TESTIMONY OF

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ON

CURRENT ACTIVITIES OF THE FEDERAL DEPOSIT INSURANCE CORPORATION
CONCERNING BANKS AND SAVINGS AND LOANS

BEFORE THE

House COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

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1 Centro Del Artes Del Mercado
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Good morning, Mr. Chairman and members of the Committee. I am pleased to be here today in San Antonio to testify on the current activities of the Federal Deposit Insurance Corporation ("FDIC") concerning both banks and savings and loans ("S&Ls"). This is a city I remember with great affection. My grandfather spent his winters here in the 1930s and I was privileged to visit him on occasion. They were my first trips out of the snows of Michigan and I loved them. So it is nice to be back, Mr. Chairman, in your beautiful hometown.

My testimony will address banking conditions and failures in the Southwest, the FDIC's approach to asset disposition, the ongoing interagency oversight effort relative to insolvent S&Ls, and the FDIC's supervisory practices and capabilities.

Before turning to these topics, however, I would like to state our support for President Bush's Reform Plan for the S&L industry. We believe it should be enacted promptly. In addition to providing for prompt action to resolve the S&L situation, the President's plan proposes structural and regulatory reforms designed to make the federal deposit insurance system cost-effective. The FDIC's detailed views on the proposed legislation, including changes we believe are desirable, are contained in our testimony of this past Wednesday before the Financial Institutions Subcommittee.

Many of the reforms in the Bush Reform Plan are consistent with the recommendations made in the FDIC's recently released study, Deposit Insurance for the Nineties: Meeting the Challenge. A draft of our study has been provided to each member of the Committee previously.

BANKING CONDITIONS AND FAILURES IN THE SOUTHWEST

FDIC Efforts. In recent years the FDIC has devoted a tremendous amount of its financial and personnel resources to dealing with bank problems and failures in the Southwest. For example, as shown in the attached Table 1 ("Table 1"), in 1988 the Dallas Region (which consists of Colorado, New Mexico, Oklahoma and Texas) accounted for about seventy percent of all bank failures and assistance transactions. Texas banks alone comprised over fifty percent of the total.

Over the past three years, the FDIC has handled 206 bank failures and assistance transactions in Texas, resulting in cash outlays totalling $7.7 billion. In 1988 alone, the FDIC made cash outlays totalling $6.0 billion for the 118 Texas bank failures and assistance transactions.

Mainly because of these significant outlays, in 1988 the FDIC suffered an operating loss of $4.3 billion -- the first operating loss in its 55-year history. That means the FDIC insurance fund dropped from $18.3 billion at year-end 1987 to about $14 billion at the end of last year.

By the end of 1989, we anticipate that the recapitalization of nine of Texas' ten largest banking organizations will have been accomplished during the preceeding three years. The FDIC has or will have provided substantial financial assistance in seven of those transactions. Notably, in 1988 we handled First RepublicBank Corporation with total assets of approximately $30 billion and First City Bancorporation with total assets of $11 billion. Also, in 1987 we provided assistance to the BancTexas Group, Inc. with total assets

of $1.2 billion. We feel that this injection of new capital into the Texas economy will help provide the financial strength needed to foster future growth in Texas.

Recent Trends. Recent statistics show that banks in the Southwest were the only regional group whose 1988 profitability was lower than in 1987. Credit quality problems continued to plague banks in the Southwest, especially in Texas. For example, more than one in three Southwestern banks lost money in the fourth quarter of 1988. Nonperforming asset levels decreased in 1988 for the first time in three years, however, indicating that loss levels might be stabilizing.

As shown in the attached Table 2, the number of problem banks in the Dallas Region remains high, even as the total problem banks nationwide appears to be declining steadily. However, the rate of increase in the number of problem banks appears to have abated and the total seems to have peaked.

Bank failures escalated to new highs in the Region, as well as nationally, in each of the last three years. As shown in Table 1, Texas failures increased substantially each year since 1985. In fact, last year Texas failures exceeded the combined total for the rest of the country. So far this year, with seventeen failures and one assistance transaction, the pace is running slightly behind the same time last year.

Thus, banking problems and failures in Texas and the Southwest are still very substantial, but it is our best estimate that they reached their peak in 1988.

FAILED INSTITUTION AND PROPERTY DISPOSITION

We frequently are asked about the FDIC's program for handling failed institutions. Our efforts are directed toward returning those institutions to the private sector as rapidly as possible. We seek to sell them as going institutions, if possible. If not, we dispose of them in pieces as the market will absorb them. In this process we have real estate for sale and certainly will have more in the future.

