FDIC NEWS RELEASE

FEDERAL DEPOSIT INSURANCE CORPORATION

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Statement on

THE POTENTIAL IMPACT OF A NYC DEFAULT ON NONMEMBER BANKS

Submitted to the

Committee on Banking, Housing and Urban Affairs
United States Senate

by

Frank Wille, Chairman
Federal Deposit Insurance Corporation

October 18, 1975

The Federal Deposit Insurance Corporation is pleased to contribute certain factual information about the potential impact on the banking system of a New York City default to the Committee's deliberations on various bills to provide financial assistance to municipalities and/or States and their agencies in distress.

At the outset, I should note that the FDIC surveys have been limited to the nation's 8,889 nonmember banks which the FDIC examines on a regular basis, i.e. those insured banks, including mutual savings banks, which do not belong to the Federal Reserve System. An accurate overall view of the the banking system's exposure must, therefore, include an aggregation of the information developed by the Comptroller of the Currency and the Federal Reserve System for member banks in addition to the FDIC's results for nonmember banks.

Secondly, the FDIC has sought to obtain factual information as to the holdings of various types of State and local obligations by nonmember banks and then to apply a variety of market assumptions to that information in order to quantify the full range of possible impact on nonmember banks which might be caused by a New York City default. The FDIC has no background of expertise, however, with which to evaluate likely market reactions in the event of a New York City default, and must therefore caution the Committee that its estimates of impact on nonmember banks are only as good as the assumptions on which they are based.

Any prediction as to impact requires two basic assumptions to be made. One relates to the extent market values of State and local government obligations, particularly those issued by New York City, will drop if a default occurs, and the other relates to whether or not issuers of State and local obligations other than New York City will also be forced to default because market developments make it impossible for them to roll over existing debt in a timely manner. The various market assumptions FDIC has made in preparing its estimates are clearly expressed later in this Statement and are obviously fundamental to the FDIC's predictions.

Thirdly, the FDIC has viewed the potential effects on the banking system to be serious enough to warrant contingency planning on a joint basis with the other bank regulatory agencies in three areas which relate to the safety and solvency of individual institutions: (i) the examination treatment of defaulted obligations held by an insured bank, (ii) the liquidity needs of particular banks whose holdings of affected State and local obligations may result in adverse depositor reaction, and (iii) the capital needs of particular banks which suffer a loss of public confidence because of such holdings. I am sure that all of us who are here today from the three Federal bank agencies would be glad to respond to any questions members of the Committee may have concerning these contingency plans.

The FDIC surveys of nonmember bank holdings of selected State and local obligations have been conducted in three stages. The first effort, which began in late July, was a review of the most recent FDIC examination workpapers for a selected sample of approximately 540 nonmember commercial banks, including all of the 44 nonmember commercial banks located in New York State, in order to estimate the relative percentages which each bank's holdings of New York City and New York State Housing Finance Agency obligations bore to that bank's total capital and reserves. The sample of nonmember banks used in this initial survey (other than those in New York State) consisted of those nonmember banks which had been supplying weekly money supply data during a recent ten-month period ending in May, the purpose of which was to assist the Federal Reserve System to estimate more accurately the nonmember component of the nation's money supply. For that purpose, the sample had been reasonably representative of all nonmember banks in the country, but we recognized that its use for estimating nonmember holdings of the two types of issues in question might not produce estimates with the same degree of reliability. In addition, the data derived would reflect different dates of examination, some of them more than six months before. Nonetheless, this type of survey was manageable in numbers and could be made without undue publicity at a delicate time for New York City and the Municipal Assistance Corporation in their refinancing efforts. This survey, which we recognized would result in a rough approximation only, of the holdings of the nation's 8,559 nonmember commercial banks, showed the following:

-- In New York State, there were only 8 nonmember banks, smaller than $100 million in total deposits, which held New York City obligations representing 25% or more of total capital and reserves, and only one nonmember over $100 million in deposit size with a comparable exposure.

-- In New York State, if holdings of New York State Housing Finance Agency obligations were added to those of New York City, there were only 12 nonmember banks, smaller than $100 million total deposits, which had 25% or more of their total capital and reserves exposed, and only 4 nonmember banks over $100 million in deposit size similarly exposed.

-- In New York State, less than one-third of the nonmember banks appeared to have capital exposures between 10% and 25%, based on their holdings of similar obligations.

-- Nationwide, it appeared that approximately two and a half percent of all nonmember banks below $100 million in deposit size would have holdings of New York City obligations in excess of 25% or more of their total capital and reserves, while only about 1% of the nonmember banks larger than that would be similarly exposed. If New York State Housing Finance Agency obligations were added to their holdings of New York City obligations, about three and one-half percent of the nonmember banks in both size categories appeared to be similarly exposed.

