Originally Processed With FOIA(s):
1998-0004-F[2]

FOIA Number:
S

FOIA MARKER

This is not a textual record. This is used as an administrative marker by the George Bush Presidential Library Staff.

Record Group/Collection:	George H.W. Bush Presidential Records
Collection/Office of Origin:	Chief of Staff, White House Office of
Series:	Sununu, John, Files
Subseries:	Issues Files

OA/ID Number:	29151
Folder ID Number:	29151-006

Folder Title:
Credit Crunch 1991 [3]

Stack:	Row:	Section:	Shelf:	Position:
G	**15**	**25**	**1**	**3**

THE WHITE HOUSE

WASHINGTON

AC/ER

February 27, 1991

MEMORANDUM FOR GOVERNOR SUNUNU
DICK DARMAN
MICHAEL BOSKIN

FROM: EDE HOLIDAY

SUBJECT: Credit Crunch News Release

Attached is a joint press release and statement regarding the credit crunch effort being made by federal banking regulators. Plans presently call for release of these documents by the agencies Thursday afternoon, but Treasury informs me that a joint press conference is not contemplated.

Attachment

DRAFT - NOT PUBLIC

February 28, 1991 Release expected 1:00pm

OCC • FDIC • FRB • OTS

Joint Agency News Release

Washington, DC

REGULATORS ISSUE JOINT SUPERVISORY POLICIES

The four federal regulators of banks and thrift institutions today issued joint statements and guidelines to clarify certain regulatory and accounting policies. In announcing the changes, the agencies said the intent of this effort is to contribute to a climate in which banks and thrifts will make loans to creditworthy borrowers and work constructively with borrowers experiencing financial difficulties, consistent with safe and sound banking practices. The policies would encourage increased disclosure about the condition of financial institutions' loan portfolios, facilitate extensions of credit to sound borrowers and the workout of problem loans, and better assure sound assessments of the value of real estate that secures loans.

The four regulatory agencies that issued today's statements are the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), and the Office of Thrift Supervision (OTS). Together, the four agencies supervise the activities of the nation's 12,000 commercial banks and 2,400 thrift institutions.

The joint policy statements cover a wide range of issues, including the following specific points:

- <u>Recognition of income for certain non-performing loans.</u> The agencies are considering the merits of proposed guidelines addressing the accrual of income on loans that have been partially charged off. Draft guidelines have been referred to the Securities and Exchange Commission for further discussion and consideration.

- <u>Valuation of real estate loans in examinations</u>. The joint statement clarifies that the supervisory evaluation of real estate loans is based on the ability of the collateral to generate cash flow over time, not upon its immediate liquidation value.

(more)

- <u>Guidance on other issues relating to nonaccrual assets and formally restructured debt</u>. This guidance covers a range of accounting issues, including cash basis income recognition on non-performing loans, treatment of multiple loans to one borrower, and acquisition of nonaccrual assets.

The four agencies also issued a general statement that stressed the importance of financial institutions working with borrowers who may be experiencing temporary difficulties. The general statement discusses previously released policies that deal with increased disclosure on nonaccrual loans and guidance on the application of the definition of highly leveraged transactions (HLTs). The statement also addresses regulatory policies on lending by under-capitalized institutions and loan concentration risk.

The agencies intend to communicate the clarifications and statements to field examiners and supervisory personnel. The agencies may also issue more detailed guidance on the issues covered in today's joint statements. Copies of the general statement and the joint policy guidelines released today are available from the OCC, FDIC, FRB and OTS.

# # # #

NOT PUBLIC UNTIL 2/28/91 estimated 1:00pm

OCC • FDIC • FRB • OTS

GENERAL STATEMENT

Recent credit problems have underscored the importance of prudent lending practices to the overall safety and soundness of the nation's financial system. The emergence of credit problems in a number of sectors of the economy has prompted many depository institutions to review their lending practices as well as their capacity to meet credit demands. Many institutions have wisely tightened credit standards where such standards had become too loose. Others have reduced the pace of lending in response to the need to shore up their capital positions and strengthen their balance sheets.

