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Statement of the Shadow Financial Regulatory Committee on the Need to Make FSLIC and FDIC Assistance Deals Accountable

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As the number of economically insolvent and near-insolvent depository institutions has surged in recent years, the creativity that FDIC and FSLIC personnel have shown in dealing with such problems has grown too. Deposit-insurance officials have developed a series of imaginative ways to proffer financial assistance both to firms that acquire the institutions whose insolvencies the agencies decide to resolve and to individuals they permit to operate quasi-failed firms. While we applaud the initiative and administrative flexibility that deposit-insurance officials have shown, we are disturbed by the incomplete way in which they have chosen to lay out the salient economic facts of many of these deals.

FDIC and FSLIC officials typically fail to provide -- even as background -- the precise financial information that an outside analyst would need to monitor the economic reasonableness of the individual assistance transactions the agencies decide upon. Frequently, the most significant element in large or complicated assistance transactions is the expected drain on agency reserves from various contingent agreements. Yet reproducible estimates of the agency's expected losses or recoveries from such agreements are seldom supplied.

To build up public confidence in the capacity of the FDIC and FSLIC to manage the many problem cases that need to be resolved over the next few years, the agencies should not ask the public to settle merely for an assurance that they habitually strive to cut the best deal possible. To establish confidence in the honesty and efficiency of their decision making, it is critical that agency staffs prove in each instance how and why the deal they made was a good one.

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Taxpayers deserve to learn of the expected benefits and costs of each transaction and a reproducible description of the procedures by which these estimates were developed. Weaknesses in agency accountability increase the probability that, in moving a troublesome case off their immediate agenda, FDIC and FSLIC officials may choose to act myopically or self-interestedly. By not giving the press and outside financial analysts the information needed to evaluate these transactions as they develop, officials insulate themselves from the discipline of informed criticism. Open debate between agency personnel and informed critics is needed if taxpayers and politicians are to approve or reject in timely fashion the effects of agency policies and priorities that unfold slowly over time.

More generally, incentives to manage the risk exposure of both the FDIC and the FSLIC would be improved if each agency was regularly required both to report its best estimate of its expected future losses and to set up a reserve to cover these losses. The two major components of this expected-loss reserve would consist of (a) allowances for the contingent liabilities in assistance likely to be delivered to presently identified troubled insured institutions, and (b) assistance apt to be given to institutions not yet so identified.

The Shadow Financial Regulatory Committee and others have regularly provided rough estimates of the unrecognized capital losses buried in FSLIC's potential caseload. For FSLIC, outside estimates now fall in the range of $75 billion to $100 billion. The order of magnitude of the FDIC's unrecognized losses can and should be analyzed in parallel fashion. As of year end 1987, we conservatively estimate that allowing for expected losses of troubled banks would reduce the FDIC's gross reserves by half.