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

STANLEY J. POLING
DIRECTOR
DIVISION OF ACCOUNTING AND CORPORATE SERVICES
FEDERAL DEPOSIT INSURANCE CORPORATION

Room 2128, Rayburn House Office Building
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10:00 a.m.

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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4. Assets Acquired in Assistance to an Insured Bank:
On July 26, 1984, the FDIC, the Federal Reserve Board, the Comptroller of the Currency and a group of major U.S. banks agreed to provide a "permanent assistance program" to the Continental Illinois National Bank and Trust Company of Chicago ("CINB") and its parent, Continental Illinois Corporation. This program, which became effective on September 26, 1984, after Continental Illinois Corporation shareholder approval, replaced a temporary, emergency assistance package among the same parties that had been in effect since May 1984. Major elements of the new package included a financial assistance plan to remove problem loans from CINB and infuse new capital resources into CINB, the continuation of ongoing lines of credit from the Federal Reserve Board and a group of major U.S. banks to alleviate liquidity pressures and the installation of a new management team. Additionally, the FDIC agreed to commit more capital or other forms of assistance if the permanent assistance program proves to be insufficient for any reason.

The key aspects of the permanent assistance program applicable to the FDIC are embodied in an Implementation Agreement and an Assistance Agreement between the FDIC and CINB, Continental Illinois Corporation, and Continental Illinois Holding Corporation, a new holding company formed to own all Continental Illinois Corporation stock as of the effective date for the purpose of implementing the FDIC Option (described below). Discussed below are the major aspects of the FDIC's participation in the permanent assistance program and their effect on the FDIC financial statements.

The assets acquired by the FDIC in assistance to CINB on the commencement date and as of year end are as follows (in thousands):

	(Commencement Date) September 26, 1984	December 31, 1984
Loans and related assets purchased	$2,000,000	$2,010,313
Promissory note	1,500,000	1,447,116
Preferred stock investment	1,000,000	1,000,000
	$4,500,000	$4,457,429

Loans acquired were selected by CINB with the restrictions that such loans were nonperforming, classified or otherwise of poor quality (i.e., "troubled loans"). Certain foreign loans were excluded from selection. On September 26, 1984, after consummation of the permanent assistance program, CINB transferred $2.0 billion of troubled loans to the FDIC. The unpaid legal principal value of these loans was approximately $3.7 billion.

Also, on September 26, 1984, the FDIC received a promissory note from CINB for $1.5 billion. At CINB's option, the promissory note can be paid anytime within three years by transfer of additional troubled loans (subject to the above restrictions) at CINB's book value as of the date of transfer. Until such time as the promissory note is paid, interest will be charged. As of December 31, 1984, CINB transferred $52,844,000 of additional troubled loans to the FDIC as partial repayment on the original promissory note. As a result, the remaining unpaid principal balance on the note is $1,447,116,000.

The purchase of these assets was, in part, funded by the assumption of $3.5 billion of indebtedness to the Federal Reserve Bank of Chicago (FRB) on behalf of CINB. These borrowings will bear interest at specified rates established by the FRB and the U.S. Treasury. The FDIC will repay these borrowings by making quarterly remittances of its collections, less expenses, on the troubled loans. If there is a shortfall at September 26, 1989, the FDIC will make up such deficiency with its own funds.

Assets Acquired in Assistance to an Insured Bank (continued):
The Implementation Agreement provides for the FDIC to be reimbursed each quarter for its expenses related to administering the transferred loan portfolio and for interest paid on the indebtedness to the FRB which it assumed. Thus, such costs are recorded as assets. The FDIC and CINB have entered into a service agreement whereby CINB will administer the transferred loan portfolio on behalf of the FDIC. The FDIC is also permitted to establish a special reserve account from troubled loan collections. The balance in this account, if any, reverts to the FDIC in those quarters when loan collections have been insufficient to cover interest owing on the indebtedness which it assumed. For financial accounting purposes, cash collections received on the transferred loan portfolio (plus certain other amounts) are applied quarterly in accordance with the Implementation Agreement terms, as follows: 1) to the administrative expenses paid by the FDIC; 2) to the interest owing on the assumed indebtedness; 3) to fund the special reserve account such that this account plus accrued interest thereon is at least $75 million; and 4) to principal owing under the FRB Agreement. The FDIC is entitled to receive interest on the cumulative deficiencies between cash collections and the costs incurred in administering the troubled loans and the interest on the assumed debt. Further, CINB has assigned to the FDIC all its existing and future claims against any party which may be related to any loss incurred in connection with any transferred loan.

Total cash flow consists of the above collections of principal and interest on the transferred loan portfolio, interest payments on the CINB promissory note and interest earned on daily collections. As of December 31, 1984, the FDIC received cash flow totaling $147,044,000. Cash flow was applied to administrative costs and interest expense of $3,224,000 and $94,564,000 respectively, and to establish a special reserve account balance of $49,256,000. Accordingly, total FDIC obligations for purposes of exercising the FDIC option (discussed below) are $3.457 billion. The collection results during this period should not necessarily be considered indicative of the ultimate loan portfolio collectibility.

