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FDIC'S INSURANCE FUND GREW IN 1981 DESPITE HEAVY COSTS OF FAILURES

The Federal Deposit Insurance Corporation in 1981 added $1.18 billion to its insurance fund despite heavy costs in assisting the mergers of three large failing mutual savings banks in New York City, FDIC Director Irvine H. Sprague today told members of the District of Columbia Bankers Association.

The fund grew to just over $12 billion by year-end, an all-time high. FDIC's gross income for the year from assessments and interest amounted to $2.14 billion. From this were deducted $965 million for reserves for losses and mutual savings bank costs, insurance and administrative expenses and reduced credits to banks against their 1981 insurance assessments.

Sprague said the 1981 assessment credits payable to banks in July will take a "heavy hit" because of the estimated $747 million cost of assisting the mergers of Greenwich Savings Bank, Central Savings Bank and Union Dime Savings Bank. Under the statutory formula set forth in the FDI Act, 60 percent or $448 million of this amount, will be paid for by the banks in the form of reduced assessment credits. Sprague noted that the cost of deposit payouts, had the three banks been permitted to close, would have been an estimated $1.41 billion and the cost to banks would have been about $846 million.

Sprague said the net result of the 1981 transactions is to cut assessment credits to about $124 million, compared to $521 million for the preceding year and $6.5 billion for the previous 31 years.

The FDIC and the Federal Reserve for two years have repeatedly urged the Congress to approve the "Regulators' Bill" to expand the options for handling failing banks. If enacted, said Sprague, such legislation would reduce costs to the FDIC, reduce assessment costs to the banks and reduce the national debt, since FDIC's fund is included in that computation.

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Speech Text Attached

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FDICs insur fund grew
despite bail-outs

REMARKS OF

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IRVINE H. SPRAGUE

DIRECTOR, FEDERAL DEPOSIT INSURANCE CORPORATION

TO THE

DISTRICT OF COLUMBIA BANKERS ASSOCIATION

STATE ROOM, MAYFLOWER HOTEL

WASHINGTON, D. C.

5:00 p.m.

MONDAY, JANUARY 18, 1982

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Last November, shortly after we arranged the Greenwich Savings Bank merger in New York City, FDIC Chairman Bill Isaac received a very angry letter from a small town banker in the heartland of Nebraska.

He said: "Why don't you quit bailing out these uninsured savings and loans with our money?"

A little later I received another letter from a banker in Illinois. He attached a clipping from the Wall Street Journal headlined: "Greenwich Savings Rescue by FDIC to Cost Banks, Thrifts $280 Million in Premiums." The banker wrote: "Enclosed is another example of the 'good guys' getting kicked in the rear end. Our bank has paid the FDIC assessments each year since the inception of the FDIC."

The letters show a lack of knowledge about our responsibility as insurer of the nation's banks, but the bankers were right in saying that they and the rest of you are going to take a heavy hit in the assessment credit this year.

Our failed and failing bank actions in 1981, especially involving New York mutual savings banks, were very expensive, and banks are going to find their 1982 assessment credits cut by almost 80 percent because of it. Where in 1981 there were $521 million in credits, in 1982 there will be an estimated $124 million. (The precise figure will be computed this spring when the books are closed.)

We faced a major challenge in 1981, certainly the most significant challenge in the Corporation's history. We weathered it well. As we enter the new year, our system is intact, our insurance fund is sound, and we are prepared for the future. We have no intention to request changes in the law to increase assessments.

It may be a down-side year for the assessment credit in 1982, but we need to look at it in context. It comes after banks have benefited from 31 uninterrupted years of large assessment credits that have totaled $6.5 billion.

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What is happening is that our deposit insurance system is working exactly as it is intended to work under law. I'm going to go into that in detail in just a few minutes.

I mentioned some of our mail. I believe I can say that D.C. bankers are more sophisticated. You know the difference between a savings bank and a savings and loan. You know that FDIC does not protect uninsured institutions. You know that we have collected the insurance payments and thus have an absolute obligation to the depositors of failed institutions.

But the letters I cited, and others, indicated a general lack of awareness of how we operate -- how the law requires that we operate. I'll attempt today to fill that gap from my experience. (I personally have been involved in FDIC activities related to 51 bank failures plus seven cases of assistance to avert a failure during my two terms on the FDIC Board, dating back to 1968.)

