

ORAL STATEMENT OF

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WASHINGTON, D.C.

ON

THE FINANCIAL CONDITION OF FDIC-INSURED INSTITUTIONS

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

10 a.m.

May 21, 1987

Room SD-538, Dirksen Senate Office Building

Good morning, Mr. Chairman and members of the Committee. I appreciate this opportunity to address the condition of the banking industry and its insurance fund.

We have submitted written testimony for the record. Thus, my remarks today will give the key conclusions based on the data submitted.

Point 1: The series of banking data provided by the FDIC and my fellow regulators demonstrate both strength and weakness within the industry. The system remains viable despite the record numbers of problem and failed banks. In one sentence, on average, the system is adequately, but certainly not over capitalized, less profitable than in previous years and becoming more efficient under the prod of deregulation and increased competition.

Point 2: The industry averages mask some unsettling trends. The averages don't reveal that results of banks west of the Mississippi are at all time lows, while in the East banks are doing relatively well. I brought with me today final 1986 banking data (Tables A & B) that will appear in the next issue of our new Quarterly Banking Profile, a copy of which is attached to my statement. This publication, which we publish every three months, is the most timely data available to this Committee on the condition of the banking industry. I apologize for not submitting the data in the attached Tables A & B earlier, but they just became available.

I think these data reflect clearly the disparity among banks. For example, Table A shows the aggregate return on assets for the banking industry was 0.64%, but this ranged from a negative 0.32% for banks in the Southwest to a positive 1.02% for banks in the Southeast. Over 80% of the banks that lost money last year were west of the Mississippi River. Nonperforming assets represented 1.95% of total industry assets but the ratio ranged as high as 4.08% in the Southwest and as low as 1.02% in the Southeast.

Table B shows the same data as Table A broken down by size rather than geographic location. A quick review shows major differences among size groups. Aggregate earnings of small banks, those under \$100 million, are way down compared to other banks. But, we believe it also reflects differences in banking structure. States in the mid and Southwest tend to have fairly restrictive branching laws which limit opportunities to diversify and reduce risk.

Incidentally, there are a number of ways to compute averages -- on aggregates or units -- and, thus, you will note differences based on the computation method used. Consider the difference between the industry equity ratios. The unweighted average bank equity ratio in Table IV of our written testimony is 8.18% while the dollar aggregate ratio in our Quarterly Banking Profile is 6.2%. Both ways of computing the "average" give us important insights in evaluating the system.

Point 3: While most of the recent bank failures can be attributed to weaknesses in well-defined sectors of the economy, it is clear that asset portfolio risk in the system is increasing. Both net charge-offs and nonperforming assets are increasing, even in areas of the country that have a robust economic base. Our experience in liquidating failed bank assets also reflects decreasing asset quality. Our loss rate on assets received from banks that failed during 1985 and the first half of 1986 showed an increase of over 75% since 1980 and now we are losing about 25% on every dollar. If failed banks located in the agricultural and energy sectors are excluded, the increase is still 60%.

We see a variety of reasons for the increased risks in bank portfolios. First, private debt in the economy has increased dramatically in recent years. Overall in our economy -- both consumer and corporate -- there is now about 40 cents more debt for every dollar of income than there was just five years ago. Between 1981 and 1985, corporate debt jumped from 30% of net worth to 47%. Household debt reached a post-World War II high equal to 89% of after-tax disposable income compared with 80% as the previous high.

Second, as the result of restrictive laws, banks have lost a chunk of their traditional business. This has forced banks to go further out on the risk curve to maintain market share and profit margins.

Third, in a few large banks there is large exposure to LDC debt. While the relative burden is decreasing, many of the large U.S.

banks still have significant exposure, especially to Latin American countries. In part, Citibank's recent decision to add \$3 billion to reserves reflects this problem. On this point, let me emphasize that while asset risk has increased, the capital that is available to cushion potential losses also has increased.

