FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

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FDIC CHAIRMAN LAUDS S&L INDUSTRY FOR SEEKING TO SOLVE ITS OWN PROBLEMS

L. William Seidman, Chairman of the Federal Deposit Insurance Corporation, today praised the savings and loan industry for seeking private rather than government solutions for refinancing the Federal Savings and Loan Insurance Corporation.

"Given the size of the problem, a huge loss to be paid for and sunken costs to be assumed, it is to the great credit of the S&L industry that they are willing to attack these problems without running to the U.S Treasury for help," he said.

Mr. Seidman, addressing the National Council of Savings Institutions in San Francisco, California, added: "It doesn't seem to have been recognized how much credit the industry deserves for stepping up with a proposed solution financed by the industry. Whether one feels it is sufficient or not is a matter of judgment, but it is a rare occurrence today for a completely private solution to be adopted by an industry. We at the FDIC salute the S&Ls for their effort to achieve a non-governmentally financed solution."

While praising the S&Ls for their efforts, Mr. Seidman said the problems of the savings and loan industry still are a major concern to the FDIC. He noted that an increasing number of well-run thrifts are considering their responsibility to earn profit for their shareholders and are reviewing the possibility of joining the FDIC. He said at least 15 such applications have been received by the FDIC, some of them from relatively large institutions. He added that about 1,000 S&Ls appear able to meet the FDIC's membership standards.

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"The effect on the FDIC could be substantial if significant numbers of institutions seek to convert," Mr. Seidman said. He noted that the FDIC's projected ratio of reserves to deposits would decline about 13 percent if all the eligible S&Ls switched to the FDIC. Such a decline could lead to a reexamination of the need for an additional premium surcharge for institutions insured by the FDIC, he said.

Mr. Seidman said a recapitalization of the FSLIC can be an effective solution to the industry's problems if three conditions are met:

- The funding is adequate.
- The supervisory rules and procedures prevent a repeat of the problems that "broke" the fund before.
- The incentives for preventing the exit of large numbers of S&Ls by transfer to the FDIC are sufficient to maintain a viable fund.

The FDIC Chairman said the S&Ls and the banks should work together on a plan for the future of insured depository institutions that includes:

- Sound supervision for safety and soundness.
- Appropriate powers for prosperous operations.
- A well-defined role for each industry.
- A level playing field with respect to non-regulated competitors.

"The matter is now before the Congress. It is far from decided. The two industries could begin now to work together to make insured depository institutions fully competitive in the new world of financial institutions," Mr. Seidman said.

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An Address By

L. William Seidman, Chairman
Federal Deposit Insurance Corporation
Washington, D.C.

Before the

NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

San Francisco, California
May 13, 1987

It is a pleasure to be with you again and have the chance to exchange views on topics of mutual concern. My concerns at the moment include the FDIC's record number of insured bank failures, and the relationship of our fund to FSLIC. The situation requires some positive action by both the S&L and banking industries. In fact, we could use a miracle or two, but as Peter Drucker has said "Miracles are great -- but they're so darned unpredictable."

This morning I would like to make a few brief comments about the current status of the FDIC insurance fund, then talk about the way we see the FDIC's and the banking industry's relationship to the S&Ls and their insurance fund.

First, as background for this discussion, let me review the status of the FDIC fund. In a nutshell, our resources are beginning to show the effects of unprecedented numbers of bank closings.

Our ratio of reserves to insured deposits is dropping. As of year-end 1986, the reserve declined to $1.12 per $100 of insured deposits, from just under $1.20 a year earlier. This is an all-time low. Insured deposits grew about 8.7% last year. If we project a similar growth rate for 1987, and assume no growth in the $18.2 billion fund, then the projected ratio of the fund to insured deposits at year-end will drop to about 1%. At the rate banks are failing (almost 80 failures and 2 assistance transactions expected by this Friday, May 15), we will be lucky to keep the reserve fund from shrinking in 1987. You will remember it grew by less than $300 million last year when our total failures and assists were only 145. Our current rate of failures is almost double that. Last year at this time, we only had 44 failures and one assist.

As you may already know, the Congress has indicated that the federal deposit insurance fund should not drop below 1.1% of insured deposits. If our fund goes below that, mandatory assessment rebates are excluded. I need not remind you that such rebates have not been forthcoming recently. As of today, the FDIC fund is probably at the 1.1% threshold. It may even be below it when all the numbers are in.

Our ratio of reserves to total deposits fell from 0.91% to 0.84% at the end of 1986; at the end of 1987 it is expected to fall to about 0.76% -- a drop of 17% from 1984.

However, there is some more encouraging news. Our problem bank list is moving up much more slowly than it did last year at this time, when it was increasing one bank per day. It has hovered around 1,500 for the last 6 months. However, in the last few weeks it has begun to rise slowly and is now at 1,555. Almost all the increase in problem banks is in the Southwest. Other parts of the country show improvement. It is possible we are beginning to see a peak-out in bank failures -- at least under current economic conditions.

Let me emphasize, the FDIC is solvent. Based on the present state of affairs, it can and will handle foreseeable problems. We have a sound and viable deposit insurance fund. On the other hand, it is not an unlimited resource. It cannot possibly handle all the financial problems of FSLIC.

Second, let us look at the FSLIC problem and its relationship to banks. The magnitude of the S&L industry's FSLIC problem should concern all financial institutions. The FHLBB has estimated that about $23 billion (present value cost) will be needed to resolve selected problem S&Ls. This estimate does not include resolution of the problems of all insolvent S&Ls, or marginally solvent institutions. It also does not reflect the effects of increases in interest rates now taking place.