Usually, we have ten or a dozen failures a year, mostly smaller commercial banks, and mostly due to bad or greedy management. In 1981, the number was ten, if we include the assisted mergers of three big savings banks in New York, due primarily to the interest rate squeeze. To date in 1982, we have had one assisted merger, also a New York mutual savings bank.

A bank failure is a sad and traumatic happening -- no matter how well the transaction is done. I have witnessed long lines of customers waiting for hours for their deposit payoff checks in the searing summer heat of Texas and in the freezing winter rain and snow of Illinois.

The recent savings banks failures are particularly troublesome. Groups of working class citizens banded together to help each other by forming these institutions early in the last century when the existing banks would not

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serve them. They have done the job for more than 150 years and survived the Civil War and the Great Depression, only to succumb to relentless inflation and interest rate pressures of the current recession.

As banks grow larger, those that fail are larger too. The ten largest occurred in the past 10 years, four of them in the past 10 weeks. Following is the list of the 10 largest institutions by asset size that were in imminent danger of failing and were provided either capital or merger assistance to forestall a closing:

	YEAR	BANK	ASSET SIZE	ASSISTANCE
(1)	1980	First Pennsylvania	$ 8.4 billion	Capital Note
(2)	1974	Franklin National	3.6 billion	Assisted Merger
(3)	1981	Greenwich Savings	2.5 billion	Assisted Merger
(4)	1981	Union Dime Savings	1.4 billion	Assisted Merger
(5)	1973	United States National	1.3 billion	Assisted Merger
(6)	1972	Bank of the Commonwealth	1.3 billion	Capital Note
(7)	1982	Western Savings	1.0 billion	Assisted Merger
(8)	1981	Central Savings	900 million	Assisted Merger
(9)	1978	Banco Credito y Ahorro	712 million	Assisted Merger
(10)	1976	Hamilton National	412 million	Assisted Merger

The assistance we rendered in 1981 was by far the most expensive in FDIC history. During the first 47 years of FDIC operations, we suffered losses totaling $301 million in 568 bank failures. In the last eight weeks of 1981, our estimated losses totaled $747 million for three savings banks in New York City alone. Between November 4 and December 18, three mutual savings banks -- Greenwich, which had assets of $2.5 billion; Central, with assets of $900 million; and Union Dime, with assets of $1.4 billion -- were merged out of existence.

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(I am not here today to tell you it is over. Last Friday the first action of 1982 was recorded as we assisted the merger of the $1 billion Western Savings Bank of Buffalo, New York into the $4.5 billion Buffalo Savings Bank at a cost to the FDIC of $30 million. There may well be more.)

Even with the extraordinary expenses of 1981, we ended the year with over $1 billion more in our fund than we started with last January. The January 1, 1982, total was just over $12 billion. During 1981 we had almost $1.04 billion in gross income from assessments and $1.10 billion in interest on our portfolio, providing gross income of $2.14 billion. From this we had deductions for reserves for losses and mutual savings bank expenses, insurance expenses and administrative operating expenses and the assessment credit -- a total of $965 million -- for a net gain to the insurance fund of about $1.18 billion.

We do not trigger FDIC assistance. For example, look at the four New York mergers. In each instance, the State Supervisor advised us the institution was in danger of failing and the trustees passed a formal resolution asking us to act.

Once we receive such a request from either the State Superintendent or the institution, or both, the FDIC takes full control, making the decision on how to proceed and under what conditions. The other regulators -- the Federal Reserve Board, Comptroller of the Currency, the State, the Federal Home Loan Bank Board -- are consulted fully during the process but the responsibility is ours and the decisions are ours.

With that general introduction, I'll give you specifics about our recent experience. First, let's take a look at what we accomplished.

Our actions in the New York situation, given the severe restraints of existing state and federal law, have been remarkably effective. Four major mutual savings banks, in effect, failed within the last ten weeks; all were

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merged promptly into other mutual savings banks, causing not a ripple among the general public. No depositor lost a penny. No customer was inconvenienced. None of the involved institutions missed a single banking day. And our insurance fund is growing stronger.

While the expenses have been considerable, they are substantially less than what the FDIC would have been required to pay if the banks had been allowed to fail outright and we had gone to a deposit payoff, i.e., issuing individual checks to 925,000 insured depositors in the four institutions. Combined estimated costs of payoffs of the four institutions were $1.6 billion, of which 60% or $960 million would have been charged to the banks' assessment credit. Our estimated cost of the four assistance packages is $777 million, of which 60% or $466 million will be paid for by the banks in the form of reduced assessment credits.