Point 4: The FDIC insurance fund is solvent and our fund is sound and viable. However, our resources are beginning to show the effects of the unprecedented number of bank closings.

The ratio of reserves to insured deposits is dropping. As of year-end 1986, the reserve declined to \$1.12 per \$100 of insured deposits, from just under \$1.20 a year earlier. Assuming a normal growth rate in insured deposits, about 200 bank failures this year and, thus, no net increase to the fund, the ratio will drop to about 1% by year-end. This is less than the 1.1% ratio below which assessment rebates are precluded. We will be fortunate to keep reserves at the current level of \$18.2 billion at the end of 1987.

We shall be immeasurably aided in our endeavors by the recognition of our need to be free of OMB budgetary dictates which is granted us by the Senate banking bill. We thank you Mr. Chairman, Senator Riegle and members of the Committee for recognizing this most important aid to our ability to manage the fund.

Point 5: Restructuring of the financial services industry is needed now. The banking system and economic and competitive factors -- both national and international -- are changing with unprecedented speed. To date, the response to this evolution has been a hodgepodge of ingenious private sector initiatives that test the limits of existing legal frameworks. The archaic system of laws under which the banking industry operates has created an inefficient system that is contributing to some of the disturbing trends in the banking industry that are being discussed here today.

We believe that long-range financial services restructuring must be undertaken soon. We know that the issues are difficult and the turf to be protected is lucrative. However, the stakes for the stability and competitiveness of our banking industry and, thus, our economy is high. We stand ready to assist the Congress in any way possible in this very difficult undertaking.

Thank you. I will be happy to respond to any questions.

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Good morning, Mr. Chairman and members of the Committee. I am pleased to present the FDIC's views on the condition of the banking industry and its insurance fund. At your request, the regulators already have submitted, through the Federal Reserve, a variety of statistics. My testimony today will highlight those statistics by providing the FDIC's overview of the financial condition of FDIC-insured banks. It also will respond to the specific questions raised in your letter of invitation.

The entire financial services industry is undergoing a period of rapid evolution. This evolution is a challenge both to bankers and regulators. It is a challenge as great as any other time in history. Perhaps the hardest job falls to the Congress which has to determine how best to change the laws to respond to these marketplace occurrences. Opinion is divided on what needs to be done. The issues are difficult. The turf to be protected is lucrative. The stakes for the stability and competitiveness of our economy are very high. We hope that these hearings will provide information that will assist the Congress in its deliberations. As the repository of the Call Report data for all U.S. banks, the FDIC stands ready to provide data or help in any other way it can. In this connection we call attention to our new Quarterly Banking Profile on the banking system (See Appendix A) which provides the most current information on the banking industry every three months and contains answers to many of the questions raised by this Committee.

FAILED AND PROBLEM BANKS

The condition of the banking system has been better and in a number of areas the trends are adverse. As you are aware, bank failures are at record levels. In 1986, 138 FDIC-insured banks failed and another 7 received financial assistance to avert failure. Unfortunately, we have been setting new records each year, as evidenced by Tables I and II of Appendix B which set forth the number of failed and assisted banks for 1970 through 1986. This year is not expected to be an exception. As of May 15th, there have been 78 failures and 3 assistance transactions, with several other assistance transactions in process. If the current pace continues, we can anticipate at least 200 failures and assistance transactions this year. It should be noted that 87 percent of these failures were West of the Mississippi River and banks in Texas and Oklahoma alone accounted for about half of all bank failures so far this year.

As indicated in Table III of Appendix B, the number of problem banks also is at a record level. As of the end of the first quarter of 1987, there were 1,531 FDIC-insured problem banks with total deposits of \$237 billion, up from 1,484 as of year-end 1986 and 1,140 at year-end 1985. Of the 1,531 problem banks, approximately 600 were agricultural banks and 150 were energy banks. Eighty-five percent of the banks on the current problem list are West of the Mississippi River and over 55 percent are in just 6 states. In reviewing the trend in the number of problem banks, it is important to note that there is considerable turnover in the specific banks on the problem list. For example,

in 1986, about 800 banks were added to the list, while around 350 were deleted because of improved condition. The current number of problem banks is a record, but the rate of increase has slowed markedly. In fact, the number in recent months has been relatively stable. We expect the number to increase moderately during the balance of the year. Our guess is that, barring any adverse change in the economy, the number of problem banks will top out in the next year.

