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FEDERAL DEPOSIT INSURANCE
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STATEMENT ON

REGULATORY AND SUPERVISORY APPROACHES
RELATING TO FOREIGN LENDING BY U. S. BANKS,

PRESENTED TO

the Senate

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

BY

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WILLIAM M. ISAAC
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

9:30 a.m.

Monday, April 11, 1983,
Room 538, Dirksen Senate Office Building

*Chief
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Mr. Chairman, I am pleased to have an opportunity to present the FDIC's views on S. 502, the International Lending Reform Act of 1983 and on the regulation of foreign lending activities of American banks.

On February 17, 1983, I appeared before the Subcommittee on International Finance and Monetary Policy to discuss the international and domestic implications of U.S. commercial bank lending to foreign governments and corporations. The Subcommittee members made it clear they believed we should make some changes in our policies and practices in order to impose some discipline on the international lending activities of our banks to avoid a recurrence of the current dilemma. We concur in that view. The only real questions are how much restraint is required and how will the discipline be imposed. We are of the view -- for a variety of reasons which we discussed that day -- that the greater marketplace discipline must be brought to bear on bank risk-taking.

As I testified on February 17, we feel that until market participants, such as large depositors and other major funds suppliers, come to understand that their position is not 100% protected by the Federal government in the case of a large bank, marketplace discipline will be inadequate. We will soon submit a study to Congress which outlines our proposals for changing the manner in which we handle bank failures. While I will not dwell on the specifics of those proposals, I would report to you here that we consider those plans an integral part of any program to impose market discipline.

With respect to international lending activities of American banks, there are several areas in which we are prepared to act by regulation. With one exception, country lending limits, they track closely the thrust of S. 502. They involve disclosure of foreign exposures, accounting for fees, and the establishment of prudential reserves against certain foreign debts.

DISCLOSURE REQUIREMENTS

At present, certain banks are required to report semiannually on their foreign lending activities. This report, the Country Exposure Lending Survey, is used by regulators to track lending patterns of American banks. Two problems exist in this system. First, the data are not reported in a timely enough manner. We are working on a proposal to increase the reporting of these data to quarterly in an effort to eliminate this problem.

The second, and perhaps more important, drawback of the system is that none of the information we collect is available to the public on an individual bank basis. If the market is to assist us in imposing discipline, it must have timely information. We, therefore, are working on a proposal to make certain of the information in the Country Lending Survey publicly available. In general, we are thinking along the lines of making available information on bank exposures to countries where those exposures exceed a specified percentage of a bank's total assets. This is not too dissimilar from the SEC's reporting requirements, except that we would not limit the disclosure to those countries

experiencing "liquidity problems." By requiring banks to report exposures in all countries where the exposures exceed one percent of total assets, we would allow the marketplace to judge the extent and nature of the risk in a bank's international loan portfolio.

FEE INCOME

The level of international lending and increased incidence of reschedulings over the past two years has provided many banks with substantial income in the form of front-end fees. Those fees are often taken into income in the period a loan is made, providing a boost to current earnings. A more realistic approach, particularly for rescheduled debt, would have that portion of the fee used to increase the yield on the loan taken into income over the life of the loan. We propose that all such fees not identifiable as reimbursement for out-of-pocket administrative costs be amortized over the life of the loan. This would discourage banks from originating or rescheduling loans merely to boost current earnings or sustain past earnings levels.

PRUDENTIAL RESERVES

The third area of concern relates to how problem foreign loans are carried on the bank's books. There has been much criticism of the regulators' failure to force banks to write down international loans which appear marginal to many observers. A very valid question

arises as to whether their failure to do so results in a misrepresentation of the banks' true condition. It seems obvious that the full collection of certain foreign loans is in serious doubt, and we believe prudential reserves for those loans should be established. Our proposal is that such reserves be established out of the income stream, and we intend to require them. Moreover, these reserves will not be included in our definition of capital for purposes of capital adequacy calculations, as is the traditional reserve for bad debts.

LENDING LIMITS

We have given a great deal of thought to the notion of country lending limits and have concluded they would be highly inappropriate. Lending limits based on objective criteria are likely to be too rigid. Such limits would fail to distinguish between countries capable of carrying substantial debt without significant risk and countries where smaller amounts of debt pose great risk. Limits based on subjective criteria that change over time are likely to have abrupt effects on credit flows, imply a degree of foresight on the part of regulators that may be unrealistic, and be difficult to administer while avoiding political complications. Finally, in view of the already substantial exposures in many banks, a program of lending limits would need a very long transition period that would tend to vitiate its credibility.

DIVERSIFICATION RESERVES

An additional area we at the FDIC are exploring is that of diversification reserves -- that is, requiring banks to in effect

maintain higher equity capital positions when those banks choose to concentrate their foreign lending activities. We understand a bill has been drafted that would require a minimum capital base for all banks. Although we would have several suggestions for improvements in the bill, we would strongly object to banks being singled out from other very similar, insured financial institutions -- in particular, savings and loan associations -- we are interested in the concept of a minimum capital standard. Such a requirement would add significance to mandated diversification reserves, since amounts taken from capital to establish our reserve presumably would have to be replaced if the statutory minimum were violated.

Thank you Mr. Chairman and members of the Committee. I will be pleased to respond to any questions you may have.