Recently the real estate disposition issue has become even more prominent given the FDIC's pending new responsibilities over S&Ls, and the anticipated need to dispose of a very significant additional pool of assets. As we have stated in the past, the FDIC's position on this issue is that all the assets we take over will be for sale. We will sell property, however, only at the current appraised fair market value. No sales will be made on a "whatever we can get" basis and we do not engage in "dumping." If we are unable to sell property at the appraised value, we will hold it. Our auctions are on a reserved-price basis.

We believe a government-subsidized warehousing of large amounts of property actually can be detrimental to the real estate market and local economy. Having large amounts of property hanging over the real estate market, under asset maintenance agreements, creates uncertainty and only delays the return of this property to true private-sector management. No one knows when the government might open the floodgates of warehoused property, and markets can be expected to react to this uncertainty.

Further, if held by private institutions with government subsidies, the subsidies provide an unfair competitive advantage. The way the private sector can make rational economic decisions is to get property back into private hands as promptly as possible. Unfortunately, however, even with such a policy, sales will not be accomplished over night.

Some people have expressed support for our asset disposition program including businessmen in the real estate and construction businesses. Others, primarily property owners, disagree with our program -- sometimes violently. Obviously, it is a difficult question and requires judgmental decisions.

In 1988 we achieved considerable success in limiting the increase in the FDIC's acquisition of loans and other assets of failed banks. Some background may be helpful here. Traditionally the FDIC had taken over the poor and charged-off assets of failed banks and, when consistent with our statutory cost test, sold the remaining healthy part of those banks intact. However, the dramatic increase in the number of failures caused a reappraisal of that approach.

As I have pointed out, now we attempt to structure sales so that the purchaser acquires substantially all of the failed bank's assets (referred to as a "total asset purchase and assumption," "TAPA" or "whole bank" transaction). These whole bank transactions leave property in the private sector, reduce the FDIC's overall outlays and costs and, we believe, are best for the local economies.

When unresolved issues about commercial loans or other assets prevent us from marketing a TAPA transaction, we attempt to structure a sale whereby the

purchaser takes all of the small loans and nonloan assets (generally referred to as a "SLAPA"). Among other things, TAPAs and SLAPAs must meet the statutory requirement of being less costly to the FDIC than paying off insured depositors.

In 1988, nationwide, we completed sixty-nine whole bank transactions (counting the First Republic banks as one transaction), equaling approximately one-third of all failed bank and assistance transactions for that year. In the Dallas Region, we started with six whole bank transactions in 1987 and increased to 45 (again, counting the First Republic banks as one transaction) in 1988. Additionally, we structured 26 SLAPAs in 1988. So far this year, in the Dallas Region we completed nine whole bank transactions and five SLAPAs.

INTERAGENCY OVERSIGHT EFFORT

I now would like to turn to the interagency oversight effort underway to deal with the S&Ls that are currently insolvent under regulatory accounting principles ("RAP").

As part of the Bush Reform Plan announced February 6th, the President requested that the FDIC lead a joint effort to evaluate and oversee most of the RAP insolvent thrifts. In addition to the FDIC and the FSLIC, the Federal Home Loan Bank Board, the Federal Reserve, and the Office of the Comptroller of the Currency are participating in this interagency initiative.

The purpose of this interagency effort is to limit the growth of problems in our nation's insolvent thrifts until a comprehensive reform of the deposit

insurance system and the necessary funding are authorized by the Congress. Insured deposits will remain fully protected throughout this process.

Since the program was announced by the President, a joint task force of regulators, led by the FDIC, has taken control of approximately 120 of the RAP insolvent thrifts and expects to assume oversight of the rest of the over 200 RAP insolvent thrifts in the next three-to-five weeks. FDIC examiners are presently managing more than 50 thrifts in the Dallas Region and that total will reach in excess of 80 in the next few weeks.

The FSLIC has contracted with the FDIC to take control of these institutions that are being placed in conservatorship or receivership. That means the FDIC, with the help of other regulators, will oversee operations of the insolvent thrifts. Managements of the various institutions are subject to the regulators' authority. From the customer's perspective, however, the only visible difference will be a few more people in each institution. Day-to-day operations will continue to preserve basic services to deposit and loan customers.

One of the first priorities of these oversight efforts will be to evaluate the losses at each S&L. Another top priority is to identify and stop any abuse, waste, or fraud that may be present. We seek cost reduction and increased liquidity through consolidations, sales of property, and more efficient operations.

While in control of these institutions, we and the other regulators will seek to stop any unsafe or unsound practices. We will limit their growth, and

downsize them through asset liquidations where practical. However, we will avoid firesales of assets and emphasize the need to sell at values that reflect current appraised values.

Finally, we will develop longer-term solutions to these problems. Our staff will recommend different approaches -- from liquidating the institutions to selling them to qualified purchasers. But our current job is a holding action only.

