FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

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FDIC FUND STANDS AT $16.3 BILLION;
GROWTH IN '89 EXPECTED AS FAILURE RATE SLOWS

The banking industry's deposit insurance fund ended the third quarter with a net worth of $16.3 billion after deduction of estimated losses relating to all failures and assistance transactions occurring during the first nine months of 1988, including those attributable to First RepublicBank Corporation's banks, according to Federal Deposit Insurance Corporation Chairman L. William Seidman

"After handling all of the major problems in Texas, and over 200 failures and assistance transactions for the year, the FDIC should end 1988 with a net worth between $15 billion and $16 billion," Mr. Seidman said. The fund's net worth stood at $18.3 billion at the beginning of the year. "We probably will book the estimated cost of handling MCorp in 1988 even if we don't actually provide any assistance this year," Chairman Seidman said.

During 1989 "we should add about a half billion dollars to our net worth as both the number and size of bank failures begins to decline," Mr. Seidman added. "Yes, we do expect to make a profit again if economic conditions remain stable," he told thrift industry executives meeting in Hawaii.

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"Bank failures and assistance agreements next year will decline to approximately 150 to 175 transactions, reversing an upward trend which has lasted almost a decade. Moreover, available data indicates the largest potential bank failure next year will involve assets of no more than $3 billion," he said.

"The last few years have been particularly difficult for the FDIC," Mr. Seidman noted. "We have handled over 570 bank failures, involving some $70 billion in assets, since I became chairman three years ago. That amounts to more failures in the last three years than the FDIC handled in the thirty years following World War II."

Despite the record number of failures and assistance agreements, the financial condition of the FDIC insurance fund remains strong and liquid, Mr. Seidman commented. While the loss this year will be the first in the FDIC's history, Mr. Seidman sharply disputed assertions by some parties that the FDIC is in bad financial shape. "These commentators are misinformed," he said.

"Our predictions for next year reflect the fact that we do not have a large inventory of insolvent banks to deal with and all of the major banking problems in Texas will be behind us, Mr. Seidman said. "We have responded to problems as they appeared, refined our approaches for dealing with failures and conserved our resources. Now, after the explosive growth in failures and the FDIC staff over the past few years we are looking forward to reductions in both areas."

The FDIC has already begun reducing its liquidation staff, largely due to use of new approaches to selling failed banks that result in fewer assets being transferred to the FDIC. Mr. Seidman noted that the FDIC's "problem bank" list has continued a steady decline from a 1987 high of 1624. "Last week it declined to 1434 institutions. That's one of our best indicators of improving performance in the banking industry," he said.

"While the industry experienced especially low profitability over the last few years, profitability has turned around," Mr. Seidman said. He noted that last year the industry moved aggressively to fortify its reserves and took steps to improve overall asset quality--moves which helped the industry nationwide earn a record $10.5 billion in the first half of 1988.

"We are looking at record profitability levels for the industry during 1988," Mr. Seidman said. "Together with improving conditions in the Midwest, and to a lesser extent in the Southwest, there should be fewer bank problems down the road. While the industry and the FDIC have faced some difficult times, the FDIC has emerged intact."

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Remarks by

L. William Seidman
Chairman
Federal Deposit Insurance Corporation

Before

U.S. League of Savings Institutions
Annual Meeting
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Once again, it gives me great pleasure to talk to the members of the U.S. League, fellow members of the federally insured deposit industry.

I'd like to salute Bill O'Connell for his leadership of your organization, and welcome Fred Webber to your helm. Fred and I have been good friends for many years and we intend to keep it that way. You made a great choice to succeed the legendary Bill O'Connell.

This is an historic changing of the guard in your organization, and it certainly comes at an historic moment in the history of your industry.

At this critical time, I'd like to repeat what I've said before, that working with bankers to meet the challenges of the day will be more rewarding than working alone.

The real value of <u>your franchise</u> is greatly dependent on a sound federal deposit insurance system -- and this is also true for most banks.

I believe this common dependency is a fact we should all recognize.

I want to focus today on some other <u>facts</u> that may help banks and thrifts work together.

Lets begin our cooperative undertaking by looking at the facts on the FDIC insurance fund.

We've all heard a lot of "guesstimates" about how the two deposit insurance funds are doing. Some commentators, such as the League's Mr. Jacobe, have even concluded that the FDIC is in as bad financial shape as its thrift counterpart.

These commentators are misinformed.