Given the size of the problem, a huge loss to be paid for, sunken costs to be assumed, it is to the great credit of the S&L industry that they are willing to attack the problems without running to the U.S. Treasury for help. It doesn't seem to have been recognized how much credit the industry deserves for stepping up with a proposed solution financed by the industry. Whether one feels it is sufficient or not is a matter of judgment, but it is a rare occurrence today for a completely private sector solution to be adopted by an industry. We at the FDIC salute the S&Ls for their effort to achieve a nongovernmentally financed solution.

Nevertheless, where you stand depends importantly on where you sit. Thus, it perhaps is not surprising to learn that increasing numbers of well-run thrifts are considering their responsibility to earn profits for shareholders and they're reviewing the possibility of joining the FDIC. Recently, we have received fifteen applications from S&Ls seeking FDIC insurance. At least a dozen others have expressed interest in conversion. Several of these are relatively large in size.

They are intrested in a change because of our lower premiums, but also because of our tighter supervision and standards. They do not wish to pick up the deficits of badly run and potentially poorly supervised institutions in the future.

A quick review of available financial data indicates that as many as 1,000 S&Ls earned more than 50 basis points last year and would qualify for FDIC insofar as capital levels are concerned. They hold about 20% of the industry's assets. Capital adequacy is, of course, fundamental to the FDIC's admission policy. We will also evaluate the history and condition of the FDIC applicant. We will review the quality of the institution's assets, the degree of interest rate sensitivity, the nature and scope of the business expected to be conducted and other risk factors. Quality of management will be important.

The effect on the FDIC should significant numbers of institutions seek to convert could be substantial. If the 1,000 S&Ls mentioned earlier were to transfer to our fund this year, our projected reserves to insured deposits ratio would decline about 13% to about 0.9% of insured deposits.

Good business policy would suggest that an S&L transferee bring with it sufficient "reserve funds" to maintain the insurance reserves at appropriate levels. This is not required, and they bring no reserves.

Bankers must note, perhaps with concern, that further reduction in the ratio of reserves may call for examination of the need for an additional premium surcharge for the banks which are insured by the FDIC.

A large number of S&L transfers from FSLIC to the FDIC could become a "back door merger." In my view, such an unevaluated and unplanned result is not good public policy.

We have no legal way to prevent this result unless current legislation is changed. The "exit fee" in the House bill is so low that an S&L can recover the cost in about 3 years at current FDIC premium rates.

I do not fault those of you who wish to keep the fee at the levels in the House bill. As I've indicated, each executive must respond to the needs of the owners of his institution.

While many will disagree with some of the points I made, I do believe that it is our duty to point out the possible results of the proposed plan for saving the FSLIC.

There is talk of the FDIC providing a form of "capital forbearance" in admission standards. It has been suggested that the forbearance we have given to FDIC-insured savings banks and other institutions should apply to all that wish to join our fund. It is true we do forbear. We have allowed a number of savings banks and others to operate with less than desired capital levels. It should be noted, however, that these institutions were already insured by the FDIC; they were not seeking admittance to the system.

Over the last few years, the FDIC has granted federal deposit insurance to about 300 non-insured institutions of various types, ranging from co-operative banks in Massachusetts to thrift and loan associations in California. We can think of no instance where our admission standards were less than the basic standards we have for all our insurees.

CONCLUSION

It seems to us at the FDIC that a recapitalization of FSLIC can be an effective solution to the problems described only on the following basis:

1. The funding provided is adequate.

2. The supervisory rules and procedures prevent a repeat of the problems that "broke" the fund before. In that respect, some of the forbearance language in the House bill, without going into all the details, can be described as unwise and unworkable, because they legislate the judgment of our supervisory process. Forbearance would be mandated by legislation -- overriding the discretion of the professional regulators. It requires an unwieldy appeals process which can prevent weak or ill-managed institutions from being closed.

3. The incentives for preventing the exit of large numbers of S&Ls by transfer to the FDIC are sufficient to maintain a viable fund.

It is important to the S&L, the bank, and the public that a workable solution be found.

As is well known, we at the FDIC have not, and do not support a merger of the two insurance funds. I have also tried to stick by our 11th commandment -- thou shalt not speak evil of thy fellow insurer and seek only to be as helpful as we can be.

But that does not mean that we don't have much in common to discuss. In fact, all the events to date suggest we have much on which to confer.

Insured depository institutions have a special role in our country. Our economy will not work well unless these institutions work. In my opinion, we need to think of the S&Ls and the banks as institutions with more interests in common than they have to quarrel about. Both industries have common interests in being competitive in their field, having safe and credible insurance funds, and in being the major fund gatherers in our economy.

The S&Ls and the banks ought to be able to agree on a future which includes:

1. sound supervision for safety and soundness;

2. appropriate powers for prosperous operations;

3. a well-defined role for each industry;

4. a level playing field with respect to non-regulated competitors.

Together they would be a formidable force to achieve results in our capital. So, I would suggest that the depository institutions begin to think of themselves as <u>two parts of one industry</u>.

What form that cooperation may take in the long run, the industries will have to work out. It could be agreement on a common governing board for regulatory purposes or, perhaps, some inter-relationship between the insurance funds. The "new" industry can address the question.

The matter is before the Congress. It is far from decided. The two industries could begin now to work together to make insured depository institutions fully competitive in the new world of financial institutions. Of course, you could wait for chance or luck to present an opportunity or miracle -- but, then, miracles are so unpredictable.

Thank you.