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**Banking** by John Hoefle

# The FDIC is insolvent

*The insurance fund backing up depositors' funds in the bankrupt U.S. banks, is itself bankrupt.*

Since the Great Depression of the 1930s, one of the tenets of the nation's banking system has been that bank deposits were absolutely safe, that even were your bank to fail, the Federal Deposit Insurance Corp. would pay back the depositors. For the average citizen, bank deposits were considered so safe that "money in the bank" became a synonym for security.

However, the FDIC was designed to handle isolated failures in an otherwise healthy banking system. When the problem is systemic, as in today's depression-fueled banking crisis, the deposit insurance fund becomes quickly overwhelmed.

That is precisely what has happened. The FDIC's commercial bank deposit insurance fund, now called the Bank Insurance Fund, stood at $18.3 billion at the end of 1987. Since then, it has lost money every year. In 1988, the FDIC lost $4.2 billion, ending the year at $14.1 billion, or 83¢ in insurance money for every $100 in deposits. In 1989, the FDIC lost $852 million, ending the year at $13.2 billion, or 70¢ for every $100 of deposits. This year, the FDIC expects to lose $3 billion, falling to $10 billion, or less than 60¢ for every $100 in deposits, the lowest fund-to-deposits ratio in the FDIC's 56-year history.

Furthermore, the yearly losses are net, not gross. Since the fund will receive $3 billion in premiums from banks and earn an additional $1 billion in interest on its cash reserves this year, to show a net loss of $3 billion the FDIC would actually have to lose $7 billion—over half the $13.2 billion in the fund at the end of 1989.

The magnitude of the FDIC's losses is staggering. From 1980 to 1987, the insurance fund averaged $1.17 for every $100 in deposits. Thus, by the end of the year, according to the FDIC's own projections, the fund will have collapsed to less than half of its 1980-87 coverage level.

"The insurance fund is under considerable stress, and it is at the lowest point at any time in modern history," FDIC chairman L. William Seidman admitted back in July, when the FDIC was projecting only $2 billion in losses.

The FDIC is not the only agency sounding the alarm. The Government Accounting Office, in a September study on the Bank Insurance Fund, warned that the "fund is too thinly capitalized to deal with the potential for bank failures in the event of a recession." The GAO analyzed the 200 banks on the FDIC's problem list with assets over $100 million, and all of the nation's 100 largest banks. Of this group, the GAO found "35 institutions in such severe financial condition that without some form of recapitalization, they are likely to fail or require regulatory assistance within the next year." The GAO estimated that the failure of these 35 banks, which have assets totaling $45.1 billion, would cost the FDIC between $4.4 and $6.3 billion. However, the GAO admitted, "our cost estimates could be significantly understated," since they are based upon the FDIC's historical loss rates, "which do not reflect the major changes in the composition and quality of the industry's loan portfolio."

The GAO study also found "a significant number" of additional banks which it termed "less troubled" than the 35, "but also at risk to fail within the next few years. . . . If many of these troubled banks were to fail, the fund could be significantly impaired. A recession could exacerbate this problem and result in even more bank failures, which could deplete the fund."

"We could lose this fund, just like we lost the [savings and loan] fund," Comptroller General Charles Bowsher, head of the GAO, told the Senate Banking Committee Sept. 11. "We have a lot of situations out there that could wipe the fund out." Bowsher reiterated that "a recession could exacerbate this problem, causing failure of other large banks beyond those we have identified, exhausting the fund, and resulting in a taxpayer bailout."

Faced with the prospect of a taxpayer bailout of the banking system, Congress voted to allow the FDIC to raise deposit insurance premiums as high as necessary to maintain its solvency. Previously, the law had prohibited the FDIC from charging banks more than 32.5¢ per $100 in deposits and barred increases of more than 7.5¢ per $100 in deposits in any single year. Shortly after the bill was passed, the FDIC announced that premiums would be raised from 12¢ per $100 in deposits in 1990, to 19.5¢ per $100 in 1991, a 37% increase.

But even that will not be enough. Roger Watson, the FDIC's director of research, told the *Wall Street Journal* in early November that the FDIC was considering increasing the deposit insurance premiums for one year to as high as 50¢ for every $100 in deposits. Watson said it was "a very real possibility" that the FDIC would take that action if losses to the fund are "much higher than anticipated."



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