STATEMENT ON

S. 2372, LEGISLATION TO STRENGTHEN THE
EMERGENCY INTERSTATE ACQUISITION PROVISIONS
OF
TITLE I OF THE GARN-ST GERMAIN ACT,

PRESENTED TO The

Senate COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
~~UNITED STATES SENATE~~

BY

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I. INTRODUCTION

Mr. Chairman, I want to start by expressing my appreciation to you for initiating prompt hearings on S. 2372, a proposal to broaden the emergency interstate acquisition provisions of Title I of the Garn-St Germain Act. We at the FDIC, in conjunction with the other federal bank regulators, seek to anticipate potential bank problems. Our goal is to resolve these problems with minimal disruption to our financial system and at minimal cost to our insurance fund. You know from experience that we are not infallible, but I trust you will agree that we are right to try.

I will center my testimony today on the economic conditions underlying the need for expanded emergency interstate bank acquisition authority. First, however, I would like to share with you some of our recent insights on the handling of bank failures. I believe this experience bears directly on the legislation you are considering.

II. HANDLING OF BANK FAILURES

Coping with bank failures has proved a formidable administrative challenge in recent years. The FDIC handled 120 bank failures and assistance transactions in 1985. We expect a similar volume in 1986, possibly including some institutions that are larger than those which failed last year.

We are attempting to handle these failures through purchase and assumption transactions whenever we are authorized to do so by law. P&A transactions are desirable for three distinct reasons. First, P&As are less disruptive than payoffs to the affected communities. A P&A minimizes customer disruption by keeping the failing bank's doors open -- albeit under a new name. Moreover, under a P&A, all deposits and most other liabilities to general creditors[1/] are assumed by the acquiring bank. Thus, all depositors and most general creditors come out whole. In contrast, when a bank is liquidated through a payoff, uninsured depositors and other general creditors usually do not receive the full amount of their claims.[2/] Second, reliance on P&As in lieu of payoffs helps dispel the perception that we handle small bank failures differently than large bank failures. Third, experience shows that P&As are less costly than payoffs to the Insurance Fund.

III. EMERGENCY INTERSTATE TAKEOVER LEGISLATION

Now let me return to the legislation currently before you. S. 2372 pertains to bank acquisitions involving FDIC assistance, as well as transactions not involving such aid. I will confine my remarks to assisted transactions. Before discussing specific provisions, I will review the changes in the banking environment that have created a need for the statutory modifications we seek.

1/ The exception to this statement involves general creditor obligations, where they exist, in state-chartered banks located in states that have depositor preference statutes.

2/ In early 1984 the FDIC utilized "modified payoffs," under which insured depositors' accounts -- but not the liabilities of uninsured depositors and other general creditors -- are transferred to an acquiring bank. These transactions proved less disruptive than straight payoffs, while retaining some market discipline from bank creditors. Modified payoffs have been used infrequently in the past two years, usually in situations where a P&A was not feasible. See L. W. Seidman, Statement on Deposit Insurance Reform 6-7, Senate Comm. on Banking, Housing, and Urban Affairs, 99th Cong., 2d Sess. (Mar. 13, 1986).

Most of the failing banks we have seen in the past two years have been small. We have been able to deal with most of them effectively through intrastate acquisitions. In some cases, however, we have been unable to arrange P&As, due to a lack of interested within-state bidders.

The potential problems we face today are greater. Oil and gas banks are threatened by a continuation of today's oil prices. Assets of all the 62 farm banks that failed in 1985 would not equal the assets of the lead bank in some of those companies. In a recent survey, we identified 563 commercial banks as "energy" banks. Eighteen percent of them -- 103 institutions -- are on the problem bank list. At the April 1985 shared national credit review, 17.5 percent of oil and gas credits were criticized. The volume of problem loans is expected to expand dramatically in the next review, now under way.

While we prefer to rely on intrastate solutions, many of the failing bank situations we see today simply may not be resolvable through intrastate P&As. In some states, it may not be possible to find a buyer that is strong enough financially to make an acquisition of a failed or failing bank of moderate size. As recently as a year or two ago we had a sellers' market. In some areas of the country, we find we have to make deals increasingly attractive, even with very small banks. Furthermore, even healthy within-state institutions may not have an incentive to bid for troubled banks.

As we confront situations where few or no within-state buyers are to be found, it becomes important to expand the number of potential bidders. This can be done by allowing out-of-state institutions to make bids. Opening up

P&As to out-of-state bidders greatly increases the pool of potential purchasers. It thereby heightens competition and maximizes a bank's sales price. This reduces costs to the FDIC and thus to other banks around the country. The new combined institutions tend to be more diversified and healthier than the unions that result from more limited auctions. As a result, both the stability of the banking system and economic efficiency are enhanced.

