORM WARNINGS ARE UP, SEIDMAN SAYS

While savings banks continue to earn strong profits, and have made good progress in their ability to handle interest rate risk, some danger signs have developed that merit the industry's attention, Federal Deposit Insurance Corporation Chairman L. William Seidman said.

In remarks to the New York Savings Bank Association, Mr. Seidman identified the following warning signals:

- Net charge-offs remain low but seem to be rising;
- Nonperforming loans are increasing;
- The industry's high rate of asset growth is outpacing capital expansion.

Mr. Seidman noted that some institutions are exposing themselves to rate and funding risk through increased reliance on repurchase agreements, out-of-area deposits and jumbo certificates of deposit. He commended the savings banks for their progress in reducing their vulnerability to long term interest rate shifts. However, he recommended the industry give more attention to short term interest rate changes.

"More effort could be made to restructure portfolios to reduce the imbalances, including through the development of new adjustable-rate products," Mr. Seidman said. Securities transactions, he noted, could be tailored to reduce rate sensitivity. Mark-to-market accounting is another good approach, Mr. Seidman said.

"We have seen some danger signs in asset quality developing as some of you have increased out-of-area lending, leveraged buyout financing, and off-balance sheet activity," Mr. Seidman said. "The bottom line is we are happy how well things are going for your banks. But we hope you will keep on top of these issues."

The financing of leveraged buyouts is becoming popular among financial institutions, and the extent to which individual institutions are exposed will be scrutinized by FDIC examiners, Mr. Seidman said. He noted that LBOs represent almost 10 percent of all commercial loans at some major banks--a lending concentration that may become a major risk to the financial system during an economic downturn.

"This is certainly an area we all need to pay closer attention to," Mr. Seidman said. Bank lending for LBOs now stands at about $150 billion, or about one-half of the LBO debt assumed by corporate America.

"LBO lending has filled the gap in loan demand for many banks created by the near-disappearance of what had been three major markets: energy-related lending, certain real estate lending, and loans to lesser-developed countries," Mr. Seidman said. He acknowledged that LBO lending has been profitable, but he added that it also "poses significant risks if in an economic downturn borrowers no longer have the cash flow to support their debt."

A recent survey of 1,500 corporations conducted by Princeton University indicated that about 150 of the respondents could go bankrupt during an economic downturn due to unserviceable debt. "To the extent these bankruptcies result in bank failures, these problems will end up on the books of the FDIC," said Mr. Seidman.

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