STATEMENT ON

S. 2531, THE "CAPITAL ASSISTANCE ACT OF 1982"

AND

S. 2532, THE "REGULATORS' BILL"

PRESENTED TO the Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

BY

WILLIAM M. ISAAC, CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

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DIRKSEN SENATE OFFICE BUILDING
ROOM 5032

Mr. Chairman and Members of the Committee:

We appreciate this opportunity to present the FDIC's views on pending bills S. 2531 and S. 2532.

On October 30, 1981, we appeared before you to urge enactment of the "Regulators' Bill" and to support the variety of new asset powers embodied in S. 1720. Five days later on November 4, 1981, one of the greatest tests in the FDIC's 48-year history began with the merger of the Greenwich Savings Bank into the Metropolitan Savings Bank at an estimated potential cost to the FDIC of $421.5 million. This single transaction obligated more money than we had spent in handling the 575 previous bank failures in the history of the Corporation.

Since then we have handled eight additional large savings bank failures at a total estimated cost, including the Greenwich transaction, of $1.7 billion. In addition, so far this year we have handled 11 commercial bank failures. Even under the most optimistic projections for declining interest rates, the probability of additional assisted mergers is high.

Our comments this morning are based in large measure on the experience of these past months. We would like to share some of that experience with you.

We worked diligently in handling the nine savings bank failures and utilized the most efficient, cost-effective means at our disposal to resolve the problems. In seven of the nine cases, the resolution involved a merger with another thrift entity. In every case an in-state bidder was the acquiring party.

The process has not been easy. Limitations on our ability to bring an adequate number of potential acquirers into the bidding process have made it extraordinarily difficult to find effective solutions to individual problems.

In three instances, with the blessing of cooperative state legislatures and/or state bank supervisors, we have entertained interstate proposals. Although we finally handled these three problems on an in-state basis, the mere existence of the interstate bidders reduced our costs by more than $100 million.

High interest rates are having a devastating impact on thrift earnings, are eroding the deposit base of all depository institutions and are contributing to an increase in non-performing loans. We must have regulatory and legislative changes to permit depository institutions to compete in today's markets and to give us greater flexibility to address problems as they arise.

You have asked us to testify on two proposals -- a revised Regulators' Bill and the Capital Assistance Act of 1982. The Regulators' Bill, in particular, will enhance our ability to meet the challenge of failing institutions. However, this is only a solution to our most immediate, serious problems. The need remains for long-run structural reform which can be accomplished through deposit interest rate deregulation, new asset powers as set forth in S. 1720, and legislation to preempt state usury statutes and due-on-sale clause prohibitions.

Prior to last December's DIDC meeting, DIDC members were subjected to intense pressures to delay the course of deregulation Congress had charged us to carry out. The Committee did delay, after which I wrote that the one course we simply could not afford to follow was maintenance of the status quo. Now, five months later, little has happened except that we have obligated another billion dollars to assist failing savings and commercial banks, not to mention the S&L experience.

We believe the time has come for Congress to make the hard choices needed to preserve and strengthen our depository institutions in today's climate and to prepare them for tomorrow. In our judgment, this should be accompanied by the DIDC's authorization of an instrument that is truly competitive with the money market funds, returning funds to our banks and thrifts to finance homes, cars, farms and businesses.

The Regulators' Bill, which we submitted to you last year for inclusion in S. 1720, was essentially drafted two years ago in anticipation of forthcoming problems. The version submitted jointly with the Federal Home Loan Bank Board last week -- S. 2532 -- has been modified based on our actual experiences.

Some people question the need for this legislation, observing that we always seem to find a way to carry out our responsibilities under existing law. We have been fortunate up to this point. We had a state legislature pass emergency legislation on four days' notice in one instance, a truly remarkable feat. In several situations, when things have looked their bleakest -- with a major problem at hand and no good solution in sight -- an acquirer has finally appeared with an acceptable proposal. This cannot continue indefinitely; with each transaction our options for resolving the next problem are narrowed.

The amendments to Section 13 of the FDI Act will provide greatly needed flexibility. We have expanded the proposal introduced last year to cover not only a failed bank that is closed and placed in receivership but also an insured bank in danger of failure. Our experience indicates it is generally preferable to avoid the actual closing of a mutual institution. The threshold size for employing interstate bidding has been lowered from $2 billion to $500 million or more in assets.

One major change in S. 2532 from the earlier version is that FDIC and the Federal Home Loan Bank Board have reached agreement on the problem of indemnification in the case of savings bank conversions from state to federal charter. Under the provisions of S. 2532, the FDIC would continue as the insurer of the converted savings bank but the Bank Board would be the bank's regulator. The bank's relationship with the FDIC would be the same as that of a national bank. In the event of a failure, the FDIC would be appointed receiver. We and the Bank Board believe this is a perfectly workable arrangement which meets every legitimate interest and concern of the savings bank industry.