It is possible, however, that some depository institutions may have become overly cautious in their lending practices. In some instances this caution has been attributed to concerns on the part of lenders that the regulators of depository institutions are applying excessively rigorous examination standards.

The Federal banking and thrift regulators do not want the availability of credit to sound borrowers to be adversely affected by supervisory policies or depository institutions' misunderstandings about them. As a result, the agencies today are issuing a series of guidelines and statements that are intended to clarify regulatory policies in a number of areas and reduce concerns depository institutions may have about extensions of credit to sound borrowers. Specifically, the guidelines and statements released today: (1) encourage enhanced disclosure to the public, (2) facilitate extensions of credit to sound borrowers and the workout of problem loans, and (3) better assure sound assessments of the value of real estate by depository institutions and Federal examiners.

Recent concerns related to a tightening of credit have focused the agencies' attention on regulatory policies and their effects on institutions' willingness to extend new credit and to work with troubled borrowers. The guidelines and statements released today, which have been under development for some time, are not intended, nor are they expected, to "solve" all credit availability problems. When combined with other steps that have been taken (such as lower money market interest rates and changes in reserve requirements), these initiatives should help facilitate prudent credit extensions to sound borrowers.

Enhanced disclosure will help to ensure that the public is better informed about the nature of institutions' portfolios. The new guidance recently issued by the Office of the Comptroller of the Currency (OCC) on suggested disclosures of more detailed information about nonaccrual loans in public financial statements, and recent banking agency guidelines on Highly Leveraged Transactions, should help by differentiating among broad groups of assets with varying degrees of risk.

Depository institutions have traditionally worked with their borrowers who are experiencing problems. In the current economic environment, it is especially important for institutions to avoid shutting off credit to sound borrowers, especially in sectors of the economy that are experiencing temporary problems.

Consistent with sound banking practices, depository institutions, including those with low capital positions, should work in an appropriate and constructive fashion with borrowers who may be experiencing temporary difficulties. Such efforts may include reasonable workout arrangements or prudent steps to restructure extensions of credit. Institutions that have in place effective internal controls to manage and reduce excessive concentrations over a reasonable period of time, need not automatically refuse credit to sound borrowers because of the borrower's particular industry or geographic location.

The documents released today by the Federal bank and thrift regulatory agencies aim to facilitate the workout of problem loans by addressing the income accrual treatment of formally restructured debt and acquired nonaccrual loans under generally accepted accounting principles. Further, there is a clarification of the accounting treatment of multiple loans to a single borrower when some, but not all, of the loans to the borrower are troubled.

The agencies have also clarified when payments may be recognized as income on a cash basis for loans that have been partially charged-off. In addition, the agencies are developing guidelines that address how institutions can accrue income on loans that have been partially charged-off.

Finally, the agencies are also clarifying their policies on the supervisory valuation of real estate. The policies provide that the evaluation of loan loss reserves or net carrying values for real estate loans should reflect a realistic market analysis and not be based solely on liquidation values.

1. <u>Enhanced Disclosure to the Public</u>

<u>A. Disclosure of Nonaccrual Loans</u> Nonaccrual loans vary widely with respect to their quality and cash generating capacity. Consequently, the simple total of such

loans on an institution's books may not be a good indicator of the institution's financial position. One method to address this is to provide more information to the public on these assets. For example, useful supplemental disclosures might include information on the amount of charge-offs taken on nonaccrual loans, the amount of cash payments received on these assets, and the portion of these loans that generate substantial cash flow.

OCC recently issued a Banking Bulletin that contains suggestions for the voluntary disclosure of additional information on nonaccrual loans. The Federal regulatory agencies fully support the voluntary disclosures of the type suggested by the OCC and described in the attached statement.

B. Disclosure of Highly Leveraged Transactions (HLTs)

The Federal banking agencies have previously developed a uniform supervisory definition for HLTs. The purpose of the definition is to provide a consistent means to monitor loans to HLT borrowers. The agencies have recently provided the attached additional guidance to examiners and bankers on the application of this definition. This guidance stresses that the HLT designation does not imply a supervisory criticism of the credit.

