PRESS RELEASE
Federal Deposit Insurance Corporation

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**ORAL STATEMENT
OF
DONNA TANOUE
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
BEFORE THE
COMMITTEE ON BANKING AND FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
FEBRUARY 8, 2000**

Mr. Chairman, Congressman LaFalce, and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation. This morning, I will briefly discuss three subjects: One, what the FDIC is doing to address subprime lending; two, what the FDIC is doing to address fraud; and, three, H.R. 3374 and our support for it.

This hearing follows an uptick in bank failures and losses, and particularly three failures where the estimated loss rates for the FDIC are significantly above historical averages: BestBank in Boulder, Colorado; First National Bank of Keystone, Keystone, West Virginia; and Pacific Thrift and Loan Company in Woodland Hills, California.

Why are banks failing during these extraordinarily profitable times? Banks are in the business of managing risks. Not all will be successful. Some bank managements have not been up to the job. Furthermore, it appears, a few bank managements have been up to no good -- apparent fraud contributed significantly to losses in two of the recent high loss failures.

All three of the high loss institutions had concentrations in subprime lending - so let's turn to subprime first.

With proper safeguards, subprime lending can be an acceptable activity for insured institutions, and can be beneficial for consumers and the economy. Most banks active in subprime lending have such safeguards; some do not. Because these safeguards are not always maintained, subprime lenders represent a disproportionate share of problem institutions. Subprime lenders represent just over one percent of all insured institutions, yet they account for 20 percent of all problem institutions - those with CAMELS ratings of "4" or "5." In other words, they are 20 times more likely to be problem institutions. In addition, while not necessarily the cause of the failure, significant subprime portfolios were held by 6 of the 11 banks that failed over the past 18 months.

We have been addressing subprime lending since 1997. Most recently the FDIC has developed a proposal that would require some institutions with concentrations of subprime loans to hold more capital. We are currently discussing that proposal with the other banking agencies. Subprime lending is moving into the banking business because the capital requirements for banks are less than what the markets force nonbank subprime lenders to hold. Our capital proposal would help to level the playing field.

Turning to the second subject, as I noted earlier, fraud appears to have played a role in two of the recent high loss failures - and in the most recent bank failure, that of Hartford-Carlisle Savings Bank, of Carlisle, Iowa, as well. Because fraud is both purposeful and hard to detect, it can significantly raise the cost of a bank failure.

Bank management is the first line of defense against fraud, and the banks' independent auditors are the second line of defense. Bank examiners also have a role to play - assessing a bank's internal control system.

In a recent memorandum, we reemphasized to our examiners that if they suspect fraud at a bank, they are to investigate it, using whatever resources necessary. They are to give these investigations the highest priority and call in our fraud specialists. And we listed particular warning signs or "red flags" that indicate a potential for fraud; the number one warning sign being management that obstructs us in our doing our job. My written testimony also discusses several other approaches we are taking in addressing fraud at banks.

Finally, Mr. Chairman, the FDIC supports passage of H.R. 3374. The FDIC needs to be in a position to expeditiously examine institutions that pose higher risk profiles to the insurance funds. H.R. 3374 would accomplish this objective. We also strongly support the information sharing provisions of the legislation. I would like to emphasize that the agencies are working together well now, but the legislation would settle a long-standing issue among the banking regulators. Along with initiatives discussed in my written testimony, H.R. 3374 will enable the FDIC and other bank regulators to proceed in a unified, coordinated effort to ensure stability in the banking industry and to minimize losses to the insurance funds.

Thank you, Mr. Chairman and members of the Committee, I look forward to answering your questions.