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STATEMENT ON The

INTERNATIONAL LENDING SUPERVISION ACT OF 1983

PRESENTED TO the

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND
MONETARY POLICY
Senate COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS,
~~UNITED STATES SENATE~~

BY

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I would like to begin my remarks by calling attention to Exhibit 1. This is an updated version of the table which appeared in the House report accompanying the International Economic Recovery and Stability Act, which was signed into law on November 30, 1983. Title IX of that Act is the International Lending Supervision Act of 1983 (ILSA). The table provides a useful backdrop to my comments. The data show that country exposure for the nine largest banks, as a percentage of capital funds, has declined from 898 percent of the banks' total capital funds in June 1982 to 428 percent at year-end 1985. This percentage decline reflects the $20 billion increase in the capital of the nine largest banks as well as the absolute decline in total outstanding country exposure, especially to industrialized countries, in these banks. Outstandings to non-OPEC South American countries, however, have increased slightly.

Let me now comment on the agencies' response to the major provisions of ILSA and their impact on international lending practices and the international debt situation.

In December 1983, the Federal Reserve, the Comptroller of the Currency and the FDIC adopted new uniform examination categories for credits that have been adversely affected by transfer risk problems. This was in response to Section 904 of ILSA, which requires the agencies to evaluate banking institutions' foreign country exposures and transfer risk for use in supervision, including evaluation of capital adequacy. New definitions for transfer risk classifications were adopted and a new category, "Other Transfer Risk Problems," was added to highlight transfer risks not warranting classification. Such "OTRP" credits are now considered by examiners as a judgmental factor in their assessment of a bank's asset quality and the adequacy of reserves and capital. These changes in procedures were designed to be more effective in transmitting agency concerns about transfer risk to bank management. There are presently eleven country exposures which are identified as "OTRP," representing $85.4 billion in total U.S. bank outstandings. Since year-end 1983, exposures to eight "OTRP" designated countries have declined while exposures to three have increased, for a net overall decline of $2.1 billion in outstandings to these countries.

Section 905 of ILSA was designed to address concerns that some banks were not acknowledging errors of judgment in foreign lending by failing to account for potential losses. This section provides for the federal banking agencies to require banking institutions to establish and maintain reserves whenever the quality of the asset has been impaired both by a protracted inability of the foreign borrower, whether public or private, to make payments and where no definite prospects exist for the orderly restoration of debt service. Any reserves established under this section may not be considered as part of capital and surplus or the allowance for loan losses.

In implementing Section 905 of ILSA, the agencies adopted new rules and regulations which became effective in February 1984, providing for a joint determination of assets which are subject to risks warranting establishment of an Allocated Transfer Risk Reserve (ATRR), the size of the ATRR, and whether an existing ATRR can be decreased due to the improved quality of the assets.

Since the inception of ILSA the credits of seven countries have been classified as "Value Impaired." The reserves range from 85 percent, for one country, to 15 percent. To date, the reserves have increased and none have been reduced. At the end of 1983, assets judged to be "Value Impaired" totaled $4.1 billion, including $2.5 billion in the nine largest banks. By year-end 1985, outstandings in "Value Impaired" countries had declined to $2.4 billion, $1.5 billion in the nine largest banks.

In order to eliminate what Congress perceived to be one of the foremost abuses in international lending, the recognition of income immediately upon the granting of a loan rescheduling or restructuring, Section 906 of ILSA directed the promulgation of fee accounting rules. The agencies issued joint regulations in March 1984. The principal provisions distinguish between restructured and all other international loans in establishing accounting treatment for fees. The regulations prohibit the charging of a fee in connection with a restructured international loan unless the excess over administrative costs is deferred and amortized over the effective life of the loan. With respect to syndicated loans, interest yield adjustments must be recognized over the life of the loan, with other fees permissible as immediate income only if identifiable with specific services. Finally, commitment fees must be recognized over the life of the commitment.

In connection with loan fees, we should note that the Financial Accounting Standards Board recently issued an exposure draft on accounting for loan fees, and comments on the draft were due by April 30, 1986. Perhaps ultimate resolution of how to account for such fees would be better left to accounting conventions rather than agency rules and regulations.

In order to provide for more timely data, both to the public and to regulators, Section 907 of ILSA provides that each banking institution with foreign country exposure submit, no fewer than four times a year, information in a format prescribed by the agencies. The agencies promulgated rules and regulations to implement Section 907 and amended the existing Country Exposure Report forms. In addition, a new requirement for public disclosure of countries and outstandings where the banks' exposures are in excess of one percent of total assets or 20 percent of primary capital was added. Institutions must also disclose the names of those countries where outstandings are between .75 and one percent of total assets or between 15 and twenty percent of primary capital, whichever is less.

Section 908 of ILSA mandates the federal agencies to achieve and maintain adequate capital by establishing minimum levels of capital. It provides that failure on the part of a banking institution to maintain such a level may constitute an unsafe and unsound practice within the meaning of Section 8 of the Federal Deposit Insurance Act. These provisions are aimed at enhancing and maintaining capital levels of U.S. banking institutions whether or not those institutions are involved in substantial international lending.

