LBOs

Summary of Statement

Witness: Mr. L. William Seidman
Chairman, FDIC
550 17th Street, N. W. Washington, D.C. 20429
898-6974

The Impact of Highly Leveraged Transactions Upon the Banking Industry

I. Definition
   A. Means different things to different people.
   B. What is high in one industry may not be in another.

II. Economic Policy Concerns
   A. Nonfinancial corporate debt level is at record high and corporate debt-service ratio is rising. Concern is proper for highly-leveraged firms should downturn occur.
   B. Why have number of LBO transactions mushroomed?
      1. Tax Code bias toward debt.
      2. Failure of 1960s diversification trend.
      3. Financial innovations such as junk bonds.
   C. Are LBOs good or bad?
      1. Buyers and owners can profit.
      2. Can lead to sound return on investment.
      3. Must maintain stable cash flow over business cycle.
      4. Recession could be made worse.
      5. Firm's employment and research and development may by effected.
      6. Target companies spend money fighting takeovers.
      7. Employee Stock Option Plans made use of.

III. Banking Concerns
   A. Largest banks originate most LBO financing.
      1. Much LBO financing participated out to other smaller institutions.
      2. LBO profits for banks help replace reduce business opportunities elsewhere.
   B. FDIC concerned about credit quality of LBO financings due to size.
   C. Change in favorable economic climate could produce problems for banks with high LBO lending.
   D. FDIC monitoring situation closely to control risk and protect insurance fund.

IV. FDIC Activity
   A. Have monitored LBO activity for several years.
   B. LBO concentrations are listed that exceed 25 percent of bank's capital.
      1. Loans criticized in examination report depends on several factors.
   C. LBO lending requires more than minimal capital protection.
   D. Federal banking agencies cooperate on LBO initiatives.