Only if we both operate from the same set of <u>facts</u> concerning the FDIC's status, can we work towards a common goal of a strong insurance system.

The last few years <u>have</u> been difficult for the FDIC.

Since I became Chairman three years ago, the FDIC has handled over 570 bank failures, involving some $70 billion in assets.

That amounts to more failures in the last three years than the FDIC handled in the thirty years following World War II!

Already this year the FDIC has handled over 190 banks that have failed or required assistance, and unfortunately, we will break last year's record of over 200 with no difficulty.

The assets of these 190 institutions stand at over $50 billion.

To put this year's $50 billion figure in perspective, it is more than double the amount of assets the FDIC handled during its entire first 50 years of existence!

Despite a record number of problems, I'm pleased to report -- and you should be pleased to hear -- that the financial condition of the FDIC fund remains strong and liquid. That's good for all of us since two insolvent funds will not help us provide a sound insurance system for the nineties.

The FDIC's financial statements for 1987, showed the FDIC fund had a year-end net worth of roughly $18.3 billion, most of that being in cash type reserves.

Our net worth is attested to by the General Accounting Office (GAO). And incidentally, the GAO uses exactly the same standards for our audit as it does when auditing FSLIC. Those who say there is a difference are wrong and are really questioning GAO's accounting ability and integrity -- an unrewarding and unjustified exercise.

The problems in the banking system have taken a toll on the FDIC fund, and we will have our first operating loss in history in 1988.

Our third quarter statement is just hot-off the press. It shows a net worth of $16.3 billion, and a loss to date of about $2 billion. That includes the cost of the biggest problem ever -- First Republic.

Based on our current estimates, the FDIC fund will end the year with between $15 to $16 billion in net worth. This estimate includes the projected cost of handling all the major problems in Texas, and the over 200 other failures and assistance transactions for the year.

Fortunately, 1989 looks like a much less costly year. We expect to add approximately a half billion to our net worth by year-end. Yes, we expect to make a profit again if economic conditions remain stable.

We believe there will be significant declines in the number of bank failures and assistance transactions in 1989. At this point we estimate that the FDIC will need to handle approximately 150 to 175 bank failures and assistance transactions next year.

We didn't just pull these estimates out of the air, but generated them through a thorough analysis of the condition of the banking industry, and an individual review of each problem bank.

Let me provide you with some additional facts.

First, we are handling all bank insolvencies when they are identified. We don't have an inventory stockpiled for future action. We do keep a watchful eye on a small group of banks that may fail in the relative near-term so our people can be ready to handle them when, and if, they fail.

Second, as far as future problems, the number of banks on our "problem bank list" has been shrinking steadily for most of this year, and is now down from its high of 1624 in June 1987, to 1434 last week. That list is one of our best indicators of the problems developing down the road in the banking system.

Third, we have taken a good look at our potential major bank exposure in 1989. Unlike 1988, there are no mega banks on the list. Of course, conditions could change.

But as of today, we don't anticipate having to handle any banks with more than $3 billion in assets next year.

Fourth, as you are all aware, the FDIC's greatest exposure, as yours, has been in Texas. But even there, through FDIC and private sector assistance, 8 of the 10 largest banking organizations have now been dealt with. And we are dealing with a 9th member of that group at the present time -- MCorp. We will probably book the estimated cost of handling MCorp in 1988 even if we don't actually provide any assistance this year.

Fifth, improvements in the overall strength of the banking industry are becoming apparent. A stronger system will translate into less stress on the FDIC.

The banking industry experienced especially low profitability over the last few years, most notably last year owing to significant reserving for losses on certain developing country debt. In the second quarter of 1987 alone, commercial banks lost almost $10.6 billion, most of that attributable to this reserving for developing country loans. A repeat of that level of reserving is unlikely, especially since most large holders of developing country debt are now reserved from 30 to 50 percent of book value.

Bank profitability has already turned around dramatically this year. Commercial banks nationwide earned a record $10.5 billion in the first-half of 1988, bolstered by the best second-quarter earnings ever. Earnings for the four quarters ended June 30, 1988, totalled $19.5 billion, another record.

We now expect to see record profitability levels for banks in 1988.

Taken together, the facts indicate that while the banking industry and the FDIC have faced some difficult times, the FDIC has emerged intact. Things are improving and the FDIC is in a position to deal with any challenges we forsee at this time.

So as Mark Twain might have said, the reports of our demise have been greatly exaggerated.