We prefer to rely on within-state solutions to troubled bank situations whenever feasible. We fully respect the deference to state authority over banking embodied in the Douglas Amendment and the McFadden Act. But if interstate banking is necessary, it should be accomplished directly. Our aim is to be given adequate tools to cope effectively with the failing bank situations we may confront.

The current interstate acquisition provisions have some very helpful features. They provide for out-of-state purchases of failed commercial banks and failed or failing mutual savings banks with assets of $500 million or more. These provisions have materially increased the FDIC's options and reduced its costs in handling several bank failures. In February of this year, for example, they were used in the failure of Park Bank in Florida, and at least $37 million was saved by the FDIC as a result of this transaction alone.

But these provisions have significant limitations. Eligible commercial banks may be acquired only if they are closed. In contrast, an eligible mutual savings bank may be acquired prior to closing. Absent specific state legislation, existing law does not provide for acquisition of holding company affiliates of a failed or failing bank. In addition, if a bank is acquired by an out-of-state bank holding company, the bank may expand throughout the state by branching if permitted, but not by holding company acquisitions. This means in unit banking states, the out-of-state bank holding company's entry is limited to the site of the bank it acquires.

As a result, we believe that existing law needs not only to be extended but also to be broadened and improved. Our purpose is to provide the FDIC greater flexibility in order to reduce the cost to the Federal Deposit Insurance Fund and therefore to member banks, minimize disruption of financial services to the communities involved, and maintain the safety and soundness of the banking system as a whole.

Briefly, our proposal would do four things. First, it would lower the size threshold of a bank eligible for acquisition. Second, it would permit the acquisition of failing as well as failed commercial banks. Third, it would extend the scope of interstate acquisition authority to include bank holding company systems when the failing bank exceeds the statutory size threshold and represents a sizeable part of the holding company system. Fourth, it would authorize acquiring banks to expand to the three largest metropolitan statistical areas in the state of acquisition. Our proposal also reflects our sensitivity to federalism concerns and to the continued importance of the dual banking system.

Lowering the Size Threshold

Now for some specifics. The existing interstate provision works this way. When a bank of $500 million or more in total assets is closed, the FDIC, as receiver, may arrange the sale of assets and assumption of liabilities of the closed bank by an out-of-state bank or holding company. The $500 million threshold is too high a hurdle, as most troubled banks are considerably smaller. We propose a reduction to at least $250 million.

As of year end 1985, 134 insured savings banks and 953 insured commercial banks had assets greater than $250 million. Of this total, 443 commercial banks had between $250 million and $500 million in assets. Our proposal would therefore almost double the number of commercial banks eligible for emergency acquisition transactions. (Of the 1,087 total institutions, 78 were on our problem list. Of the 443 commercial banks between $250 million and $500 million, 24 were on the problem list.) We also considered other alternatives to the $250 million threshold. For example, a proposal to include the ten largest banks in each state or all banks presently meeting the $500 million threshold would represent an increase of 213 commercial banks eligible for acquisition. An attachment to this testimony provides a detailed state-by-state breakdown of banks falling into the "$250-500 million" and "over $500 million" asset categories.

Others have suggested that the threshold should be lowered further or eliminated altogether for a temporary period for farm banks. Should the Congress decide to do this, the FDIC would have no objection. We would note however, that a small farm bank in a unit banking state would probably not attract many out-of-state bids. On the other hand, in unit banking states that permit multibank holding companies, interstate buyers might be attracted to purchasing the holding company. Permitting this at a threshold lower than $250 million might help resolve some problems in the agricultural sector.

Failing Bank Assistance

Second, arranging an assistance transaction for a failing bank before failure can be cost effective. Franchise value would be less eroded by the flight of bank customers and tax benefits may be retained. This would increase the bank's sales price, thereby decreasing the FDIC's costs and increasing our flexibility to pass assets. In addition, this could avoid the process of decline into insolvency that might create a ripple effect in the financial community. Thus, an out-of-state acquisition should be permitted not only for failed banks, but also for banks in danger of closing, i.e., banks that are expected to close if assistance is not provided.

