STATEMENT ON

THE FINANCIAL RESOURCES AND CONDITION OF THE
FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

BY

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Mr. Chairman, members of the Subcommittee, we are pleased to have this opportunity to provide testimony on the financial resources and condition of the FDIC as the Subcommittee continues its evaluation of the need for modifications to our system of Federal deposit insurance.

As you are aware, the FDIC has over the past five years, dealt with a post-World War II record number of bank failures throughout the United States. We have responded to 11 bank failures in 1981, 42 in 1982, 48 in 1983, 79 in 1984 and 78 so far in 1985. This period has been difficult for the Corporation and its employees and we see no letup in the immediate future.

Although failures since 1981 involved over $30 billion in bank assets, exclusive of Continental Illinois, the resources of the FDIC have been strengthened rather than diminished over the period. The deposit insurance fund, which is defined as the FDIC's net worth, has increased from $11.1 billion at the beginning of 1981 to its current level at $18.8 billion - more than a 70% growth rate. Moreover, the Fund as a percentage of insured deposits during this period increased from 1.21% to approximately 1.26%, continuing a trend started in the mid-1970's. The ability of the insurance fund to grow during a period of frequent bank failures is a tribute to the inherent strength of the Federal deposit insurance system. The growth of the fund has been achieved through: (1) a broad assessment base and system that appears actuarily sound in terms of the volume of failures in the insured system; (2) a large and growing investment portfolio of U.S. Treasury securities; and (3) a range of flexibility which allows the FDIC to respond to failing and failed bank situations in ways which are designed to minimize insurance losses.

We submit that the FDIC has functioned exactly as it was designed in 1933...a self-help safety net supported by a broad-based industry's insurance premiums. With a current income stream in excess of $3 billion annually, the FDIC does not use a single dollar of taxpayer funds. We at the FDIC are fully confident of the ability to maintain this tradition.

In response to the specific areas requested in the invitation to this hearing, we have presented in an appendix, summary financial statements of condition and income of the FDIC for the last five years. We also have provided a financial statement as of July 31, 1985. The statements present the major asset, liability, revenue and expense components of our financial position. Further and more detailed presentations are contained in our annual reports which are available to the Subcommittee.

Review of our current financial statements quickly reveals the financial resources available for the Corporation's insurance responsibilities. The major components can be aggregated as the $18.8 billion deposit insurance fund, annual gross income (largely from investments and insurance premiums) now in excess of $3.0 billion, and additionally, the Corporation's statutory authority...never used...to borrow up to $3 billion from the United States Treasury.

The bulk of the $18.8 billion deposit insurance fund consists of $15.6 billion invested by law in U.S. Treasury securities. That portfolio is highly liquid with an average maturity of approximately two years and one month. The portfolio presently contains total market appreciation of some $430 million in excess of its $15.6 billion book value. With regard to the major elements of the Corporation's income, 1984 insurance premium assessments amounted to $1.254 billion, income from the investment portfolio amounted to $1.495 billion and $283 million represented earnings on advances and assets related to our liquidation activities and assistance transactions.

In the area of availability of funds for the Corporation's operations, we have built exceptional liquidity into our resources. We have provided in the appendix a schedule of our operating cash flows projected for the twelve-month period beginning July 1, 1985, which reveals a residual funds' flow of $7.1 billion. We should also note that over the years we have been able to utilize the credit facilities of the Federal Reserve System in a number of failing and failed bank situations, such as Franklin National and Continental Illinois, in scheduling over time, the repayment of debt extended those institutions through the Fed's discount window. This facility enables the FDIC to further refine our funds' flows by coordinating repayment schedules with asset collections from liquidation efforts at those institutions.

As is apparent from the data presented, the combination of resources, income, and funds' flows has enabled the Corporation to absorb without strain, the adverse impact of closed bank activity while strengthening our reserves, even over this very difficult five-year period.

The Subcommittee has also requested the nature and amount of contingent liabilities of the FDIC arising from assistance provided failing banks in previous years. The ready answer is that the FDIC has no contingent liabilities other than those related to banks which will fail in the future...on which estimates are impossible to make. By policy, the

Corporation establishes estimated allowances for losses shortly after a bank fails. These allowances are also established for those banks involved in assisted merger transactions. Thus, the balance sheet presentation of "assets acquired from failures of insured banks" is <u>net</u> of estimated allowance for losses. These loss reserves, including estimated future cash outlays at present value, are reflected on the year-end 1984 balance sheet at a total of $2.430 billion.

We should also note that the Continental Illinois transaction has been booked (according to generally accepted accounting principles) with a separate line presentation on our balance sheet (Assets Acquired/Liabilities Incurred In Assistance to Insured Banks). At the time of the transaction, an estimate of the ultimate collectibility of booked assets was not possible. The Corporation's Liquidation Division is completing its initial determination of the net realization value of the transferred loan portfolio at the present time and an appropriate allowance for losses will be established by year-end 1985 against 1985 revenues. We continue to view this assistance transaction favorably and are confident that the ultimate overall cost, if any, to the insurance fund will not be material. For your convenience, we have attached a copy of the disclosure on this transaction contained in our 1984 Annual Report (Exhibit I).

The Subcommittee has also requested comment on the kinds and amounts of financial obligations we anticipate during the next twelve to eighteen months. AS FDIC Director of Bank Supervision Shumway testified yesterday, the number and deposits of problem institutions appear not yet to have peaked. Based on the level of bank failures this year and the size of our problem list, we are currently projecting at least 100 bank failures in 1986. We are, therefore, planning for a continued level of activity which will present the same kinds and amounts of financial obligations as we have experienced over the past eighteen months. Under these conditions, we will continue our present posture of maintaining a high degree of liquidity in our balance sheet and concentrating on the sale at the time of failure of more bank assets to purchasing organizations.

We believe that the trend of our financial strength and resources over the past five years has demonstrated beyond question our ability to cope with any foreseeable contingencies without financial strain...thereby assuring the safety of depositors in insured institutions. We, likewise, will continue to move aggessively in the areas of supervision, enforcement and disclosure. We are, of course, additionally devoting considerable resources to planning efforts for contingencies involving individual banks and large numbers of failed banks. The environment clearly mandates that we be imaginative and responsive to particular situations as they arise if we are to remain a symbol of confidence to the banking public.

I would be remiss if I did not press our case against the insurance of brokered deposits. Chairman Isaac has frequently testified on and documented this massive abuse which we see as the primary threat against the soundness of the Federal deposit insurance system. The issue is basic...the deposit insurance system was never designed to enable banks which would otherwise be unable to do so, to attract brokered deposits solely through the Federal guarantee. Without the Federal guarantee, the flow of funds to weak institutions would cease in a competitive free market. We need your help in containing this most serious threat to the deposit insurance system.

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

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