As can be seen, the pattern of increases and decreases in the number of problem banks correlates with economic conditions. While much of the country and most sectors of the economy now are experiencing relative prosperity, the differences among areas are much wider than has been experienced historically. The areas West of the Mississippi River, with economies that are largely based on agriculture and energy, have pockets of severe recession or even depression. Most of the FDIC's problem banks today, and in the foreseeable future, are located in these distressed regions. As shown in Table III, the vast majority of problem banks have deposits of under \$300 million and most agricultural-and energy-sector banks are in this deposit-size category. Our quarterly bank statistics contained in Appendix A indicate clearly the problems by geographic area.

Deficiencies in bank management and policy exacerbate the natural tendency for banks to suffer from weaknesses in the economy. Historically, inept or abusive management has been the primary cause of problem banks. However, the downturn in agriculture and energy has been so severe and protracted that we are past the time when we can simply point to management deficiencies as a

general cause. Today, in the depressed areas of the country, many banks with good records and acceptable management are having financial difficulties. As regulators, we are using new approaches in supervising these institutions.

Traditionally, when bank management was the primary cause of bank difficulties, the FDIC initiated cease-and-desist actions or other formal enforcement procedures. These actions were designed to stop the unsafe and unsound activities and institute corrective measures. They also frequently required the immediate infusion of new equity or new management. This approach was appropriate when management was at fault and is still followed under those circumstances. In fact, enforcement actions against state, non-Federal Reserve members banks totalled 298 in 1985, 241 in 1986 and 75 through April of this year.

We believe that enforcement actions are often counterproductive when management is acceptable, the bank's problems are the result of adverse market conditions, and the prospects for recovery are good, given a reasonable economic cycle. The FDIC seeks to work cooperatively with the management of such banks in a joint effort to restore the financial stability of the banks. The supervisory approach in these circumstances may include meetings with a bank's board of directors, informal agreements in the form of memorandums of understanding or board resolutions detailing the bank's commitments for corrective action and ongoing correspondence with the bank to monitor its progress.

Early last year the FDIC, along with other bank regulators, adopted a formal policy of capital forbearance for banks in the agricultural and energy sectors with severe capital problems. If a bank is granted forbearance, the FDIC will not use its cease-and-desist powers under the Federal Deposit Insurance Act to require immediate restoration of adequate capital. Rather, the bank develops a plan for restoration over a reasonable period of time. Banks qualify for the program if they meet the definition of an agricultural or energy bank, have acceptable management, have capital problems resulting from economic factors, possess sufficient capital to protect against near-term insolvency -- generally considered to be about 3 percent -- and have a business plan that gives promise that the banks can survive. This program has been reasonably successful on a limited basis. As of April 30, 1987, the FDIC had approved 70 of the 154 applications for capital forbearance. Forty applications were denied and the remainder are being reviewed.

We are in the process of improving the effectiveness of the program. We expect to expand the use of capital forbearance beyond agricultural and energy banks to include other economically troubled sectors. Our basic test for forbearance will be geared to the survivability of the institution. If it has a reasonable chance for survival under foreseeable economic conditions then arbitrary benchmarks will be avoided. We expect to modify the program to eliminate fixed capital requirements, to expand it to include any bank that can demonstrate that its problems are primarily attributable to economic problems beyond the control of management and to extend the deadline for admittance.

In addition, the FDIC is considering the feasibility of a program similar to the Net Worth Certificate program used for savings banks under the Garn-St Germain Act. This particular program, however, is in an early stage of consideration and, if instituted, would be used in a limited way for appropriate cases where such use is likely to reduce insurance costs and strains on the banking system.