The FDIC has established four task groups to address these responsibilities. These task groups are designed to ensure stable operations in the insolvent thrifts and to evaluate options for permanently resolving their insolvency once funding is approved by Congress.

One of our most important task groups is our new Fraud Squad. As President Bush has said, "unconscionable risk-taking, fraud and outright criminality have also been factors [in the thrift problem]." Investigators assigned to this Fraud Squad will constitute a mobile unit. Whenever our on-site teams discover evidence that fraud or insider abuse may have occurred, the Squad will be sent to conduct a full-scale investigation. This includes looking for ways to get back misappropriated assets when possible, and helping send some to jail when appropriate.

Our three other task groups have separate but complementary assignments.

Our Oversight and Evaluation task group will take control of these institutions, assess their condition and take steps to reduce operating costs where possible.

Our Planning and Restructuring task group will recommend steps to restructure and consolidate institutions where appropriate.

And our Transaction and Acquisition task group will begin the process of seeking out buyers for institutions, real estate and other assets. We will seek to reach agreements with purchasers subject to resources being made available to provide assistance.

The FDIC and the FHLBB have agreed that, until the agencies review the status of the insolvent thrift institutions placed under joint regulatory oversight, only unassisted or cash assistance transactions will be undertaken by the FSLIC. We have no authority to issue notes or enter into income maintenance agreements.

We also must note that these additional responsibilities will place some strain on FDIC resources. As discussed below, we believe that this will not substantially interfere with our responsibilities as a bank regulator. We did not ask for this job, but we are dedicated to succeeding in this new task. We do expect to experience growing pains and recognize our need to climb a learning curve in the process.

FDIC SUPERVISORY PRACTICES AND CAPABILITIES

We now would like to address the FDIC's supervisory capabilities under the current thrift interagency oversight effort and our bank supervisory practices and capabilities.

Interagency Oversight Effort. The FDIC's current principal role under the Bush Reform Plan entails the FDIC's additional responsibilities just discussed as management agent of thrifts that are now RAP insolvent and those to become insolvent before the Bush Reform Plan is enacted. While there is no doubt that this new responsibility will have an impact on FDIC resources, we anticipate that the large call on FDIC personnel will be for a relatively short period of time, perhaps two-to-three months.

During the peak-time period we anticipate the need for approximately 1,200 to 2,000 interagency personnel. Considering that we are receiving substantial assistance from the other federal regulatory agencies and state supervisory agencies, we anticipate that we will have to detail approximately 800 FDIC employees to this task during that peak period. Of these, approximately half, or 400 employees, will be from our examiner force -- namely, the Division of Bank Supervision ("DBS"). The other half will be from the Division of Liquidation ("DOL"). After that peak period, when agency personnel in each institution will be cut back to a minimum, we anticipate that the number of FDIC employees being used will level off at around 400. Since half of those will be from DOL, we expect about 200 of our examiners -- or only about ten percent of our supervisory workforce -- will continue to be detailed to this effort.

During the two-to-three month peak period we have set priorities for our bank examiners to assure that all banks will continue to receive adequate supervision. We believe the FDIC can handle this additional burden for a time, in part because the number of problem banks is decreasing (currently under 1,400 -- down from a peak of 1,624 in 1987), the number of examiners

continues to increase (our goal is 2,200 examiners by year-end 1989), and our examination efficiency is improving. In fact, we have been increasing our examiner force rapidly -- from a low of 1,389 in 1984 to 2,029 at the present time.

While the FDIC does not underestimate the magnitude of the responsibility facing it, we believe we are up to the task. The sooner the Congress acts to restructure the system and provide the necessary funds to resolve these insolvent thrifts, the sooner the resource strain can be alleviated. In the meantime, we will not let our major bank supervision responsibilities slip.

Bank Supervision Practices and Capabilities. The overriding goal of supervision is maintaining a safe-and-sound banking system. On-site examinations have great importance in effective supervision. This process puts the examiner in the best possible position to throughly evaluate the quality of bank assets; estimate the level and trend of earnings; determine whether capital levels are adequate; evaluate liquidity, review for adherence to laws and regulations, analyze internal policy and controls; and evaluate management. Among other things, the examination results in the bank being assigned a composite rating which measures the bank's level of risk: sound and stable institutions are rated 1 or 2 and near problem and problem banks are rated 3, 4 or 5.

Because the FDIC is the only agency directly responsible for maintaining the soundness of the bank insurance fund, protecting insured depositors and handling bank failures, the FDIC has authority to examine all insured banks. However, the FDIC traditionally has relied largely on the OCC and the Federal

Reserve for safety-and-soundness information on national and state member banks, and has limited its examinations of such banks to specific problem institutions. In this regard it is important to note that the FDIC has very limited rule-making or enforcement authority over national and state member banks.