The guidance also makes clear that certain extensions of credit, such as loans to debtors-in-possession (DIPs), do not fit the definition of HLT loans and should not be so reported. The criteria for the removal of a loan from HLT status have been expanded in the attached document. The agencies will continue to review these criteria to determine if other steps are warranted in view of the characteristics and performance of HLT credits.

2. <u>Other Lending Issues</u>

There appears to be some concern that any new lending by institutions that fail to meet minimum capital requirements will result in supervisory criticism. While it is essential that depository institutions that fail to meet minimum capital standards take effective and timely steps to address this deficiency, such institutions are not necessarily required to cease prudent, low-risk lending activities. Institutions should attain capital compliance in a prudent manner that strengthens their financial conditions. Institutions that seek to improve their capital-to-assets ratios through shrinking their balance sheets should avoid actions that raise their risk exposure, such as the sale of all high-quality assets or of core deposits. Such actions by themselves, or the refusal to lend to sound borrowers, fail to achieve the important objective of improving the quality of under-capitalized institutions' portfolios.

The agencies share common procedures to address capital deficiencies at depository institutions. In general, each agency requires such institutions to prepare a plan that details the steps they will take to attain the minimum capital levels. Approved plans generally do not preclude a continuation of sound lending activities, including prudent steps to work with borrowers encountering financial difficulties.

Similarly, there appears to be some concern that institutions with loan concentrations are automatically turning down good loans. The benefits of adequate portfolio diversification are well recognized by depository institutions and their regulators. Although the regulatory agencies have not established rigid rules on asset concentrations, they are in agreement that, as a matter of sound operating policy, depository institutions should establish and adhere to policies that control "concentration risk."

Institutions that have in place effective internal controls to manage and reduce undue concentrations over a reasonable period of time, need not automatically refuse credit to sound borrowers. The purpose of institutions' policies should be to improve the overall quality of their portfolios. The replacement of unsound loans with sound loans can enhance the quality of a depository institution's portfolio, even when concentration levels are not reduced.

3. Recognition of Income on Certain Nonperforming Loans

Questions have been raised regarding the recognition of income on loans that have been partially charged off. This subject is not explicitly addressed in the agencies' regulatory reporting requirements. The agencies wish to clarify that payments can be recognized as income on a cash basis for loans that have been partially charged off, without requiring that the prior charge-off first be recovered, so long as the remaining book balance is deemed fully collectible.

The agencies are also considering the merits of proposed guidelines addressing the accrual of income on loans that have been partially charged off. Under existing agency reporting requirements, nonaccrual loans generally cannot be returned to accrual status until any past due principal and interest is made current and the payment in full of principal and interest is expected. The draft guidelines on returning loans that have been partially charged off to accrual status, without first recovering the prior charge-off, have been referred to the Securities and Exchange Commission. Following these deliberations, the agencies may issue formal guidance or proposals on this issue in the future.

The agencies have released today supervisory guidance on a variety of other issues related to nonaccrual assets and formally restructured debt. These guidelines include a discussion of regulatory requirements related to cash basis income recognition, multiple loans to one borrower, and the acquisition of nonaccrual assets.

4. Valuation of Real Estate Loans

In recent months, there have been significant declines in real estate values in certain markets. In response to these declines, examiners have reviewed the adequacy of institutions' loan loss reserves and, where they believed it appropriate, have required additional reserves based on, in part, their estimates of real estate values.

These actions have focused attention on the techniques used to assess the value of real estate, especially commercial real estate. It is important that valuation techniques reflect not only existing market conditions, but also reasonable expectations of the property's performance in the market over time. The Federal regulatory agencies are reiterating their policy on the assessment of real estate values and the establishment of loan loss reserves.