Ultimate collection results on the transferred loan portfolio are subject to significant uncertainties because of the financially troubled nature of the borrowers and the effects of general economic conditions on their industries. Due to the number and complexity of the loans within the transferred loan portfolio, an estimate of the ultimate collectibility has not been completed by the FDIC. Accordingly, no determination has been made as to whether or not any allowance for loss related to the CINB permanent assistance program is necessary. Consequently, none has been recorded in the financial statements for the year ended December 31, 1984. The Corporation expects to complete its initial determination of the estimated net realization on the transferred loan portfolio during 1985.

The FDIC holds an option to acquire up to 40.3 million shares of Continental Illinois Corporation common stock. The shares subject to the option are owned by Continental Illinois Holding Corporation, which is owned by the former stockholders of Continental Illinois Corporation. The option cannot be exercised prior to the fifth anniversary of the commencement date, September 26, 1989. Further, the option is exercisable only if the FDIC suffers a loss (disregarding any profit or loss from the FDIC's interest in Continental Illinois Corporation preferred or common stock) on the transferred loan portfolio, including unrecovered administrative costs and interest expense. If the FDIC suffers a loss, the FDIC will be entitled to retain any remaining transferred loans and to exercise the FDIC Option for one share of Continental Illinois Corporation common stock for every $20 of loss, at the exercise price of $0.00001 per share of common stock. No value has been assigned to the FDIC's right to exercise this option as of December 31, 1984. If the FDIC does not suffer any loss under the permanent assistance program, all remaining loans and other assets acquired will be returned to CINB and the option would not be exercisable.

The FDIC also purchased $1 billion of two non-voting, Continental Illinois Corporation, preferred stock issues. The proceeds of these issues were transferred to CINB in the form of a capital contribution. The Junior Perpetual Convertible Preference Stock, in the amount of $720 million, is convertible into 160 million shares of Continental Illinois Corporation common stock upon sale or transfer by the FDIC. Dividends are to be received on this preferred stock only to the extent that dividends are paid on the Continental Illinois Corporation common stock and are equivalent to that which would be paid on 160 million shares of common stock. The Adjustable Rate Preferred Stock, Class A, in the amount of $280 million, is a cumulative issue that is callable at the option of Continental Illinois Corporation. The issuer also has the option to pay dividends on this issue in the form of additional shares of this issue or cash until the third anniversary of their original issue date.

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENT OF FINANCIAL POSITION
July 31, 1985
(In Millions)

ASSETS

CASH	$ 81
INVESTMENT IN U. S. TREASURY OBLIGATIONS	15,583
OTHER ASSETS, principally accrued interest receivable on investments	464
CERTIFICATES AND NOTES RECEIVABLE FROM INSURED BANKS	626
ASSETS ACQUIRED IN ASSISTANCE TO AN INSURED BANK	4,274
ASSETS ACQUIRED FROM FAILURES OF INSURED BANKS	2,743
PROPERTY AND BUILDINGS	42
TOTAL ASSETS	$ 23,813

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENT OF FINANCIAL POSITION
July 31, 1985
(In Millions)

LIABILITIES AND THE DEPOSIT INSURANCE FUND

ACCOUNTS PAYABLE, ACCRUED LIABILITIES AND ESCROW FUNDS	$ 76
NET ASSESSMENT INCOME CREDITS DUE TO INSURED BANKS	
Available July 1, 1986 (Estimated)	98
Available July 1, 1985	54
UNEARNED ASSESSMENTS:	
To be apportioned to fund (Estimated)	86
To be apportioned to banks (Estimated)	129
LIABILITIES INCURRED IN ASSISTANCE TO INSURED BANKS	3,758
LIABILITIES INCURRED FROM FAILURES OF INSURED BANKS	793
TOTAL LIABILITIES	4,994
DEPOSIT INSURANCE FUND	18,819
TOTAL LIABILITIES AND THE DEPOSIT INSURANCE FUND	$ 23,813

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENT OF INCOME AND THE DEPOSIT INSURANCE FUND
FOR THE SEVEN MONTHS ENDED JULY 31, 1985
(In Millions)

INCOME

Gross assessments earned	$ 748
Provision for assessment credits	98
Net assessments earned	650
Interest on U. S. Treasury obligations	918
Interest on notes receivable	22
Interest on assets in liquidation	150
Other income	31
TOTAL INCOME	1,771

EXPENSES AND LOSSES

Administrative operating expenses	91
Merger assistance losses and expenses	17
Provision for insurance losses	0
Nonrecoverable insurance expenses	6
TOTAL EXPENSES AND LOSSES	114
NET INCOME	1,657
DEPOSIT INSURANCE FUND - January 1	17,162
DEPOSIT INSURANCE FUND - July 31	$18,819

APPENDIX

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENTS OF FINANCIAL POSITION
FOR THE YEARS ENDED
December 31, 1984, 1983, 1982, 1981, & 1980
(in millions)

