

ORAL TESTIMONY OF

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ON

THE STATUS OF THE BANK INSURANCE FUND

BEFORE THE

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

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Mr. Chairman and members of the Subcommittee: We appreciate the opportunity to testify on the financial condition of the FDIC and on the study prepared for your Subcommittee.

Overall, while there are certainly statements in the report which we would not support, we believe the report is credible and useful -- particularly the recommendations for reform of the system. But let me make clear that we are talking here more than about FDIC funding and banking matters. If we do not assure that credit is made available by a sound and strong financial system, our economy will wither and our economic strength will erode.

So let me begin, this morning, with a review of the financial position and resources of the FDIC Bank Insurance Fund. Our Fund has declined from \$18.3 billion at year-end 1986 to \$11.4 billion as of mid-year 1990. We estimate our loss at year-end 1990 will be about \$4 billion. Of this amount, over 80 percent represents year-end reserves for losses on banks which will not fail in 1990, but are expected to fail early in 1991. These anticipated losses result in our projection that the Fund balance will decline to about \$9 billion by year-end 1990.

What is the outlook for the Fund and the banking industry beyond 1990? Even in stable times it is difficult to identify potential failures significantly in advance of the event. While there is general agreement that the economy is slowing, the severity and length of the slowdown is unknown.

Therefore, let me emphatically state that we do not identify with the leading economic forecaster whose maxim is as follows: "Often wrong, but never in doubt."

We also would stress that the numbers we are talking about represent our best professional judgment on the condition of the Bank Insurance Fund. Forecasting designed to attempt to minimize the problem, or to be "safely" on the high side, would be a disservice to the banking industry, to the Congress, and to the American public.

To state the obvious, it is easier to project revenues than to predict insurance losses. So let us start with a review of our expected resources. Over the next three years, if we make certain assumptions regarding future action to bolster fund resources, we estimate our available resources will be as follows:

Bank Insurance Fund Balance January 1, 1991	\$9.0 billion
Assessment Income (1991 - 1993), assuming 23 basis points in assessment rate in 1992 and 4.5 percent deposit growth.	\$18.0 billion
Interest on Investments (1991 - 1993)	\$1.0 billion
Revenue generated from a 1 percent of deposits recapitalization funded by the banking industry.	\$25.0 billion
Total BIF Resources (1991 - 1993)	\$53.0 billion
Estimated operating expenses (1991 - 1993)	(\$1.0 billion)
Net Resources Available to absorb insurance losses (1991 - 1993)	\$52.0 billion

In addition to 1991 failures already reserved for in 1990, our preliminary forecast for 1991 is for about 180 bank failures with a total of \$70 billion of assets. This would result in approximately \$10 billion in insurance losses, before offsetting premium revenue. Our net loss in 1991 after accounting for premium revenue, would be about \$5 billion, reducing our fund to about \$4 billion at year-end, 1991.

We have estimated our losses for 1991 by reviewing all problem banks, on a bank-by-bank basis, and identifying likely failures based on the results of examinations by supervisory staffs.

Deducting the 1991 insurance loss of \$10 billion from the \$52 billion of resources available to absorb insurance losses which we previously set forth, leaves approximately \$42 billion available to resolve failed banks in 1992 and 1993. At current loss rates, the BIF could handle at least \$200 to \$250 billion of failed-bank assets in these two years. This would be in addition to \$70 billion of failed-bank assets handled in 1991. Thus, over the next three years, our total capability to handle losses in failed institutions would be from \$270 to \$320 billion of institutional assets.

To give a standard for comparison, assets on which losses were handled from January 1, 1987 to June 30, 1990 -- a three and one half year period -- were \$102 billion.

How likely is it that we will experience losses of that magnitude? Bank-by-bank failure forecasting for 1992 will be completed in January, 1991. Predictions for two and three years ahead can really only be educated guesses. Three years ago, who could have predicted that Germany would be reunited and that we would be shipping food to Russia? In three years, will we be in a booming economy, stagflation or a deep recession? Since no one knows, very little reliance, in terms of operating plans, can be put on such forecasts.

However, taking all these factors together, our best assessment of the situation is that the Bank Insurance Fund remains solvent, and will be solvent at the end of 1991. But, it is very weak. A recapitalization will be necessary. With recapitalization, the FDIC Fund should be able to handle the problems of the next three years unless a disaster occurs.

However, there are scenarios under which the Fund would need additional resources even with a recapitalization.

The BBL report would appear to agree as it indicates that BIF likely is facing bank failure costs of between \$31 and \$43 billion during the next three years if we experience a mild recession. While those predicted losses appear to be high, assuming recapitalization, the Fund will have at least \$52 billion of projected resources with which to handle them.

However, if we take the BBL report's worst case scenario, "a Texas style recession," with estimated costs of \$65 billion at the high end, then the fund would have to borrow \$13 billion, \$5 billion of which has already been authorized by the U.S. Treasury. It is our view, however, that the report's estimate of loss, in the case of a major, deep recession, probably is too low.

Thus, the immediate problem that needs to be addressed is how to strengthen the Bank Insurance Fund. We have initiated talks with Treasury and banking industry officials on this issue. We are in agreement on several key points. First, recapitalization refunding should be in place before it is actually needed. In other words, action should be taken early next year.

Second, any strengthening of the Bank Insurance Fund can and should be financed by the banking industry, not by the American taxpayers.

Beyond refunding measures, measures to reduce losses and enhance credit availability -- including alternative failure-resolution methods -- as a means to strengthen the Bank Insurance Fund must be put into place. My written testimony discusses a number of methods for dealing with failed or weakened institutions designed to reduce losses to the fund. If economic conditions continue to erode, we must also explore means to reduce losses and improve credit availability by preventing failures. We cannot let weakness in the financial system bring on recession or worse in the economic system.

Longer term, we must address the need to restructure the banking industry and reform the deposit insurance system in a way that will enhance profitability, the safety and soundness of the system and the availability of credit to worthy borrowers.

The BBL report contains many recommendations in this area and, as you may know from our many past testimonies, we support most of them.

Our country's banking system can operate safely and soundly only if it can provide competitive services and credit to its customers at a reasonable profit. Outdated restrictions imposed by the Glass-Steagall Act, the product and ownership limitations of the Bank Holding Company Act, and the geographic barriers imposed by the Bank Holding Company Act and the McFadden Act should be eliminated.

Banking organizations should be free to offer a wide range of products and service. But, it is critical that those products and services should not be funded with insured deposits or provided by financial institutions with weak capital positions.

The Treasury, in conjunction with the FDIC and other bank regulatory agencies, is going to propose financial restructuring designed to make the system competitive and reduce the exposure of the federal safety net. Our financial system must be strengthened if we are to have a prosperous and growing economy in the future. Let me repeat -- we are talking here about more than FDIC funding and banking matters, we must assure that credit is available on a sound basis -- without that, the economy will wither.

In closing, we would like to make one additional comment on the BBL study and the information provided by the FDIC. The only information withheld was certain private-sector information, primarily exam reports, that could not be provided absent the existence of legal protection -- including criminal sanctions -- that apply to those limited number of individuals now permitted access to such information.

Since those legal safeguards were not in place with respect to the authors' requests, certain limited categories of information had to be denied.

Mr. Chairman, this concludes my testimony. I would be pleased to answer questions at this time.