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Banking by John Hoefle

The FDIC is broke

The commercial banks are careening down the same slippery slope as the S&Ls did before them.

'The bank insurance fund is insolvent," economist Dan Brumbaugh told the House Banking Committee's Financial Institutions subcommittee on Dec. 17. Brumbaugh has said such things before—and was dismissed by Stanford University for doing so—but the truth of his statement was even more obvious this time around.

Brumbaugh was there to testify about a subcommittee-sponsored report which he co-authored with James Barth of Auburn University and Robert Litan of the Brookings Institution, on the health of the Federal Deposit Insurance Corp. and its Bank Insurance Fund.

The report concluded that the FDIC would need between $19 billion and $43 billion in funds to cover deposit insurance payoffs from 1991 through 1993—and that's assuming a mild recession. In a "New England"-style recession, the report said, the FDIC would need $24-51 billion, and for a "Texas"-style recession, $27-63 billion. The FDIC is totally unprepared to handle such payments. In the week before the hearings, FDIC chairman William Seidman revealed that the Bank Insurance Fund will lose an estimated $4 billion in 1990 and another $5 billion in 1991.

From its peak of $18.3 billion at the end of 1987, the FDIC has been in a tailspin. In 1988, the insurance fund lost $4.2 billion, the worst year in its history. In 1989, it lost another $850 million. With the projected losses of $4 billion this year and $5 billion next year, the insurance fund will have lost $14.3 billion in four years, a loss of nearly 80%. That would leave the FDIC just $4 billion in funds to back up some $2.6 trillion in deposits, or about 18¢ for every $100 of insured deposits. Federal law requires the FDIC to have $1.25 in funds for every $100 in insured deposits.

On top of that, the FDIC is facing the potential loss of an additional $6-7 billion in 1991, buying back bad assets from banks it has already sold. Therefore, by Seidman's own figures, the FDIC's insurance fund could go into the hole by as much as $3 billion in 1991.

The FDIC cannot even begin to cover the losses it faces over the next three years, and that's using the government's own highly optimistic figures.

The FDIC is increasing the premiums the banks must pay for insurance from 12¢ per $100 of insured deposits, to 19.5¢ next year, but even this 60% increase is totally inadequate, raising only $28 billion over the three-year period.

Seidman has proposed that the premium be raised to 23¢ per $100 in 1992, and that banks be assessed a one-time fee equal to 1% of their deposits early next year. These measures, he says, would raise $52 billion over the next three years. Closer, but still not enough.

The government line is that the banks, not the taxpayer, should pick up the tab. But the idea that the FDIC can somehow raise enough money from a bankrupt banking system to cover that system's losses is absurd. Sooner or later, the taxpayer will get the bill.

It's the S&L scenario all over again, but on a much larger scale.

Meanwhile, the bankers, with the tacit approval of the regulators, continue to paper over their losses. According to the FDIC, the nation's banks made a profit of $3.75 billion in the third quarter of this year. That represents a decline of 29% over the $5.3 billion profit they supposedly earned in the second quarter.

These profits, however, are illusory. At the end of September, the banks' non-current loans and leases plus other real estate owned hit 2.65% of assets, the highest level since banks began reporting that data in 1982. But the amount of reserves backing these noncurrent loans has decreased over the last three quarters. At the end of the third quarter, the banks had only 73¢ in reserve for every dollar in noncurrent loans, down from 83¢ a year earlier. Money that should have gone into reserves was instead claimed as "profit."

Despite the depression in real estate prices, the banks continue to increase their holdings in that sector. Their real estate loans grew by $15.4 billion in the third quarter, their holdings of mortgage-backed securities grew by $12 billion, and their inventory of foreclosed properties grew by $2.3 billion, for a total increase of real estate assets of $29.7 billion. Total bank assets grew only $20 billion during the quarter, meaning that real estate holdings rose 150% faster than total assets.

The banks' headlong rush toward failure caused BCA, a bank-rating agency based in Montreal, to warn in November of "the risks of a run on the banks." The risk is indeed great, especially when the bureaucrats tamper with deposit insurance. As one Treasury official recently said, "It's like perching at the top of a rickety, mile-high flagpole. Climbing down is as dangerous as staying up there."

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