This year has certainly seen the FDIC come up against the toughest tasks in its 54 year history.

What helped make it possible for the FDIC to meet those challenges?

The battle between a small British fleet and the gigantic Spanish Armada four centuries ago this year, might provide some insight. By all odds the Spanish should have easily defeated the British.

The Spanish fleet was far bigger and was armed with heavier guns. Yet when the smoke cleared, the Armada had lost half its ships, and 20,000 men. By contrast, not one British ship was sunk.

It seems that one big reason why the British won was that it sailed into battle with the right tools to win the fight, while the Spanish had the wrong equipment.

The Spanish guns had been designed for use on land, and were too cumbersome to fire more than twice a day.

By contrast, the British were armed with the first guns designed for war at sea, meaning they could be loaded and fired with speed and accuracy.

These better tools gave the British the edge they needed despite the odds.

Having the right tools helped make the difference for the FDIC, too.

The key to <u>why</u> our tools are meeting the challenge is that they allow the FDIC to handle banking problems in the least <u>costly</u> way -- and by doing so allow us to keep our insurance fund able to meet its obligations.

For example, early last year the FDIC took its old "Purchase and Assumption" approach for handling bank failures, and developed an improved model.

We were able to introduce our new "Whole Bank P & A" transaction. In this approach, we ask qualified bidders how much assistance we need to provide for them to take all of a failed bank's good and bad assets, and we give all the bids a good look.

We accept the lowest viable bid <u>if</u> it constitutes the cost effective approach to solving the problem. And we developed a complex, but accurate, costing system so that we know our costs, and thus what we could sell it for.

Our success in achieving whole bank and assistance transactions since 1987, not including First City and First Republic, translates into about $3.5 billion less cash tied up in liquidating assets. With our large assistance transactions included, the savings are more than doubled.

Our new bridge bank authority, which we obtained from Congress in 1986, represents another new tool in our arsenal. As a result of that authority, our cost for handling First Republic was reduced by leaving billions of dollars of obligations behind in the holding company.

So while we were radically increasing our staff four years ago to handle a mountain of new assets coming in under our old failure resolution approaches, we are now actually reducing our liquidation staff. It is now down from over 5,000 three years ago to slightly more than 3,500.

Staffing has declined by over 20 percent just this year alone. And for the first time since I became Chairman, the amount of total assets the FDIC is liquidating has actually declined -- down over a billion dollars from year-end 1987 to under $10 billion in book value despite record failures!

Let me conclude by taking a look at what the future holds for federally insured depository institutions.

Congress and others have recently called for studies of the whole issue of deposit insurance and the FSLIC problem.

All year we have been conducting a thorough study in this area. Our study, "A Deposit Insurance System For the Nineties," will be completed by the end of November.

Clearly the job of rescuing the thrift insurance fund and preserving the thrift industry is one of the most difficult tasks facing our government today. We at the FDIC have a real understanding of the magnitude of the challenge facing Chairman Wall and his Board.

I'm sure Danny can empathize with President Kennedy's statement that when he got into office, "the thing that surprised me the most," Kennedy said, "was to find that things were just as bad as [he'd] been saying they were" on the campaign trail.

The problems of the thrift and banking industries really are joint problems in many ways. After all, both industries are part of the insured deposit financial services industry. When the cost of funding increases for healthy institutions because sick institutions need to pay a premium, we all suffer.

The FDIC would like to help you in any way we can -- within limits, of course. The FDIC needs to protect its resources built up for years by the banks. For as Mae West might have put it about the FDIC's ample net worth, "too much of a good thing can make an irresistible target."

But I do want to emphasize that we want to help. We will explore all alternatives because it is our system that is challenged as well as yours.

Americans have faced daunting challenges before.

Almost forty-seven years ago, we suffered a defeat at Pearl Harbor as stunning as that of the Spanish Armada. On one Sunday morning most of our Pacific Fleet received a crushing blow unprecedented in our history. I probably remember it more vividly than most of you because I was in the U. S. Navy at the time.

But unlike the story of the Spanish Armada, Pearl Harbor was just the first chapter -- not the last.

Within a year, 90 percent of the ships lost that Sunday morning had been raised, refitted, and were back in action.

I feel that America's banks and thrifts can also meet the challenges ahead. We need to take Hannibal's view of a challenge. He said, "We will either <u>find</u> a way, or <u>make</u> one."

Working together, we can make a sound deposit insurance system for the Nineties.

Thank you.