The FDIC moved to the second stage of its fact-finding in late August when it appeared that the marketing difficulties of the Municipal Assistance Corporation made a New York City default sometime in September or October a more immediate prospect than it had been up to that point in time. On August 25, I asked each of the nation's 8,889 nonmember banks -- including the 330 FDIC-insured mutual savings banks -- to report to the FDIC within ten days of receipt its holdings of New York City bonds and notes as of any convenient date in August 1975. This survey, although limited to New York City obligations, had the two advantages of reflecting current information as well as the holdings of all nonmember banks. The form of this survey, together with my transmittal letters, are attached as Exhibits A and B to this statement. New York City notes were to be reported separately from bonds and the maturity schedules for both were to be reflected. Such detail was requested only of nonmember banks with more than 20% of their total net worth exposed (i.e. about 1.5% of total assets for the typical nonmember bank) --- the 20% figure reflecting an interagency judgment that most banks below that cutoff would probably not experience significant adverse consequences if New York City were to default.

By early October, the reports of 8,606 nonmember banks had been received -- about a 97% response. Of the 8,606 reporting banks, 271 indicated holdings of New York City obligations as of August 1975 amounting to 20% or more of their total net worth. Their holdings of such obligations approximated only $265 million of New York City's total outstanding debt, and was distributed as follows:

New York City Obligations
(dollar amounts in thousands)

	Number of Banks	Notes	Bonds	Total
Current book value as % of Net Worth:				
20% to 30%	125	$24,550	$53,325	$77,875
30% to 40%	54	3,120	22,223	25,343
40% to 50%	36	5,837	18,357	24,094
50% to 70%	36	19,007	16,589	35,596
Over 70%	20	69,101	32,629	101,730
	271	$121,615	$143,123	$264,638

The 271 nonmember banks reflected in the above table were located in 34 States, with ten or more located in Alabama, Arkansas, Florida, Illinois, Louisiana, Missouri, New York, Tennessee and Texas. The 56 nonmember banks reporting the largest concentrations of New York City obligations, i.e. 50% or more of their net worth, were located in 18 States, with only 5 States having 4 or more such nonmembers (Arkansas, Florida, Illinois, Missouri and New York).

The size distribution of these 271 banks was as follows, with all but 5 of them below $100 million in total deposits (as of June 30, 1975):

Holdings of New York City Obligations, by Size of Bank

Deposit Size (millions)	Insured Banks Having NYC Obligations as Percent of Capital and Reserves of: 20-50%	50-70%	Over 70%	Totals
Less than $1.	-	-	-	-
1 - 2	2	-	-	2
2 - 5	27	5	4	36
5 - 10	66	18	2	86
10 - 25	76	7	8	91
25 - 50	29	3	2	34
50 - 100	12	2	3	17
100 - 500	2	1	1	4
$500 - $1,000	1	-	-	1
Over $1 billion	-	-	-	0
Totals	215	36	20	271

The largest bank reflected on the above list was a mutual savings bank headquartered in New York City which had total holdings of New York City obligations equal to less than 30% of its net worth. The two banks in the $100-$500 million category having 50% or more of their net worth exposed were actually in the $200 - $300 million size range and both were headquartered in New York State.

With respect to the 56 nonmember banks which reported August holdings of NYC obligations equal to 50% or more of their net worth, a bank-by-bank review by the FDIC's Division of Bank Supervision revealed that the seriousness of their exposure was considerably less than the numbers alone might suggest. A good number were exceptionally well capitalized, so that even a 50% mark-down in the value of their NYC holdings in the event of a default would still leave them with a healthy and respectable capital to assets ratio. Others were members of large multibank holding companies or had access to obvious sources of additional capital, so that any significant write-down of their New York City obligations because of a New York City default would not necessarily lead to supervisory concern. Many of the 56 were thought to be so conservatively managed, with such a low level of classified assets, that a significant write-down of capital because of a New York City default would similarly not lead to supervisory concern. A few held NYC obligations maturing in the last few months of 1975 so that any successful refinancing by New York City or the Municipal Assistance Corporation would remove them from the list altogether. Only one of the 56 banks was on the FDIC's current problem bank list.

Taking all of these ameliorating factors into account, the FDIC reached the conclusion that *if* default were limited to New York City obligations and *if* the capital losses involved were limited to 50% of each bank's book value for such obligations, less than half of these 56 nonmember banks would be cause for supervisory concern, and as to those the consequences would not be immediate since the bank agencies were prepared to postpone any requirement for a write-down of these obligations for several months while market conditions stabilized and the political authorities involved had an opportunity to remedy the default.

