STATEMENT ON THE

REGULATION OF FOREIGN LENDING
ACTIVITIES OF AMERICAN BANKS

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE OF THE House
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

BY

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Mr. Chairman, I am pleased to have an opportunity to present the FDIC's views on the regulation of foreign lending activities of American banks.

I think the Committee is well aware of the problem before us and the events leading to the request to increase the United States contribution to the International Monetary Fund, which we fully support. This morning I would like to focus attention on what we believe are necessary changes to our regulatory system if we are to keep international lending risks within acceptable bounds and maintain a sound, privately-owned banking system. Our written responses to the specific questions posed by the Committee may be found in the Appendix.

THE PROBLEM IN PERSPECTIVE

Before discussing remedial measures, let me try to impart our perspective on the enormously complex problem before us. Much has been said and written alleging irresponsible behavior of American banks in failing to restrain the growth of their international loan portfolios in the face of growing risk. In fact, many view the IMF proposal as a bail-out of the banks. This is simply not the case, as the banks, for better or worse, will be required to continue to lend as part of the solution to this problem.

We believe the banking industry has indeed been much too eager to provide huge amounts of credit. At the same time, I would be remiss if I did not express our belief that a large share of the blame rests with governments throughout the world, which for years and years pursued overly stimulative fiscal policies and accommodative monetary policies that produced inflation and fueled the expectation of continuing increases in prices. Those policies encouraged an ever-growing appetite for credit to the point where debt-servicing in the current worldwide economic downturn has become extraordinarily difficult for many borrowers.

As bank supervisors, we failed to effectively caution American banks to restrain foreign lending growth. Although portfolio concentrations were identified and commented upon, sufficiently firm steps were not taken to limit concentrations and the leveraging of bank capital. Without question our supervisory efforts need buttressing.

We are now faced with the difficult task of working out these problems. Cessation of all lending is not an option. It is necessary to bring fresh funding to the table to allow countries with debt-servicing difficulties the time to make adjustments in fiscal and monetary management, which, it is hoped, will lead to economic recovery.

SUPERVISORY REMEDIES

The task before us as supervisors requires us to achieve a delicate balance. We recognize that too harsh a supervisory approach could cause harm to foreign countries as well as our domestic economy by retarding growth and limiting the banking system's ability to meet legitimate credit needs.

In previous hearings on this topic, members of Congress made it clear that some changes in our practices with respect to the international lending activities of our banks where needed to avoid repetition of the current dilemma. We wholeheartedly agree. It is not our purpose -- indeed we would strenuously oppose any attempt -- to punish the banking industry. Rather, we simply believe a degree of restraint and order must be restored. This is completely consistent with our prescription for what must be done as we move forward with the process of deregulation.

As you know, Mr. Chairman, the three Federal banking agencies recently fashioned a joint memorandum that sets forth a program for improved supervision and regulation of international lending, which has since been embodied in a legislative proposal.

Disclosure

The joint memorandum provides that the agencies will adopt regulations requiring greater disclosure by banks of their foreign exposures. The agencies have agreed to collect country-exposure data quarterly rather than semi-annually and to disclose exposures that exceed a specified percentage of a bank's total assets. Requiring banks to report exposures in all countries in excess of one percent of assets will allow the marketplace to judge the extent and nature of their portfolio risk.

Fee Income

Increased international lending, together with an increased number of reschedulings, has provided banks with substantial fee income. These fees are often taken into income immediately, providing a boost to current earnings. A more appropriate treatment, particularly on rescheduled debt, would require the portion of the fee related to increasing the loan yield to be taken into income over the life of the loan. The objectives would be to better reflect the economic substance of the transactions and to discourage banks from originating or rescheduling loans as a means to boost current earnings.

Prudential Reserves

The third major element of the proposed supervisory approach relates to prudential reserves. Full collection of certain foreign loans is in serious doubt, and provision of a prudential reserve is entirely appropriate. The reserves are to be established out of the income stream and, unlike the traditional reserve for loan losses, will not be included in our definition of capital for capital adequacy purposes.

Improved Supervision

The joint memorandum calls for strengthened supervision of international lending activities. Examiners are to be more forceful in pointing out excessive exposures to bank managements and boards of directors, and capital adequacy standards are to be tightened for these banks.

There are some areas in the joint memorandum that still need to be worked out, after receiving public comments. These have to do primarily with the definitions used in connection with the new categories of troubled foreign debt -- e.g., "Debt Service Impaired" and "Reservable" -- in comparison with the traditional problem-asset designations, "Substandard" and "Doubtful"; the criteria for situations in which reserves are to be required; and capital adequacy requirements for those banks that choose to concentrate their foreign lending activities. If we ultimately decide to adopt the new procedures and definitions, considerably more thought will have to be given to these issues.

We believe our ability to carry out our statutory responsibilities is dependent upon correctly identifying emerging problem credit situations. After making a reasonable determination of the seriousness of an asset problem, we are then in a position to determine whether the level of a bank's traditional valuation reserves is sufficiently large to cover potential losses in the loan portfolio and whether increased surveillance and enforcement are indicated. The determination of asset classifications and reserve adequacy is an exercise that should be undertaken based on time-honored tests. We would prefer to have the same degree of freedom to classify assets and require reserves that we have in domestic credit situations.

Let me make clear, since there was some confusion after last week's hearing before the Senate Banking Committee, that the FDIC supports the increase in IMF funding and the legislation proposed by the regulatory agencies. Our reservations relate solely to some issues raised by the joint memorandum, which I am confident will be worked out to our satisfaction after further study, public comment, and interagency discussions.

DEPOSIT INSURANCE REFORMS

Before I conclude, let me emphasize a point I have made previously at other Congressional hearings. Our current system of deposit insurance is in need of fundamental changes with an emphasis on bringing marketplace discipline to bear on bank risk-taking. We are convinced 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 have just released a study to Congress, pursuant to the Garn-St Germain Act, which provides a blueprint for deposit insurance reform. While I will not dwell on the specifics of those proposals at this time, we believe the changes are essential to the continuation of a sound and stable banking system and urge their prompt and serious consideration.

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