The thrust of our supervisory efforts is to do whatever we can, consistent with a safe and sound banking system, to limit our insurance losses by permitting viable banks with acceptable management to survive the present period of economic weakness and to recover financial strength once the economy improves. This does not mean that the FDIC intends to allow insolvent banks to continue operations; that every failing bank is viable and should be saved; or that incompetent or abusive management will be tolerated. There will be failures -- unfortunately, many of them -- but we will continue to take reasonable steps to reduce the number of failures and, thus, to lessen the adverse impact on local communities and on our insurance reserves.

GENERAL ECONOMIC CONDITIONS

Before turning to a discussion of the indicators of financial condition, I would like to make some general observations about the economy.

There are indications that the worst of the problems in some parts of the agricultural sector may be over. Land prices have reached levels where, with a reasonable downpayment, farming operations can generate sufficient cash flow

for debt servicing. There is still a lot of available land and equipment depressing the resale market, but those prices may be near the bottom. Thus, while we see little evidence of a rapid upturn, we should see a gradual improvement in the condition of agricultural banks in upcoming years.

The energy economy also seems to have bottomed out, at least in terms of the price of oil. However, the secondary effects of the oil price decline are still working through the economy and the normal lag time between economic decline and a deterioration in the banking community has not yet run its full course.

Are there other economic problems that will affect banks adversely? No one really knows. Real estate of all kinds is a problem in certain areas, often the same areas adversely affected by energy or agriculture. For example, office vacancies and depressed housing values in some major cities in the Southwest are in part a reflection of over-optimism that preceded the energy problems.

On several occasions, I have expressed concern over the level of U.S. private debt -- both consumer and corporate -- much of which is owed to commercial banks. In all sectors of our economy debt is at or near record levels when compared with ability to repay. Overall in our society, there is now about 40 cents more debt for every dollar of income than there was just five years ago. Between 1981 and 1985, corporate debt jumped from 35 percent of net worth to 47 percent. Household debt has reached a post-World War II high

equal to 89 percent of after tax disposable income. Prior to 1985, this ratio had never even reached 80 percent. Recent estimates are that debt service absorbs nearly a third of monthly household income and, for many families, more than half. I would be more comfortable if household and business debt levels could be returned to more normal levels.

No one knows how much private debt the economy prudently can carry. It seems obvious, however, that the higher the debt when compared with ability to repay, the worse the effects of any economic downturn are likely to be -- especially for the banking industry. While there is little indication of a near-term recession, our present recovery has gone on for an extended period by historical standards and based on history will not last indefinitely.

FINANCIAL CONDITION OF THE INDUSTRY

With problem and failed banks at record levels, it is important to maintain overall perspective. Approximately 90 percent of insured banks are not considered problems and failures last year represented only about 1 percent of the total number of banks. Indicators of the health of the banking industry are mixed, as demonstrated by the selected performance and condition indicators from our Quarterly Banking Profile. Overall the statistics show a reasonably sound industry, but the averages mask a number of problems.

Capital - The banking system as a whole seems to be maintaining adequate capital. As shown in Table IV of Appendix B, aggregate primary capital of all insured banks at year-end 1986 was \$211 billion. This represents an increase

of \$82 billion over 1981 when specific minimum capital ratios first were mandated by the federal bank regulators. The aggregate equity capital of these institutions increased by \$65 billion during the same period. The ratio of capital to assets -- the traditional measure of adequacy -- is higher among small banks than large banks, but aggregate capital of banks in all size categories exceeds the minimum ratio even with over 1,500 problem banks.

There has been considerable concern regarding banks' exposure to off-balance sheet risk. This is one of the primary factors behind the regulators' recent proposal for a risk-based system of capital analysis. Though the assessment of capital adequacy may be affected by the information received as a result of this proposal, the FDIC does not now have evidence indicating that the system as a whole is in need of substantial increases in capital. However, individual institutions may be required to increase capital. We strongly support bringing off-balance sheet activity into better focus through improved reporting and accounting techniques. This will enable regulators, as well as private industry analysts, to better and more consistently evaluate levels of capital adequacy.