In April 1985, the agencies finalized rules establishing banks' capital requirements. These rules set, for the first time, uniform capital requirements for all national, federal reserve member, and FDIC insured state non-member banks, regardless of size. Total capital levels were set at 6%, with the requirement that 5-1/2% be in primary capital. Since the passage of ILSA, the average primary capital ratio for the 25 largest institutions has risen from 5.70% at year-end 1983 to 6.97% as of March 31, 1986, ranging from 6.20% to 8.04%; up considerably from a low of 4.73% to a high of 6.49% in 1983.

In conclusion, the FDIC believes that the Act has had some effect on international lending practices as well as on the international debt situation, but the impact is difficult to measure. Since implementation of the various provisions of ILSA, total outstandings to developing and industrial countries have declined. While some of the decline since 1983 may be attributed to ILSA's increased supervision, reserve, fee accounting, and disclosure requirements, it is likely that other macroeconomic factors have been more directly responsible. Specifically, it is unlikely that reserve requirements have had any significant effect on banks' decisions to lend to "ATRR" designated countries; however, in all probability, the reserve requirements have forced recognition of losses which may have been otherwise deferred. The designation of "OTRP" exposures as an indicator of supervisory concern may have played some role in decisions to lend to certain countries. While total "OTRP" exposures have declined by over $2 billion since 1983, some exposures have increased indicating that the "OTRP" designation has not negatively impacted the decision to lend additional funds to those countries deemed to be taking positive steps to restore orderly debt service through economic adjustment measures.

While ILSA's effect on lending practices is somewhat nebulous, its impact on bank capital positions is more apparent. The average 127 basis point increase in the level of primary capital at the 25 largest institutions probably can be attributed, at least to some degree, to the capital mandate under ILSA. Also, the new disclosure requirements have provided for more complete and timely access to country exposure data.

At this time, the FDIC does not believe that there are additional supervisory problems in the international lending area that need to be addressed by Congressional action.

EXHIBIT 1

Summary of the Country Exposure Lending Survey
Amounts Owed to the Nine Largest Banks
[includes adjustments to reflect guarantees and indirect borrowings]

	June 1982		December 1983		December 1985		
	Amount (in millions)	As a % of Capital	Amount (in millions)	As a % of Capital	Amount (in millions)	As a % of Capital	Percent Change 1982/1985
G-10 Countries and Switzerland	88,264	387.7	82,595	261.9	73,612	173.9	-16.6
Non G-10 Developed Countries	23,770	104.4	25,455	80.7	21,943	51.9	-7.7
Total-Developed Countries	112,034	492.1	108,050	342.6	95,555	225.8	-14.7
Eastern Europe	3,957	17.4	3,269	10.4	2,757	6.5	-30.3
Poland	739	3.2	594	1.9	380	0.9	-48.6
Yugoslavia	1,415	6.1	1,421	4.5	1,406	3.3	-6.6
East Germany	541	2.4	293	0.9	219	0.5	-59.5
OPEC Members	16,209	71.2	17,977	57.0	14,483	34.2	-10.6
Venezuela	7,147	31.4	7,516	23.8	6,946	16.4	-2.8
Indonesia	1,920	8.4	2,659	8.4	1,990	4.7	+3.7
Saudi Arabia	1,706	7.5	1,779	5.6	1,589	3.8	-6.9
Non-OPEC South American Countries	40,660	178.6	42,656	135.3	44,363	104.8	+9.1
Mexico	13,606	59.8	13,738	43.6	13,834	32.7	+1.7
Brazil	12,335	54.2	13,754	43.6	15,837	37.4	+28.3
Argentina	5,595	24.6	5,761	18.3	6,203	14.7	+10.9
Non-OPEC Asian Countries	17,275	75.9	19,972	63.3	15,709	37.1	-9.1
South Korea	5,086	22.3	6,707	21.3	5,174	12.2	+1.7
Philippines	3,677	16.1	3,631	11.5	3,570	8.4	-2.9
Taiwan	2,652	11.6	2,473	7.8	1,184	2.8	-55.4
Non-OPEC African Countries	3,583	15.7	3,226	10.2	2,334	5.5	-34.9
Total Non-OPEC Develop. Countries	61,518	270.2	65,854	208.8	62,406	147.5	+1.4
Total - All Developing Countries	77,727	341.4	83,831	265.8	76,889	181.7	-1.1
Total - All Developing Countries and the Communist Bloc	81,684	358.8	87,100	276.2	79,646	188.2	-2.5
Offshore Banking Centers	9,888	43.4	9,574	30.4	5,457	12.9	-44.8
International Organizations	774	3.4	433	1.4	585	1.4	-24.4
GRAND TOTAL	204,380	897.7	205,157	650.5	181,243	428.3	-11.3
Total Capital of the nine largest Banks	22,767		31,538		42,318		+85.9