S. 2532 still contains an amendment to Section 13(c) of our Act to facilitate direct financial assistance where appropriate. We believe this authority is preferable to the proposal contained in Section 3 of S. 2531. The Section 13(c) language is broader as to the form of assistance. Furthermore, it is not limited to any percentage of the bank's previous losses. This combination gives us the flexibility to tailor the aid to meet the needs of a specific institution and provide enough assistance to redirect it on a path to profitability.

Mr. Chairman, we would have no objection to the enactment of S. 2531, although as I have just noted, we prefer the Section 13(c) amendment in S. 2532. It is our judgment that assistance in the amounts specified by the formula set forth in S. 2531 would slow the rate of decline of a money-losing institution, but for most institutions it would neither halt the losses nor give management any real opportunity to restructure assets.

Our objective in handling the nine assisted mergers to date has been to insure that the surviving institutions are viable. We would want to achieve

the same objective through any capital assistance program. In our judgment, the type of assistance available under the formula in S. 2531 would not achieve this result and would not be particularly helpful to us or the savings bank industry. However, our interpretation of other provisions in S. 2531 is that we need not adhere to the formula but could provide such assistance as we believe appropriate. This flexibility is most desirable and we commend you for providing this alternative. We would note that the cap on the assistance -- 100 percent of an institution's losses in the immediately preceding period -- might be unduly restrictive in some situations and we would recommend its deletion.

We recognize that if the problems in the savings bank industry continue to grow it might not always be feasible or desirable to arrange a merger even with the availability of the interstate bidding option. It is for this reason that we have requested the amendment to Section 13(c) of our Act to give us greater flexibility to provide direct financial aid. However, in general we believe mergers are preferable to direct financial aid where they can be arranged with a comparatively strong institution at a reasonable cost.

Our most recent assisted savings bank merger will, I believe, illustrate the relative merits of the merger approach as contrasted with the alternative of direct financial assistance. In evaluating the merger proposals we received for the Western Savings Fund Society in Philadelphia, our staff calculated the estimated cost of providing sufficient direct financial assistance under Section 13(c) of our Act to absorb Western's projected losses over a 10-year period assuming continuation of current interest rate levels. The estimated cost, on a present value basis, for the FDIC just to stabilize Western came

to $280 million. Using the same interest rate assumptions, we estimated the cost of our assistance agreement with Philadelphia Saving Fund Society (PSFS), which acquired Western, at $294 million. While the estimated cost of the merger was slightly higher than the estimated cost of direct assistance, the difference was not great and was, we believe, well worth it.

First, direct assistance to Western would not have resulted in a stronger institution. At the time of the merger, Western had all but exhausted its surplus account. Break-even assistance would have done nothing to alter that, and at the end of the 10-year period the institution would still have had virtually no surplus. In other words, while it would have been kept alive for the duration of the assistance period, once the assistance was terminated Western would have found itself in a precarious position for many years to come.

Second, because a significant amount of FDIC oversight is a sine qua non of direct assistance, Western would have been burdened with FDIC-imposed management and operating controls for the duration of the assistance. Not only is the notion of such direct government involvement philosophically distasteful, it could have detrimental practical effects.

Third, Western would have had difficulty retaining its present management and would have found it virtually impossible to attract competent recruits. If you are a bright young MBA, do you choose to join an institution limping along with a government subsidy or do you go elsewhere?

Fourth, significant economies will be achieved as a result of the PSFS merger. Redundant branch offices will be closed and duplicate operations will be curtailed.

The point is, sufficient direct assistance to stabilize Western could have been provided at a cost comparable to that of an assisted merger, but the result would have been a very marginal institution with a limited ability to attract and retain good management, whose capacity to grow and serve its community would be severely hampered -- in short, a financial cripple. Instead, we chose to merge Western into PSFS and provided sufficient assistance to insure that the acquisition did not weaken PSFS. The result was a stronger institution with the ability to effect numerous operating efficiencies, to grow and prosper without government interference and, consequently, to better serve the people of Philadelphia. To us, that was an obviously preferable solution.

In total we estimate that the assisted mergers to date will cost the FDIC approximately $1.7 billion over the life of the assistance agreements, assuming interest rates remain near current levels. This sum is approximately the same as our estimate of the amount of direct financial assistance that would have been required to simply stabilize these failing institutions under the same interest-rate assumptions.

Mr. Chairman, the problems in the savings bank industry are real and can only be corrected through real solutions. Our strategy in addressing problems has been to arrange assisted mergers with the most solid institutions available at a reasonable cost. We have given sufficient assistance to insure that the acquiring firms remain strong.

We are convinced that the public has been well served by these nine assisted mergers. We are equally convinced that the savings bank industry is stronger as a result.

We have the financial and personnel resources to continue to meet the savings bank challenge squarely. We are not asking for money. All we ask is that we be given the statutory flexibility necessary to do the job as it should be done.