Some of what has appeared as new equity capital in banks may be the result of so called double-leveraging by holding companies -- defined as equity investments in subsidiaries as a percent of the holding company equity. This occurs when the parent company incurs debt and uses the proceeds to purchase equity in its subsidiary bank(s). Double-leveraging can be a cause for concern. Since the normal practice is to service this debt through dividends from the banks, excessive payments can be a threat to the banks in the holding

company. The FDIC analyzes double-leveraging, as well as other parent company information, on a case-by-case basis during the examination of individual banks. We have seen a number of examples of bank holding company leveraging for purchases of bank stock that have weakened the banks in the system. This is particularly evident in unit banking states such as Oklahoma and Texas. Note the difference in double-leveraging by region as indicated in Table V in Appendix B.

In addition to double leverage, many owners of independent banks also rely on loans to finance their stock purchases. Thus, the amount of tangible, nonfinanced bank equity is much less than the apparent capital in a number of states.

Earnings - If the level of bank capital is to remain adequate, banks must prosper. They must be sufficiently profitable to retain enough earnings to maintain capital and to make the bank's stock attractive to investors. Table VI of Appendix B indicates that on the average bank earnings have been declining. However, this kind of averaging can be misleading since it is heavily weighted by the significantly poorer results of small banks west of the Mississippi. (See the chart "Return on Average Assets, East vs. West" in our Quarterly Banking Profile.) Return on equity in 1986 averaged 8.75 percent and return on assets 0.74 percent for insured commercial banks. This compares to levels five years ago of roughly 13 percent and 1 percent, respectively. Moreover, in 1986, nonrecurring items and gains from the sale of securities amounted to nearly 25 percent of the total net income for insured commercial banks.

Early results for the first quarter of 1987 indicate that earnings deterioration is continuing. The aggregate net income of the 26 largest bank holding companies was down 16 percent or \$342 million in the first quarter of 1987 when compared to the first quarter of 1986. The drop can be attributed in large part to the placement of large amounts of loans to Brazil into nonaccrual status. Even without the effect of the loans to Brazil, there was a decline in earnings, partially attributable to shrinking interest margins.

The earnings for smaller banks continue under pressure from high levels of loan losses and nonperforming assets. Preliminary data indicate that about 15.5 percent of banks under \$100 million in assets lost money in the first quarter of 1987 or about the same as last year. Of the banks in the \$100 million to \$1 billion category, between 7 percent and 10 percent had losses. For the first quarter last year, 6.5 percent of these banks were unprofitable.

There have been a variety of developments in recent years that make satisfactory earnings more difficult to achieve. Among these are the poor economic conditions in certain parts of the country, an increasing tendency of the largest most creditworthy commercial loan customers to bypass banks and access credit markets directly, and intensified competition for both loan and deposit customers from nontraditional banking businesses. In addition, bank earnings will be affected adversely by recent tax reform. In the face of increasing credit problems, the elimination of the deduction for, and the recapture of, bad debt reserves is particularly unfortunate.

Banks have been creative in developing new products and services to combat these pressures. Assets are being securitized and sold rather than held in portfolios -- a practice which frees up capital. Significant fee income now is generated by letters of credit and the swap market -- which have grown from little or nothing to billions of dollars in a very short time. As of year-end 1986, letters of credit and loan commitments alone amounted to \$750 billion. Despite these efforts, however, as evidenced by the statistics in Table VI, the profitability of banking appears to be declining.

Banks located in markets with limited opportunities for diversification have fared worse than the norm. The problems of agriculture, energy and real estate already have been discussed. Banks serving these markets are having a difficult time. In fact, there were six states in 1986 -- Oklahoma, Texas, Wyoming, Montana, Louisiana and Alaska -- in which the banking industry in the aggregate lost money.