While this conclusion was reassuring, given the assumptions made, as to the impact of a New York City default on the nation's 8,889 nonmember banks, our factual analysis had not yet taken fully into account the potential impact of a greater write-down in value than 50% or the additional complications of possible default by issuers of State and local obligations other than New York City. To develop this information, FDIC examiners during the past two weeks have obtained from those nonmember banks we thought most likely to be exposed to adverse market developments detailed information as to their holdings of State and local obligations other than New York City bonds and notes, including maturity distributions and issue by issue information for agency issuers like the New York State Housing Finance Agency which finance many different categories of construction through separate financing programs. The nonmember banks covered in this third stage of the FDIC fact-finding effort consisted of the 271 banks whose holdings of New York City obligations in August exceeded 20% or more of their net worth, all 245 nonmember banks with total assets in excess of $100 million as of June 30, 1975, the 200 nonmember banks which reported the largest percentage of asset holdings in State and local obligations as of June 30, 1975, and all nonmember banks on the current FDIC "problem bank" list.

This further review revealed that approximately 305 nonmember banks hold New York State, New York State agency and New York City obligations amounting in the aggregate to 20% or more of their net worth. The par value of such holdings totalled slightly over $560 million of the outstanding debt of all three types of issues,*/ and were distributed among these banks as follows:

*/ These figures include the 271 banks, referred to on Page 5 of this Statement, which held New York City obligations in August of $265 million, after minor adjustments for survey errors and retirements of New York City obligations during September were made.

New York State, New York State agency and New York City Obligations
(dollar amounts in thousands)

Current book Value as % of Net Worth	Number of Banks	NYS	NYS Agency	City	Total
20% to 30%	97	$11,808	$ 38,630	$ 44,127	$ 94,565
30% to 40%	79	29,780	74,160	67,729	171,669
40% to 50%	41	6,571	22,478	25,730	54,779
50% to 70%	43	4,660	14,215	30,924	49,799
Over 70%	45	31,925	63,938	93,798	189,661
Total	305	$84,744	$213,421	$262,308	$560,473

The 305 nonmember banks reflected in the above table are located in 40 States, with 10 or more located in Alabama, Arkansas, Florida, Illinois, Louisiana, Mississippi, Missouri, New York, Tennessee and Texas.

The FDIC's Division of Bank Supervision has conducted a review of the financial circumstances in which each one of these 305 banks might find themselves under the most adverse market circumstances we believe should be hypothesized at this point in time: namely, (i) that a default by New York City would be followed by a default on the part of all New York State agency issuers and by New York State itself, and (ii) that the book value of all outstanding obligations of each of these issuers would be eroded in the market not merely by 50%, but by 75%. Applying these extreme assumptions, it is our considered view that 64 of these 305 nonmember banks would be in need of additional capital, but that approximately 35 of the 64 are likely to have available to them sources of private capital. This means that approximately 30 nonmember banks would be the subject of intensive supervisory concern

(8 of them are already on the current FDIC problem bank list for other reasons) and might be in need of temporary capital assistance from the FDIC in accordance with our interagency contingency planning.

To summarize the results of our findings to date on the potential impact of a New York City default on the nation's 8,889 nonmember banks, the FDIC believes that significantly less than 30 nonmember banks would present serious cause for supervisory concern if only New York City defaulted and if the loss in the market value of its outstanding obligations did not exceed 50% of their face amount, but that the number of such nonmember banks which would be in serious trouble (i) if the default extended to New York State and New York State agency obligations and (ii) if the market eroded 75% of the par value of their outstanding issues would probably not exceed 30.

Obviously, the potential impact on nonmember banks could become significantly more serious if other municipalities besides New York City were forced to default because of general turbulence in the markets for State and local obligations. However, I am encouraged by the October 10 Congressional Budget Office staff study on New York City's Fiscal Problem to believe that any such default would most likely be temporary and might not, therefore, involve the banks of this country in any mandatory write-down of obligations issued by such municipalities.

EXHIBIT A

FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF THE CHAIRMAN

BL-20(c)
August 25, 1975

TO THE CHIEF EXECUTIVE OFFICER OF THE BANK ADDRESSED:

Subject: **Holdings of New York City Obligations**

The FDIC would appreciate your assistance in developing accurate and current information of the extent of nonmember bank holdings of bonds and notes of the City of New York, so that in conjunction with information supplied by the Comptroller of the Currency and the Federal Reserve System for member banks the exposure of all insured banks in the event of a default by New York City may be known. This information is being developed as a precautionary measure, and should not be construed as any indication that the Federal bank agencies are either expecting or predicting such a default. The survey, moreover, is being undertaken to confirm our preliminary estimate, based largely on a sampling of 1974 reports of examination, that only a limited number of nonmember banks has any significant amount of New York City obligations.

