Oral Statement
of
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Committee on Banking and Financial Services
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Mr. Chairman, Congressman Gonzalez and members of the Committee, thank you for the opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on recent developments in consumer lending.

My written testimony provides a detailed discussion of trends in consumer credit for FDIC-insured institutions -- commercial banks and savings institutions -- which hold more than one-third of all consumer loans -- or about $1.7 trillion of the $4.8 trillion in consumer credit outstanding.

In the interest of time, I will submit my written testimony for the record, and this morning will discuss a few important points.

Today we are witnessing a period of unprecedented prosperity for commercial banks and savings institutions. In the last four years, commercial bank profits have reached the highest levels in the 63-year history of the FDIC; capital-to-asset ratios are higher than at any time since 1941; and overall asset quality is the best it has been in the fifteen years that we have been tracking it. If the banking industry maintains the pace of the first half of 1996 in the second half of the year, it will earn more than $50 billion -- a record for annual earnings.

Savings associations also are experiencing historically high earnings. Despite this good news in the earnings, the Savings Association Insurance Fund (SAIF) remains structurally unsound. The SAIF is significantly undercapitalized. Nearly half of its assessments are diverted to pay interest on Financing Corporation (FICO) bonds and so are unavailable to build the fund, and the continued disparity in insurance rates between institutions that are members of the SAIF and those that are members of the Bank Insurance Fund (BIF) threatens to destabilize the SAIF and its membership.

For almost two years, the Congress, the Administration, and the bank regulators have been working on legislation to address the problems of the SAIF. I appreciate the attention that this Committee has given to this very important issue. In the brief time remaining this year, I urge

Congress to adopt a legislative package that would capitalize the SAIF and establish a lasting solution through the merger of the BIF and the SAIF.

Today's hearing is on consumer lending, which historically has been profitable for insured depository institutions. It remains so today for the vast majority of institutions.

Concerns have arisen, however, regarding the quality of credit card loans. As this chart shows (Exhibit 2), FDIC-insured institutions hold $219 billion in credit card loans -- about 13 percent of their combined consumer loan portfolio.

We are closely monitoring industry trends, as well as the performance of credit card and other consumer loan portfolios at individual institutions, for four reasons: one, rising losses in the credit card industry; two, a significant increase in burden of consumer debt; three, record rates of personal bankruptcies; and, four, the concentrated nature of the bank credit card business.

The loss rate for credit card loans has been rising. As we reported yesterday, for commercial banks, the annualized net charge-off rate on credit-card loans hit 4.48 percent in the second quarter of this year, its highest level since the fourth quarter of 1992. By comparison, the charge-off rates for bank real estate and commercial and industrial loans were around a quarter of a percent or lower, annualized.

Even so, credit card lending is currently highly profitable. As this chart (Exhibit 15) makes clear, banks that specialize in credit card lending had an almost 2 percent return on assets (ROA) in the second quarter of this year, compared to the 1.22 percent average ROA for all insured institutions. Moreover, in earlier quarters over the past few years, credit card specialty banks reported about four times the return on assets that all insured institutions reported. Traditionally, high average yields and margins have more than compensated for relatively high loan-loss rates on credit card loans.

High yields on credit card loans in fact have spurred institutions to expand lines of credit for credit cards greatly in recent years. This chart (Exhibit 12) shows the large growth in credit card loans at commercial banks. The growth of unused credit commitments -- that is, lines of credit not drawn upon by consumers -- has been particularly large. These commitments grew from $518 billion as of June 30, 1992 to $1.2 trillion at the end of the first quarter of 1996.

The overall consumer debt burden has been growing dramatically. As this chart (Exhibit 16) shows, the ratio of consumer debt to income is at an all time high of 83 percent. Moreover, debt service payments in the aggregate nationwide as a percentage of total personal disposable income are at their second highest level since 1975 -- 16.7 percent -- and are approaching the

historical high of 17.6 percent registered in the fourth quarter of 1989. These trends are of concern because they suggest that American consumers may have less flexibility in terms of liquidity for dealing with outstanding debt during a recessionary period.

I should note that it is not unusual for consumer delinquency and charge-off rates on credit cards to rise during an economic expansion. During the last economic expansion, from 1985 to 1989, consumer delinquency and charge-off rates also rose. Consumer debt rises when employment rises, since household are more willing to incur debt and banks are more willing to lend. Another recession, however, would exacerbate the increases in credit card losses and personal bankruptcies.

The third reason we are taking a close look at bank and thrift consumer lending is the growing number of personal bankruptcies, which has also been increasing during the general economic expansion. As this chart (Exhibit 5) illustrates, bankruptcy filings and credit card losses have risen significantly in the last five quarters, and indeed show a striking correlation over time. For the first time, annual personal bankruptcy filings are expected to exceed one million during this year. In fact, during the twelve months ending in June, almost a million -- 989,000 -- personal bankruptcies were filed, a record for any twelve month period.

The increase in personal bankruptcies is troubling for three reasons: One, some analysts estimate that personal bankruptcies now account for 40-to-50 percent of losses in bank card lending. Two, models used by credit card banks to predict risk may not predict bankruptcies well because they do not predict a borrower's ability to avoid bankruptcy when catastrophe strikes. Three, the average period of credit card delinquency before bankruptcy is decreasing, suggesting that the load of debt leads consumers to go straight to bankruptcy when they get into financial trouble.

Structural changes such as the rise in debt burden and the rise in personal bankruptcies -- as well as others discussed in detail in my written testimony -- are worth examining for their potential impact on delinquency and charge-off rates for credit card loans.

The fourth and last reason we are looking at consumer lending more closely is that credit card lending is highly concentrated in relatively few institutions. Almost two-thirds (65.5 percent) of all credit card loans outstanding at FDIC-insured institutions are held by 77 banks that specialize in credit card lending.

A number of factors suggest that, overall, credit card banks do not currently pose a threat to the deposit insurance funds. Credit card lending risks are normally more diversified than the lending risks that have led to losses to the deposit insurance funds, such as commercial real estate lending risks. Moreover, credit card lenders traditionally have been able to manage exposures through pricing, adjusting credit limits and other terms, or changing other marketing

practices. Anecdotal evidence also suggests that credit card lenders are responding to rising credit card delinquencies.

What is true of the credit card industry on average, however, may not be true for particular institutions. The FDIC's losses at any given time are determined not by the average performance of the industry, but by the performance of individual banks and thrifts, and individual institutions could encounter problems in the future. The FDIC is closely following their condition and performance through special quarterly reporting, examinations, and other supervisory initiatives in this area.

In conclusion, the banking industry is in strong financial condition. Consumer lending does not pose a significant risk to the deposit insurance funds at this time, but there are a few dark spots in a generally very bright picture that merit continued monitoring.

Thank you, Chairman Leach, Congressman Gonzalez and members of the Committee. I look forward to your questions.

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