Let me give you examples of how the FDIC assessment mechanism works and how it adjusts each year for our loss and recovery experience. It is important to note that this mechanism is prescribed by law. The formula for computing the assessment credit is set forth in the Federal Deposit Insurance Act. It is not FDIC fiat or regulation or option. It might be helpful to walk you through it with two recent examples, since the large assessment credit you have come to expect each July will be materially smaller this year, and it may well be some years before it returns to its former levels.

In 1980, we earned $952 million in gross assessments from banks. In that year, 10 banks failed, and we estimated FDIC losses from these failures at $21 million. We also reviewed our existing reserves for the 85 other bank liquidations from previous years and revised them downward by $59 million,

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which, when netted with our current-year estimate of losses, gave us a negative $38 million -- in effect, a reduction in our reserves for losses. This reduction subtracted from $118 million in administrative operating expenses and $3 million in nonrecoverable insurance expenses results in an $83 million total -- which is the amount under law to be deducted from gross assessment income before we compute the net assessment income credit to banks.

The credit itself is a simple computation based on net assessment income, which for 1980, was $869 million after taking the $83-million deduction from the $952 gross assessment. The law, as revised in 1980, requires that 40 percent of net assessment income be transferred to our insurance fund. The remaining 60 percent -- amounting to $521 million -- was made available to banks July 1, 1981, as their net assessment income credit.

Now I'll go through the process again, this time for 1981. It is the same process, but the results are different.

In 1981 we collected $1.04 billion in gross assessments, the highest in the Corporation's history. During 1981, 7 banks failed and we estimated losses to the FDIC at $8 million. Also during 1981, the FDIC assisted in the mergers of three New York mutuals with estimated losses of $747 million. We again reviewed our existing reserves for banks closed in prior years and adjusted them downward by $52 million. These computations result in an increase of $703 million in our reserve for loss. This figure, when added to administrative operating expense estimated at $128 million and nonrecoverable insurance expense estimated at $3 million, equals $834 million. This is the amount to be deducted from gross assessment income to arrive at net assessment income of about $206 million, of which 60% or an estimated $124 million will be returned to banks as the assessment credit in July 1982.

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> Nonrecoverable insurance expenses include certain salaries, travel and subsistence, outside attorneys' fees and other expenses connected with bank closings, including the paying off of depositors or the arranging of a purchase and assumption transaction. These expenses are incurred within a few days of the closing and are charged to the Corporation as a whole; thereafter, such expenses are charged to the individual liquidation. Nonrecoverable insurance expenses also may include Corporation purchases of assets of failed or failing banks.
>
> The administrative operating expenses constitute the annual budget for the FDIC and have been held in tight control by a rigorous budgeting process and year-round monitoring. We have about 3,300 employees, some 350 fewer than three years ago, but we are taking on a substantially greater burden. During the past three years, the FDIC budget increased at a rate of less than half of the increased cost of the Federal government as a whole.

Our system works very much like a good mutual insurance program. The insurer collects premiums from everyone, and at the end of an operating period deducts for its expenses, insurance losses, and reserves. Any excess is returned to policyholders in the form of lower premiums the next year. Or, conversely, any extraordinary loss is recouped through higher premiums the next year.

The authority of the FDIC to assess banks to pay for their federal deposit insurance is prescribed in the Federal Reserve Act of 1933. The Act sets the assessment rate at 1/12th of one percent of banks' domestic deposits.

The assessment credit was established by the Federal Deposit Insurance Act of 1950. Our annual report for that year noted: "The new law retains the previous assessment rate of 1/12th of one percent of deposits per year, but provides credits to insured banks in years in which the Corporation's assessment income exceeds its losses and expenses."

Originally, the credit was 60 percent of net assessment income. In 1960 Congress increased the banks' share of the assessment credit to 66 and two-thirds percent of net assessment income.

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The ratio was changed back to 60 percent by a provision of the Depository Institutions Deregulation and Monetary Control Act of 1980. That change was designed to compensate in part for the increased liability caused by another provision of the same Act that raised the insurance limit to $100,000 from $40,000.

The effect of the assessment credit over previous years has been to cut the assessment rate by more than half -- to an average of about 45 percent of the basic 1/12th of one percent rate. In the past 20 years, banks have been paying at effective rates running between 1/23rd and 1/32nd of one percent. The highest rate of 1/23rd of one percent in 1975 came in the wake of the failure of United States National Bank in San Diego.

