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Statement of the Shadow Financial Regulatory Committee

on

FDIC Action on Critically Undercapitalized Banks

March 1, 1993

On December 19, 1992, the provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) directing the banking supervisory agencies to appoint receivers or conservators for critically undercapitalized banks became effective. Since then relatively few such actions have been reported.

This may be for entirely appropriate reasons. For example, the very favorable interest spreads that prevailed during 1992 improved reported bank earnings and reduced the number of institutions that are critically undercapitalized (with book capital below 2% of total assets). Moreover, the existence of a regulatory regime stressing new statutory capital standards has provided a strong spur to banks to improve their capital ratios.

However, the reasons for inaction might be less defensible. The disparities that exist across institutions in specific reserve levels for nonperforming assets could reflect inadequate identification of losses, with resultant meaningful understatement of the number of critically undercapitalized institutions.

FDICIA affords a 90-day period for regulators to take over critically undercapitalized banks. If the agencies determine to take some other action in such cases, FDICIA requires that their reasons be documented. Because the FDIC's actions since December provide the first practical test of FDICIA's requirement for mandatory receivership or conservatorship for such institutions, the public interest would be well served if the agencies were to report on their actions or determinations with respect to all institutions that met this definition at December 19, 1992.

To the extent that some banks that were critically undercapitalized at December 19, 1992 were subsequently able to meet the 2% standard because the decline in long-term interest rates yielded them capital gains, the regulators should be very aware that interest rate risk works both ways and poses a danger to the deposit insurance system. While some banks may have won their interest rate gambles, the longer those bets remain on the table, the longer the FDIC is at risk. Critically undercapitalized banks should not be permitted to take such risks.