The FDIC believes that if the banking system is to remain adequately profitable it must be allowed to pursue profit opportunities throughout the financial services industry. We believe these opportunities can be pursued in a manner that is consistent with safety and soundness considerations if appropriate safety surveillance is provided by the regulators.

Asset Quality - One of the results of the changing competitive climate has been a marked increase in the volume of problem loans and loan charge-offs. As noted in our Quarterly Banking Profile, net charge-offs to loans have increased steadily from 0.56 percent in 1982 to 0.99 percent in 1986. Despite

this increase, nonperforming assets continue to remain high at 1.96 percent. As additional proof of deteriorating loan quality, FDIC losses on failed banks have risen substantially to over 22 percent of total bank assets. These increased losses reflect the larger percentage of poor quality loans in failed banks.

As you would expect, the asset quality problem is most pronounced in depressed economic areas but, to a lesser degree, is reflected in the industry as a whole. The major recognized problem areas are agriculture, energy, real estate and LDC debt. While the agricultural and energy problems are common to many banks, LDC debt is concentrated in a small number of institutions. Nine money-center banks recently accounted for 60 percent of the U.S. banking system's exposure to foreign debt and 65 percent of the exposure to Latin American debt. However, Latin American debt, as a percent of primary capital at the nine money-center banks, has declined from 180 percent in 1982 to 100 percent in September 1986.

Even outside the recognized problem lending areas it appears that banks, overall, have had to accept greater loan risk in order to maintain earnings and loan volume. It seems clear that the risk in the system has been increased by deteriorating loan portfolio quality. Limiting the losses that result from this increased risk will be necessary to insure banks' future profitability.

Liquidity - Although one of the most important areas of banking, liquidity is the most difficult to measure and the area most subject to rapid change.

Currently, liquidity throughout the system would appear to be adequate judged by the satisfactory performance in recent years despite adverse economic conditions. But interest rates have been relatively low and funds plentiful. Though individual cases can be found where brokered deposits perhaps have increased the risk assumed by the FDIC in failing banks, experience has shown that brokered deposits are not the problem that they were a few years ago. As of year-end 1986, brokered deposits held by reporting banks totalled \$6.2 billion compared to \$17.9 billion at year-end 1984. Developments such as securitization and broadened secondary markets which were not previously available now also provide liquidity for many types of assets. Liquidity, however, is a creature of economic circumstance in which confidence is of the utmost importance. If a recession occurred or if interest rates rose and money became tight, today's favorable liquidity position could change markedly, particularly for our savings banks.

FDIC SUPERVISION

FDIC supervision is directed toward maintaining the safety and soundness of the banking system and protecting the insurance fund against unnecessary loss. Much of our resources are now focused on marginal or problem banks. The FDIC has a workload that is probably greater, and a role in the smooth operation of our financial system that is more important, than at any other time since the agency was created.

The FDIC currently employs 1,744 field bank examiners. As indicated in Table VII of Appendix B, this number is up sharply from recent figures, but is

low relative to the number of examiners we employed in 1978. In that year our field examination force reached a record high of 1,760 examiners, with 342 problem banks and 7 bank failures. In contrast, as previously stated, currently there are over 1,500 problem banks and a possibility of 200 or more failures in 1987. As indicated, only 1,744 FDIC examiners are employed to handle this significantly more formidable environment. It is clear that our present number of examiners is insufficient to deal with our responsibilities and the current level of problems in the bank system.

We estimate a force of at least 2100 examiners will be necessary to achieve an acceptable examination frequency and scope. Our goal is to conduct a safety and soundness examination of satisfactory banks (CAMEL ratings of 1 or 2) once every three years, marginal banks (CAMEL 3) every 18 months and problem banks (CAMEL 4 or 5) every year. Currently, we are averaging once every four years for satisfactory banks, once every two years for marginal banks and about once every 19 months for problem banks.