We have discontinued the traditional routine of examining all banks with the same frequency. Instead, we have raised the effectiveness of our supervision by examining problem and near problem banks more frequently.

Last July, the FDIC adopted a new policy for examination priorities and frequency. For safety and soundness examinations, the new policy essentially requires an examination every 24 months for 1- and 2-rated banks and every 12 month for 3-, 4-, and 5-rated banks. These intervals can be extended up to 48 months for 1- and 2-rated banks and 24 months for 3-rated banks providing there is an interim state examination that meets FDIC's needs and our off-site monitoring system confirms the current rating of the bank. Every effort is being made to coordinate examination schedules of all FDIC-supervised institutions with state authorities to take advantage of state resources and to minimize duplication of effort and burden on the institutions. This joint undertaking -- in which we use acceptable examinations conducted by State authority -- is called the Supervisors Annual Flexible Examination ("SAFE") Program. We have found that the SAFE Program -- which was formally initiated last summer -- provides additional flexibility and efficiencies.

In addition to examinations, we also make extensive use of on-site visitations and off-site monitoring programs. Off-site monitoring involves analysis of accurate and timely information from a variety of sources. At present, our

most important source of information for supervisory purposes is the quarterly Call Report. The FDIC's principal off-site monitoring system is called CAEL, an acronym for Capital, Asset quality, Earnings performance and Liquidity. It compares ratios calculated from bank-provided Call Report data to comparable information taken from the last report of examination and to ratios for the bank's peer group. Based on the results of these comparisons, the model computes a rating for each of the four components and compares them to the component ratings assigned at the last examination. A significant difference will trigger appropriate follow-up.

We also recently changed internal procedures so that examiners will not be tied up with lengthy and routine tasks in connection with bank closings. It had been standard practice to dispatch a team of examiners to a failing bank shortly before its demise to compile extensive data pertinent to prospective purchasers. These assignments were frequent, on short notice and disruptive to planned examinations. We were successful in eliminating this problem by establishing routines that enable interested buyers to gather most of the information themselves. Also, DOL has assisted DBS by assuming responsibility for compiling most of the information that may be required in advance of prospective bidders' on-site investigations and taking over the largest part of the manpower requirements when an institution fails.

In anticipation of increased demands on examiners, we increased our staff in the past two years at a pace consistent with the need to properly integrate the new people into the system. Our number of field examiners increased from 1,726 at year-end 1986 to the present number of 2,029.

In 1987 and 1988 we increased our Dallas Regional Office and field examination staff by a net total of 48 and 27 people, respectively, and so far this year have increased examiners by another 22 people. Current plans in Dallas call for hiring approximately 70 additional examiners by the end of this year. We now have 81 people assigned to our regional office and 323 examiners in the field and plan to have a total of 393 by year-end, or about eighteen percent of the FDIC's projected total examination force.

In addition to our regular staff in the Dallas Regional Office, we have relied to a significant degree upon the assistance given by examiners from other FDIC regions. Generally these individuals come to us on temporary assignments of two-to-three months. This has allowed us to deal with problem situations on a more timely and efficient basis with our regularly assigned people who are already familiar with the situations.

CONCLUSION

In conclusion, the banking and S&L problems in the Southwest -- and particularly in Texas -- will continue to place strains on the financial institutions industry, the economy in general and the federal bank and S&L regulators. The FDIC will strive to succeed in continuing its current regulatory and supervisory responsibilities over insured banks and in assuming its new duties over insolvent S&Ls.

I would be pleased, at this time, to answer any questions the Committee may have.

Attachment

Table 1

DISTRIBUTION OF FDIC-INSURED BANK FAILURES*

	1985	1986	1987	1988
Dallas Region:				
Colorado	6	7	13	10
New Mexico	4	2	-	1
Oklahoma	13	17	33	25
Texas	12	26	62	118**
TOTALS	35	52	108	154
All Regions:				
TOTALS	120	145	203	221

*Includes open bank assistance transactions.

**Includes 41 failures and one assistance transaction for banks in the First Republic system.

Table 2

DISTRIBUTION OF FDIC-INSURED PROBLEM BANKS

	12/85	12/86	12/87	9/88	12/88
Dallas Region:					
State nonmember banks	120	233	292	291	288
National and state member banks	195	289	413	440	444
TOTALS	315	522	705	731	732
Colorado	54	81	99	89	91
New Mexico	8	10	17	19	18
Oklahoma	85	128	147	131	121
Texas	168	303	442	492	502
TOTALS	315	522	705	731	732
All Regions:					
TOTALS	1,140	1,484	1,575	1,442	1,406