Please complete and return the form on the reverse side of this memorandum within ten days of receipt, furnishing information as to your bank's holdings of such obligations as of any convenient date in August 1975. A simple checkmark in the space provided will suffice if your bank's aggregate holdings of New York City obligations are less than 20% of the bank's total capital and reserves. If your bank's holdings are 20% or more of total capital and reserves, please fill in the more detailed information requested.

Frank Wille

Frank Wille
Chairman

FEDERAL DEPOSIT INSURANCE CORPORATION

SPECIAL SURVEY OF NEW YORK CITY OBLIGATIONS

INSTRUCTIONS: Complete all applicable items below and return within 10 days to **Director of Research, Room 3008 G, Federal Deposit Insurance Corporation, Washington, D.C. 20429.** *Report obligations of New York City* **only.** *Do not include obligations of New York State or any of its agencies or obligations of the Municipal Assistance Corporation.*

ITEM 1. If current book value holdings of New York City issues are less than 20 percent of the bank's total capital and reserves as of June 30, 1975, check the block at right and return the form in the enclosed envelope. ☐

ITEM 2. If current book value holdings of New York City issues are 20 percent or more of the bank's total capital and reserves as of June 30, 1975, complete **A** and **B** below.

A. BOOK VALUE OF HOLDINGS BY MATURITY

Express figures in thousands of dollars as of any convenient day in August. **Enter date in block at right.**

DATE (As of) August , 1975

DESCRIPTION	MATURITY PERIOD							TOTAL
	1975	Jan. - June 1976	July - Dec. 1976	1977 - 1979	1980 - 1985	1986 - 1995	After 1995	
Notes								
Bonds								
TOTAL								

B. Total Capital and Reserves as of June 30, 1975	NAME AND BUSINESS PHONE NUMBER OF PERSON FILLING IN REPORT
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EXHIBIT B

FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF THE CHAIRMAN

BL-20(m)
August 25, 1975

TO THE CHIEF EXECUTIVE OFFICER OF THE MUTUAL SAVINGS BANK ADDRESSED:

Subject: Holdings of New York City Obligations

The FDIC would appreciate your assistance in developing accurate and current information of the extent of nonmember bank holdings of bonds and notes of the City of New York, so that in conjunction with information supplied by the Comptroller of the Currency and the Federal Reserve System for member banks the exposure of all insured banks in the event of a default by New York City may be known. This information is being developed as a precautionary measure, and should not be construed as any indication that the Federal bank agencies are either expecting or predicting such a default. The survey, moreover, is being undertaken to confirm our preliminary estimate, based largely on a sampling of 1974 reports of examination, that only a limited number of nonmember banks has any significant amount of New York City obligations.

Please complete and return the form on the reverse side of this memorandum within ten days of receipt, furnishing information as to your bank's holdings of such obligations as of any convenient date in August 1975. A simple checkmark in the space provided will suffice if your bank's aggregate holdings of New York City obligations are less than 20% of the bank's total surplus and reserves. If your bank's holdings are 20% or more of total surplus and reserves, please fill in the more detailed information requested.

Frank Wille

Frank Wille
Chairman

FEDERAL DEPOSIT INSURANCE CORPORATION

SPECIAL SURVEY OF NEW YORK CITY OBLIGATIONS

INSTRUCTIONS: Complete all applicable items below and return within 10 days to **Director of Research, Room 3008 G, Federal Deposit Insurance Corporation, Washington, D.C. 20429.** *Report obligations of New York City only. Do not include obligations of New York State or any of its agencies or obligations of the Municipal Assistance Corporation.*

ITEM 1. If current book value holdings of New York City issues are less than 20 percent of the bank's total surplus accounts as of June 30, 1975, check the block at right and return the form in the enclosed envelope. ☐

ITEM 2. If current book value holdings of New York City issues are 20 percent or more of the bank's total surplus accounts as of June 30, 1975, complete **A and B** below.

A. BOOK VALUE OF HOLDINGS BY MATURITY

Express figures in thousands of dollars as of any convenient day in August. **Enter date in block at right.**

DATE (As of) August , 1975

DESCRIPTION	MATURITY PERIOD							TOTAL
	1975	Jan. - June 1976	July - Dec. 1976	1977 - 1979	1980 - 1985	1986 - 1995	After 1995	
Notes								
Bonds								
TOTAL								

B. Total Surplus Accounts as of June 30, 1975

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NAME AND BUSINESS PHONE NUMBER OF PERSON FILLING IN REPORT