Some of our regions are more behind schedule than others. In our Southwest region, for example, we examined only 11 percent of the 1 and 2 rated banks last year. The pressures on our work force also have caused us to fall behind in specialized exams such as those covering consumer compliance and trust department operations.

Beginning in 1978, the FDIC purposely reduced its number of examiners. We believed that our regulatory responsibilities could be accomplished with less of the traditional onsite examination, especially in satisfactorily rated

banks. To supplement our reduced examination efforts, we used increased offsite surveillance, brief visitations, reliance on state regulators where appropriate, and increased market discipline. Though this effort was successful in the "old" banking industry, conditions have changed. We are not able to maintain even our more liberal examination schedule at the present time. Therefore, we have increased our staff and intend to continue to do so subject only to budgetary constraints.

We are in the process of trying to increase the field staff by about 350 employees during the next year. Because of the training period involved for new employees, there is and will continue to be a considerable strain on our experienced examiners in many parts of the country. To alleviate this strain, the FDIC is experimenting with supplementing our examination force with experienced certified public accountants who are hired on a per diem basis to assist our examiners in specific examinations. Early indications are that this experiment will be reasonably successful and some help can be furnished by this plan.

The current period is the most challenging and the need for effective safety and soundness supervision (not increased regulation) the greatest in the FDIC's history. We must adapt to a greater number of changes more quickly than ever before. Flexibility, creativity and innovation are absolutely essential if the FDIC is to continue to be effective in its critical role.

In the face of this environment, and after 36 years of precedent to the contrary, the Office of Management and Budget has asserted new and, we

believe, unfounded jurisdiction over the FDIC. We applaud the Chairman, the members of this Committee and the Senate for including in the banking bill a provision expressly excluding the federal bank regulators from the apportionment provisions of the Anti-Deficiency Act. I would like to reemphasize the importance of that legislation to the effective operation of the Corporation.

ADEQUACY OF THE FDIC FUND

The FDIC insurance fund presently stands at about \$18.2 billion and is adequate to handle foreseeable problems in the banking system. The fund, however, is beginning to show some effects from the unprecedented number of bank failures. Our ratio of reserves to insured deposits is declining. As of year-end 1986, the reserve slipped to \$1.12 per \$100 of insured deposits, from just under \$1.20 a year earlier. Insured deposits grew about 8.7 percent last year. If we project a similar growth rate for 1987 and assume no growth in the \$18.2 billion fund, then the projected ratio of the fund to insured deposits will drop to about 1 percent. Under the Federal Deposit Insurance Act, when the ratio of the fund to insured deposits is below 1.1 percent, the FDIC may not provide assessment rebates to insured banks.

Although the total reserves of the FDIC have increased every year, bank failures are absorbing substantially all of our current income. In 1986 the fund grew by less than \$300 million in the wake of 145 bank failures or assisted transactions. With the prospect of 200 or more bank failures in 1987, we will have difficulty breaking even in 1987. We are confident that

our financial resources are adequate for our present responsibilities, but insuring substantial amounts of deposits that now are FSLIC-insured certainly would stretch our reserves. Our estimates are that as many as 1,000 thrifts, with deposits of \$184 billion, could meet FDIC capital requirements and have acceptable earnings. If all those institutions converted to FDIC insurance, our projected reserves to insured deposits ratio would decline by over 10 percent.

CONCLUSION

To conclude, I would like to underscore some of my opening remarks. Banking is experiencing and will continue to experience rapid and critical changes. Currently, the government's presence is a hodgepodge of state, regulatory and court rulings. This mixture, combined with ingenious private sector initiatives, has resulted in an inefficient and archaic system. Long-range banking industry restructuring is overdue and should be undertaken to improve competitiveness, reduce regulatory costs and provide increased safety and soundness for the financial system. The FDIC believes action is needed and we will be happy to cooperate with you in any way we can to help achieve it.

Thank you. I will be pleased to respond to any questions.