Banking by John Hoefle

Deposit insurance fund is broke

Some 35 banks with $100-million assets will fail this year—and that's the good news, the GAO admits.

Comptroller General Charles Bowsher, testifying before the Senate Banking Committee Sept. 11, warned that 35 U.S. banks, each with over $100 million in assets for a combined $45 billion in assets, will fail in 1990, at a cost to the Federal Deposit Insurance Corp. (FDIC) of $4-6 billion. Some 15 of these $100 million-plus banks have already failed this year, he said.

The FDIC's Bank Insurance Fund currently has only $13.2 billion in funds to cover $1,886 billion in insured commerical bank deposits, or 70¢ of insurance money for every $100 in deposits, the lowest margin in the history of the FDIC. FDIC chairman William Seidman has forecast that the fund will drop to $11 billion this year.

"When you get the fund down as low as it is at present, you have a lot of individual banks that, if they go under, would take the whole fund with them," Bowsher said. "We could lose this fund, just like we lost the [savings and loan] fund," Bowsher added. "We have a lot of situations out there that could wipe the fund out."

In a recent letter to Vice President Dan Quayle and Speaker of the House Thomas Foley (D-Wash.), Bowsher warned, "The fund is too thinly capitalized to deal with the potential for bank failures in the event of a recession. Such an event could exhaust the fund and require a taxpayer bailout."

Were the FDIC to exhaust the Bank Insurance Fund, it is authorized to borrow money from the Treasury to cover its needs, according to a spokesman for the Office of the Comptroller of the Currency.

Bowsher also said that current accounting methods mask the extent of the banks' problems. Under "generally accepted accounting principles" (GAAP), auditors and bank executives can often put off admitting losses until the last moment, preventing regulators from moving quickly to prevent major losses.

"We very much need a more realistic standard of accounting so that we're not just kidding ourselves about the extent of the problem," Bowsher said. "Not since its birth during the Great Depression has the federal system of deposit insurance for commercial banks faced such a period of danger and uncertainty as it does today."

Bowsher said that during the last decade, banks have ventured heavily into new, riskier loan markets, to bolster sagging profits. "While the commerical banking industry's loan portfolio risks have increased, there has been relatively no change in the level of the industry's equity capital, its cushion to absorb losses on loans," he said.

The crisis facing the banking system is indicated by an August 1990 Moody's Investors Services "Industry Outlook" report on nine money-center bank holding companies (BankAmerica Corp., Bankers Trust New York Corp., Chase Manhattan Corp., Chemical Banking Corp., Citicorp, Continental Banking Corp., First Chicago Corp., Manufacturers Hanover Corp., and J.P. Morgan & Co., Inc.).

Moody's cited four major weaknesses at these big banks: "Significant high-risk asset concentrations," including loans to Lesser Developed Countries (LDCs), Commercial Real Estate (CRE), and Highly Leveraged Transaction (HLT) exposures; "Rising domestic problem loans"; "Disappointing revenue growth due to reduced HLT and CRE deal flow"; and "In some cases, weak reserve and capital positions."

"The money centers should continue to comply with the revised capital guidelines, unless either domestic or LDC reserves have to be boosted substantially—both of which are possible (for certain banks). In light of some of the banks' weak internal-capital generation, some money centers may have difficulty in rebuilding capital rapidly enough to absorb additional provisions while still meeting minimum capital standards," the report stated.

The Moody's report presents a devastating picture of the condition of the nation's biggest banks. At the end of 1989, all of the nine banks had "risk loans"—the sum of their HLT, LDC, and CRE loans—greater than the total of their stockholders equity plus loan loss reserves. Continental's risk loans equaled 395% of its stockholders equity plus loan loss reserves, followed by Chemical at 281%, Chase at 275%, Manufacturers Hanover at 266%, Bankers Trust at 251%, First Chicago at 248%, Citicorp at 244%, BankAmerica at 220%, and finally J.P. Morgan, at a mere 123%.

All but one of the banks also has commercial real estate loans which exceed stockholders equity. According to Moody's, Chemical leads the pack with commercial real estate (CRE loans plus other real estate owned) equal to 264% of common stockholders equity, followed by Chase at 232%, First Chicago at 204%, BankAmerica at 178%, Citicorp at 170%, Continental at 138%, Manufacturers Hanover at 122%, Bankers Trust at 102%, and J.P. Morgan at 21%.