Holding Company Acquisitions

Third, if the failing bank or banks exceed the statutory size threshold and represent a sizeable part of the bank holding company system, an out-of-state holding company should have the ability to buy the stock of the failing bank and to buy stock of any of the bank's affiliates. The existing law does not provide for the situation where a failing bank is an integral part of a larger banking organization. Because healthy holding company affiliates cannot be acquired, potential acquirers may be willing to pay far less than otherwise for a troubled bank. This diminution in a bank's sales value may raise the FDIC's costs. It may also result in the dismemberment of existing established systems, with disruptive effects in the local community.

Post-Acquisition Expansion

Fourth, acquiring institutions would automatically be entitled to expand into the three largest metropolitan areas in the acquired bank's state, under the same conditions applied to bank holding companies already located in that state. This would enhance institutions' incentives to bid on troubled banks and thereby increase the total number of troubled bank P&As that can be carried out -- to the benefit of depositors, creditors, and affected communities. At the same time, the limitations on the scope of expansion would allow states to retain substantial control over bank expansion within their borders.

Safeguards

The proposal reflects our continued sensitivity to federalism concerns and the importance of the dual banking system. When the existing interstate legislation was enacted in 1982, Congress provided specific safeguards to protect the states' interests. Our proposal retains these safeguards. It does this: (1) by providing state bank supervisors notice and an opportunity to object to proposed out-of-state assistance transactions; (2) by authorizing state bank authorities to determine whether a state-chartered institution is "failing", for purposes of out-of-state bids; and (3) by providing for rebidding procedures under certain circumstances. These safeguards provide an important role for state banking supervisors.

IV. CONCLUSION

Mr. Chairman, that concludes my prepared remarks. I would be pleased to answer any questions you may have.

Attachment

ATTACHMENT

All Insured Commercial Banks with Assets greater than $250 Million
As of December 31, 1985
($ Amounts in Millions)

STATE	Number of Banks w/ Assets of $250 - $500	Assets of Banks w/ Assets of $250 - $500	Number of Banks w/ Assets Over $500	Assets of Banks w/ Assets Over $500
ALABAMA	7	$2,134	5	$14,013
ALASKA	4	$1,477	3	$2,605
ARIZONA	0	$0	6	$22,850
ARKANSAS	8	$2,793	2	$1,864
CALIFORNIA	22	$8,167	29	$259,559
COLORADO	6	$1,969	4	$8,103
CONNECTICUT	4	$1,156	6	$21,385
DELAWARE	4	$1,583	6	$7,171
DISTRICT OF COLUMBIA	3	$1,089	5	$13,315
FLORIDA	27	$9,255	29	$52,277
GEORGIA	7	$2,369	9	$29,370
HAWAII	1	$360	4	$8,405
IDAHO	2	$718	3	$5,471
ILLINOIS	34	$11,409	17	$90,551
INDIANA	20	$6,308	13	$18,152
IOWA	4	$1,370	4	$3,808
KANSAS	8	$2,676	2	$2,229
KENTUCKY	6	$1,825	5	$10,824
LOUISIANA	13	$4,733	14	$15,678
MAINE	1	$387	5	$3,691
MARYLAND	2	$661	11	$26,749
MASSACHUSETTS	21	$7,775	17	$50,559
MICHIGAN	26	$8,910	17	$41,684
MINNESOTA	10	$3,191	6	$23,758
MISSISSIPPI	5	$1,652	5	$7,555
MISSOURI	10	$3,302	11	$19,029
MONTANA	3	$938	0	$0
NEBRASKA	1	$487	4	$4,573
NEVADA	1	$461	4	$6,416
NEW HAMPSHIRE	6	$2,103	1	$667
NEW JERSEY	14	$4,418	29	$47,119
NEW MEXICO	3	$951	2	$2,585
NEW YORK	15	$5,624	46	$602,987
NORTH CAROLINA	2	$534	10	$45,322
NORTH DAKOTA	1	$275	0	$0
OHIO	16	$5,463	28	$57,163
OKLAHOMA	8	$2,512	5	$8,341
OREGON	2	$577	4	$14,842
PENNSYLVANIA	18	$6,245	41	$108,635
RHODE ISLAND	1	$396	2	$8,216
SOUTH CAROLINA	1	$312	5	$11,035
SOUTH DAKOTA	1	$252	4	$11,898
TENNESSEE	7	$2,469	11	$19,224
TEXAS	52	$18,580	41	$97,572
UTAH	2	$526	5	$7,947
VERMONT	4	$1,809	1	$850
VIRGINIA	7	$2,308	10	$33,794
WASHINGTON	2	$791	7	$26,937
WEST VIRGINIA	6	$1,999	1	$535
WISCONSIN	9	$2,697	7	$10,265
WYOMING	2	$558	0	$0
PUERTO RICO	4	$1,527	4	$8,754