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Statement of the Shadow Financial Regulatory Committee on The Need to Estimate the True Economic Condition of the FDIC

December 5, 1988

Based on information now available from the FDIC, a crude appraisal of the condition of the Federal Deposit Insurance Corporation can be made that takes account of the agency's unbooked losses. Using these data and simple assumptions, the Committee infers that, if the FDIC were to experience losses that would not be unreasonable to anticipate in view of its recent loss experience and problem bank estimates, the FDIC's reserve balance would be virtually exhausted at present.

The Committee's calculation makes use only of inadequate information publicly disclosed by the FDIC. The table attached to this statement estimates unbooked losses from three critical assumptions: the

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percentage of assets allocated to problem banks; projected bank failure rates; and a failure-resolution cost rate.

In light of the Committee's calculation, proposals to reduce the cost of recapitalizing the Federal Savings and Loan Insurance Corporation (FSLIC) by combining it with FDIC seem futile. Indeed, in a November 1988 report entitled The Financial Services Industry, the General Accounting Office reaches a similar conclusion:

> "While merging FSLIC with the healthier Federal Deposit Insurance Corporation (FDIC) has been suggested as a possibility, it would not solve the financial problems. The FDIC's reserves cannot cover the FSLIC losses. Moreover, problems in the commercial banks, especially those related to energy, real estate, agriculture, and third world lending, may require all of FDIC's present $18 billion of reserves." (p.6)

It is impossible for us to determine the accuracy of our crude estimate of the FDIC's net reserve position. To develop a more refined estimate, we urge the FDIC to release detailed information on the asset-size distribution of both problem-bank assets and failure-resolution cost rates.

Estimate of FDIC's Net Reserve Position on December 31, 1988

1. 1987 Yearend Data: FDIC-Insured Commercial Banks

	Number	Percentage	Projected Assets (in $Billions)[1]
Problem Banks	1,575	11.5	345.1
Nonproblem Banks	12,124	88.5	2,655.8
	13,699	100.0	3,000.9

2. Crude Calculation of Amount of Losses through December 31, 1988

	Problem Banks	Nonproblem Banks
Allocated Assets	$345.1 Bil.	$2,655.8 Bil.
Failure Rate[2]	.125	.01
Failure-Resolution Cost Rate[3]	.30	.30
Estimated Booked and Unbooked Losses	$ 12.9 Bil.	$ 8.0 Bil.

3. Calculation of Net FDIC Reserves on December 31, 1988

Deposit Insurance Fund on December 31, 1987	$18.3 Bil.
Income for 1988 (estimate)	3.0
Estimated Reserve before Booked and Unbooked losses as of December 31, 1988	21.3
Estimated Total FDIC Booked and Unbooked Losses	$20.9 Bil.
Net Reserve Balance	0.4

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1 The FDIC does not provide data on the size

[Footnote continued from previous page]
distribution of banks on its problem list. This analysis assumes that the size distribution of problem banks is similar to that of all banks. Since we know that several very large institutions have well-publicized weaknesses, we do not expect that this assumption leads to an overstatement of FDIC's potential losses.

2 Over 1982-1987, the number of failures per year has averaged 14.1 percent of the number of problem banks identified going into the year. The median ratio is 13.6 percent, which our procedure rounds downward to 13.5. Because some "surprise" failures develop entirely within a calendar year, we treat roughly 7.5 percent of projected failures as developing outside of the population of banks identified as problems at the end of the previous year.

3 The 30% loss figure was developed by J. Bovenzi and A. Murton in the FDIC Banking Review (Fall 1988), for a sample of relatively small banks that failed in 1985 and 1986. Evidence exists that FDIC's loss experience in handling large bank problems is substantially better. Thus, in resolving the First City (Texas), Continental Illinois and First RepublicBank (Texas) cases, FDIC's losses are expected to be less than 10%.