For 1982, the rate is going up to about 1/14th of one percent, which is about 85 percent of the basic rate. This is still slightly lower than the basic rate for the Federal Savings and Loan Insurance Corporation (1/12th of one percent), which has no provision for assessment credits for savings and loan associations. The Credit Union Administration Share Insurance Fund also operates on a 1/12th of one percent assessment.

Should our actual liquidation experience show that our 1981 estimate of losses was high, banks would share proportionately in any credit refunds through the assessment credit mechanism in future years. That was what happened in 1979 and 1980.

In those two years the amounts of insurance losses and expenses were deficit figures. That is to say, they were not losses at all, but reductions of $13 million in 1979 and $35 million in 1980 from prior years estimated losses. Both instances are directly attributable to the liquidation of United States National

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Bank which failed in 1973. The real estate market in California was booming and inflation had increased values. Our recoveries in those years substantially exceeded our earlier estimates. We further increased our recovery through a substantial bond claim. In the initial years, our reserve for losses from USNB was as high as $162 million; over the years that has been reduced to $53 million at present. The USNB situation has been unusual. We do not expect further such large reductions in the insurance loss account. However, should the interest rate scenario turn favorable, our expected losses on the four recent savings banks assisted mergers could be smaller. Conversely, rising interest rates would increase our losses. We will make adjustments every six months, based on appraisals or sales of property previously acquired and our actual experience with recent assistance packages.

There is in the law an automatic device to reduce the net assessment income credit below 60 percent under certain circumstances. The 1980 Act, besides establishing the 60-percent figure, also provides that the FDIC board must reduce that percentage to compensate whenever the ratio of insurance fund to insured deposits dips below 1.10 percent. However, the Board cannot reduce the banks' share to less than 50 percent. The law permits the FDIC Board to increase the banks' share whenever the ratio exceeds 1.25 percent. The law mandates an increase when the ratio exceeds 1.40 percent. At present, the ratio stands at a comfortable 1.19 percent.

Whether insurance losses arise through bank failure, assisted merger or other causes, such losses are treated alike for the purpose of calculating net assessment income. That means that insurance losses for any reason are reflected in the amount of your assessment credit.

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In very limited circumstances, we can pursue a course of assistance through loans or capital infusions that are not reflected as insurance losses and that therefore do not reduce your assessment credit. Three examples still outstanding are First Pennsylvania Bank, Bank of the Commonwealth, and Unity Bank and Trust Company. In each instance the bank was found to be "essential" to its community. (We have used this authority just five times.)

In the case of First Pennsy, the FDIC, in 1980, put together a $500-million joint loan program with $175 million provided by other banks. The FDIC share of the assistance, a $325-million loan, had no effect on your assessment credit because it is carried on our books as a loan and not as an insurance loss. The Commonwealth (1972) and Unity (1971) transactions were similar, but much smaller. Should these loans not be repaid, or if they are restructured adversely to the FDIC, any loss would be reflected in the assessment credit.

What I have been describing is the financial system crafted in the law to permit the FDIC to do its job of providing assistance to failed and failing banks as an alternative to the expensive and disruptive payoff procedure. This assistance is far from the "bail out" that my letter writer called it, particularly in the case of the four big New York mutuals. There were no stockholders to benefit and the top officers and trustees resigned.

As you know, we have asked for the past two years for a "Regulators Bill" to expand our options with failing banks, reduce cost to the FDIC, reduce assessment costs to the banks, and reduce the national debt, since our fund is included in that computation. The legislation has not been enacted, although the House did pass an amended version. To date we have limited our assistance packages to institutions of the same kind in the same state. We are now exploring other

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options under existing law with the cooperation of the Federal Reserve Board and the Federal Home Loan Bank Board. It may be possible to make substantial savings by merging failed or failing institutions into out-of-state bank or savings and loan holding companies. We are aggressively working on this possibility. If necessary, we later may even look at mergers into other financial related institutions. We are exploring all options. We know that it is our responsibility to maintain public confidence by preserving the FDIC fund and to seek less costly alternatives than we have found to date. This we intend to do. We would prefer policy direction from the Congress, but we can wait no longer.

The mechanics of our fund computations may seem complicated. But the message is clear. We are all in this together. Banks large and small in every section of the country have a financial interest in FDIC assistance operations.

We have come through 1981 well. We expect the challenge to continue in 1982, and we are confident that we will continue to meet it.

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