	1984	1983	1982	1981	1980
ASSETS:					
CASH	$ 4	$ 89	$ 1	$ 0	$ 2
INVESTMENT IN U. S. TREASURY OBLIGATIONS	14,436	13,992	13,252	12,005	10,494
OTHER ASSETS, principally accrued interest receivable on investments	394	393	350	239	235
CERTIFICATES AND NOTES RECEIVABLE FROM INSURED BANKS	561	424	705	428	472
ASSETS ACQUIRED IN ASSISTANCE TO AN INSURED BANK	4,457	0	0	0	0
ASSETS ACQUIRED FROM FAILURES OF INSURED BANKS	2,144	1,992	714	547	410
PROPERTY AND BUILDINGS	42	37	34	23	23
TOTAL ASSETS	$ 22,038	$ 16,927	$ 15,056	$ 13,242	$ 11,636

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENTS OF FINANCIAL POSITION
FOR THE YEARS ENDED
December 31, 1984, 1983, 1982, 1981, & 1980
(in millions)

	1984	1983	1982	1981	1980
LIABILITIES AND THE DEPOSIT INSURANCE FUND:					
ACCOUNTS PAYABLE, ACCRUED LIABILITIES AND ESCROW FUNDS	$ 100	$ 80	$ 98	$ 47	$ 33
NET ASSESSMENT INCOME CREDITS DUE TO INSURED BANKS					
Available July 1, 1985	68	0	0	0	0
Available July 1, 1984	0	164	0	0	0
Available July 1, 1983	0	0	96	0	0
Available July 1, 1982	0	0	0	129	0
Available July 1, 1981	0	0	0	0	569
LIABILITIES INCURRED IN ASSISTANCE TO INSURED BANKS	3,848	0	0	0	0
LIABILITIES INCURRED FROM FAILURES OF INSURED BANKS	860	1,254	1,091	820	14
TOTAL LIABILITIES	4,876	1,498	1,285	996	616
DEPOSIT INSURANCE FUND	17,162	15,429	13,771	12,246	11,020
TOTAL LIABILITIES AND THE DEPOSIT INSURANCE FUND	$ 22,038	$ 16,927	$ 15,056	$ 13,242	$ 11,636

FEDERAL DEPOSIT INSURANCE CORPORATION
STATEMENTS OF INCOME AND THE DEPOSIT INSURANCE FUND
FOR THE YEARS ENDED
December 31, 1984, 1983, 1982, 1981, & 1980
(in millions)

	1984	1983	1982	1981	1980
INCOME:					
Gross assessments earned	$ 1,323	$ 1,216	$ 1,109	$ 1,041	$ 953
Provision for assessment credits	69	165	96	119	522
Net assessments earned	1,254	1,051	1,013	922	431
Interest on U. S. Treasury oblibations	1,495	1,404	1,370	1,115	863
Interest on notes receivable	112	65	79	32	13
Interest on assets in liquidation	169	91	54	2	2
Other income	2	17	8	3	1
TOTAL INCOME	3,032	2,628	2,524	2,074	1,310
EXPENSES AND LOSSES:					
Administrative operating expenses	151	136	130	127	118
Merger assistance losses and expenses	198	128	681	388	0
Provision for insurance losses	933	675	126	320	(38)
Nonrecoverable insurance expenses	17	31	62	13	3
TOTAL EXPENSES AND LOSSES	1,299	970	999	848	83
NET INCOME	1,733	1,658	1,525	1,226	1,227
DEPOSIT INSURANCE FUND - January 1	15,429	13,771	12,246	11,020	9,793
DEPOSIT INSURANCE FUND - December 31	$ 17,162	$ 15,429	$ 13,771	$ 12,246	$ 11,020

Reclassifications have been made to the 1983, 1982, 1981, and 1980 financial statements to conform to the presentation used in 1984.

Federal Deposit Insurance Corporation
Residual Funds & Cash Flow Projection
July 1, 1985 through June 30, 1986
(In Millions of Dollars)

	07/85	08/85	09/85	10/85	11/85	12/85	01/86	02/86	03/86	04/86	05/86	06/86	TOTAL
Receipts													
Maturing Gov't. Securities	884	509	283	300	300	250	0	300	300	0	296	400	3822
Int.on Gov't. Securities	82	300	43	59	253	103	81	284	23	46	248	85	1607
Bank Assessments	250	407	0	0	0	0	268	437	0	0	0	0	1362
Notes Receivable	12	3	0	8	0	1	10	2	0	8	0	0	44
Collection on Assets & Misc. Income	125	125	125	125	125	125	125	125	125	125	125	125	1500
Total	1353	1344	451	492	678	479	484	1148	448	179	669	610	8335
Disbursements:													
Expenses: (Admin,	14	14	14	14	14	14	15	15	15	15	15	15	174
Non Recov.Ins. & Liq.)	20	20	20	20	20	20	20	20	20	20	20	20	240
Notes Payable & Indebtedness	2	0	76	275	0	76	17	2	95	86	0	76	705
Income Maintenance Agreements	19	1	1	15	1	2	18	2	2	20	2	2	85
Total	55	35	111	324	35	112	70	39	132	141	37	113	1204
Total Residual Funds	1298	1309	340	168	643	367	414	1109	316	38	632	497	7131