Statement by
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Quarterly Banking Profile
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The numbers you have before you show that, in the second quarter of 1995, the commercial banking industry broke its quarterly earnings record. For the last three-and-a-half years, earnings have been rising at historic levels. Looking at the latest quarterly earnings figures -- which are $12 billion, with the tenth consecutive quarter of earnings above $10 billion -- one of the people here has said the banking industry is like Cal Ripken: It just keeps going.

In large part, of course, these record earnings were the result of continuing extraordinarily favorable conditions -- a strong economy, high loan demand, and relatively few problems in asset quality.

Profitability, as measured by return on average assets (ROA), was unchanged from a year ago, at 1.16 percent, but was up from the 1.1 percent ROA registered in the first quarter of 1995. By contrast, savings institutions earned $1.9 billion in the second quarter of 1995, for an annualized ROA of 0.76 percent. In banking, an ROA of 1 percent or more is considered to be a good return. Two out of every three banks registered an ROA above 1 percent in the latest quarter.

I want to stress that industry net interest margins have been relatively stable over the last ten quarters of fluctuating interest rates, remaining within a 21-basis-point range. At 4.3 percent the banking industry's net interest margin in the second quarter remained practically unchanged from that of the previous quarter. By contrast, the savings industry's net interest margin in the same quarter was down to 3.05 percent from the first quarter. That is 125 basis points lower than the net interest margin for banks.

In the second quarter, the banking industry's asset mix continued to shift toward loans, away from securities. Lending remained strong in all categories of loans. Loans to consumers, including home mortgage loans and credit card loans, were up by $37.5 billion, and commercial and industrial loans were up $18.2 billion.

The lending mix has continued to shift toward loans that traditionally reflect relatively more diversified credit risk -- primarily residential mortgage loans, credit cards and other loans to individuals -- and away from types of loans that reflect more concentrated credit risk, such as commercial real estate loans.

In the twelve months ending June 30, total loans and leases at commercial banks grew 12.5 percent. The last calendar year that commercial bank loan growth exceeded 10 percent was in 1984, when total loans grew by 14.3 percent. There are, however, several significant differences between loan growth then and the growth we are

witnessing in 1995. Loan portfolio risks are more diversified today than in 1984. In 1984, retail loans accounted for 29 percent of all loans held by commercial banks, while loans to commercial borrowers accounted for the remaining 71 percent. In contrast, at the end of June, retail loans accounted for more than 44 percent of the banks loan portfolios, while loans to commercial borrowers represented 56 percent. Further, in 1984, lending growth was more concentrated in terms of both geography and type of loan. For example, loans for real estate construction and land development increased by more than 25 percent in 1984 and banks in the southwest alone accounted for almost one-third of that growth. In contrast, over the most recent four quarters, these loans have increased by only 6.2 percent. In 1984, commercial real estate loans grew by 18 percent and banks in the southwest accounted for almost one-quarter of that growth. For the four quarters ending this June 30, these loans also increased about 6 percent.

All that having been said, the FDIC still has concerns as a bank supervisor and insurer. As I have often said before, it is our job to worry even in good times. We will continue to analyze credit underwriting standards, and we will monitor credit diversification and bank liquidity.

Even so, the banking industry's recent performance has been extraordinary.

In addition to record earnings, the industry has recapitalized the Bank Insurance Fund (BIF) far faster than anyone could have anticipated just a few years ago and a number of years ahead of the projected recapitalization of the Savings Association Insurance Fund (SAIF). At the end of the second quarter the BIF reserve ratio was 1.288. Why did it exceed the designated reserve ratio of $1.25 for every $100 in insured deposits? Because we do not assess banks on a pay-as-you-go basis. Our analysis shows that, if we had adhered to a straight pay-as-you-go policy for pricing risk while holding the BIF ratio at 1.25 percent over the past 45 years, during the difficult time with the most bank failures the assessment rate would have bounced from 32 basis points in 1988 to just under 18 basis points in 1989 to 49 basis points in 1990 to nearly 63 basis points in 1991.

In other words, such a course would have exposed the banking industry to unduly high and volatile insurance assessments that would have required banks to pay more, just when they needed their income the most: when they were experiencing problems and suffering high losses. For these reasons, the FDIC must consider the range of risks to the BIF so as to enable us to maintain the target 1.25 ratio on average over time.

There are medium- and long-term risks in the banking system that are not reflected in the numbers on current performance. As insurer, we need to take those risks into account, not unlike insurance companies that take smoking into consideration when setting rates and reserves even though the effects of the habit may not be evident immediately.

Favorable conditions will not last forever. If the future is anything like the past, the revenue needs of the fund will vary considerably from what they are today.

With consistently high earnings, commercial banking has never been stronger financially -- and that gives us a rare opportunity to address problems that have been given insufficient attention. In particular, there are three serious problems that may not be clearly illustrated in the numbers you have before you. One, the weakness in the SAIF is structural -- it will not go away -- it must be fixed. Two, unnecessary regulation continues to burden banking, and particularly to burden disproportionately the smaller institutions that can least afford to pay for it. Three, the banking industry needs to have its product lines expanded so that when current favorable circumstances change, as they inevitably will, it will be more diversified, and therefore stronger.

I will now entertain questions. With me are Don Inscoe, Ross Waldrop, and Tim Critchfield, FDIC analysts who put together the Quarterly Banking Profile.

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