News Release

THE FEDERAL RESERVE BANK of ST. LOUIS

ANNUAL BANK EXAMINATIONS REDUCE LOSSES TO THE BANK INSURANCE FUND

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ST. LOUIS --Annual bank examinations, which are required by a controversial provision of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), reduce losses to the Bank Insurance Fund (BIF), according to a study released today by the Federal Reserve Bank of St. Louis.

In the article "Implications of Annual Examinations for the Bank Insurance Fund," which appears in the January/February issue of the Review, the Federal Reserve Bank of St. Louis' bimonthly research journal, Economist R. Alton Gilbert studies the value of annual bank examinations and finds them effective in limiting losses to the BIF.

His study is particularly timely. Annual bank examinations have recently come under fire by Congress. In January 1993, Sen. Richard Shelby (D-Ala.) introduced legislation that would permit supervisors to examine some banks less frequently than currently required under FDICIA.

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Gilbert's research provides evidence that annual bank examinations are a crucial element in the effort to limit BIF losses. Through annual exams, supervisors are better able to distinguish between sound and troubled banks. More than 90 percent of the failed banks in Gilbert's study were rated as problem banks on their last examination, indicating that examiners are able to identify troubled banks.

Gilbert's study also confirms that supervisors discover information through annual examinations not previously disclosed through "call reports," the financial information, such as balance sheets and income statements, that banks must file quarterly with their regulators. For example, examiners found problems with asset quality at some banks that had not been revealed in their call reports. Frequent examinations, therefore, are important in ensuring the accuracy of call report information and in providing information not otherwise available on a bank's condition.

Moreover, supervisors have been effective in modifying the behavior of problem banks. According to Gilbert, banks sharply reduced both asset growth rates and dividends after being downgraded to problem status following their examination. Finally, Gilbert's study finds that the BIF's losses were smaller at banks that had been examined in the last 12 months before failing than at those that had not.

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"Annual bank examinations are a proven tool for bank supervisors to use in limiting losses to the nation's deposit insurance funds," says Gilbert. "Any modification to the FDICIA requirement for annual bank examinations must be made on the grounds that the cost of conducting and complying with annual bank examinations is greater than their measurable benefits."

Gilbert studied examination reports on more than 800 banks that failed between 1985 and 1990. To contact him about his research, please call the Federal Reserve Bank of St. Louis Public Information Office at (314) 444-8310.

Other articles in this issue of the Review include "The Government's Role in Deposit Insurance," a collection of six essays on deposit insurance and the federal government's role in providing it and "On the Macroeconomics of Private Debt," an examination of the role of private nonfinancial debt in the U.S. economy.

The Federal Reserve Bank of St. Louis has branches in Little Rock, Louisville and Memphis. It serves the Eighth Federal Reserve District which includes all of Arkansas, eastern Missouri, southern Indiana and Illinois, western Kentucky and Tennessee, and northern Mississippi.

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