The basic thrust of this guidance is to ensure that income property loans not be assessed solely on the basis of liquidation values but also on the income-producing capacity of the properties over time. Supervisory evaluations should take into account the lack of liquidity and cyclical nature of real estate markets and the temporary imbalances in the supply and demand for real estate that may occur.

5. Review of Supervisory Findings

The agencies want to make clear their policy that any institution may request a review of any major decision reached as part of the supervisory process, including those related to asset classification and required reserve levels.

THE WHITE HOUSE

WASHINGTON

DATE: 2-21-91

TO: Governor Sununu

FROM: **EDE HOLIDAY**
Assistant to the President
and Secretary of the Cabinet

Per your request, please see the attached memo from John Robson on the "credit crunch." Thank you.

Attachment

THE CHIEF of STAFF
has seen

DEPARTMENT OF THE TREASURY
WASHINGTON

February 21, 1991

MEMORANDUM FOR JOHN H. SUNUNU
CHIEF OF STAFF

FROM: John E. Robson JER

SUBJECT: "Credit Crunch"

Please find attached a draft description of the principal steps that are being considered by the bank and thrift regulatory agencies to address the "credit crunch."

I anticipate final interagency agreement in the next couple of days and an announcement by the regulators next week. I would be pleased to provide you additional information.

Attachment

cc: Secretary Brady

DRAFT

FEB 21 1991

Summary & Overview
Financial Institution Regulators Announce
Specific Proposals to Address the Credit Crunch

On [Fill-in date], 1991, the Chairman of the FDIC, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, and the Chairman of the Federal Reserve Board, (the "Agencies") announced a set of specific proposals designed to address the credit crunch.

Borrowers, bankers and community leaders have all expressed their concern over the wide perception that worthy borrowers have been unable to obtain credit for sound investment projects. These leaders believe that there is a lack of confidence in the business community from fear of the effects of the economic downturn and from the reluctance on the part of many banks to perform their important role as "shock absorber" in the economy.

The Agencies reiterated their role of preserving prudent banking practices, but at the same time not contributing to the credit crunch through inappropriate guidance to examiners or through lack of a use of common sense in the supervision process in a recessionary economy. Therefore, the following steps are meant to contribute in a positive way to building confidence and better ensuring that the regulatory system is not inhibiting credit for sound borrowers.

These constructive proposals when combined with the steps that have already been taken, such as lower interest rates and changes in bank reserve requirements, should facilitate credit availability to sound borrowers.

The Proposals

Enhance Disclosure to the Public

1) To facilitate greater understanding of the financial institution earnings actually being earned by banks on loans which are technically classified as non-performing assets, the Comptroller's office has proposed enhanced disclosure that will allow bank analysts to better project bank earnings. The other Agencies have endorsed this approach. This step could help bank stock prices for those banks that have high levels of non-performing loans which have significant levels of cash flow actually being paid. This is because analysts often allocate zero earnings potential to all loans in the non-performing category.

2) To help banks better present those loans which are disclosed as Highly Leveraged Transactions(HLTs), the Agencies have clarified the HLT definition to exempt those loans made to Debtors-in-Possession (DIP). The Agencies also better defined how a loan can be removed from the HLT classification. Further, the regulators emphasized that the HLT disclosure should in no way be considered a criticism of a particular credit.

Facilitation of the Workout of Problem Loans

3) There has been concern that new lending by banks or thrifts operating with less than the minimum required capital would be criticized by the regulators. This is not correct. In fact, the ceasing of prudent new lending or the selling of high quality assets is contrary to the goal of returning to the appropriate level of capital. Normally, the capital plans required by the Agencies include prudent steps for sound lending and working with troubled borrowers.

4) The benefits of portfolio diversification are well known to all bankers. However, there have been views expressed that the Agencies prohibit new lending or renewals of credit in loan types where an institution has a concentration. Those banks and thrifts which have internal controls to manage concentrations down over time need not automatically refuse credit to sound borrowers. Thus, the Agencies reiterate that the replacement of unsound loans with sound loans to new borrowers or the renewal of an existing good credit can enhance the overall quality of a depository institution's portfolio, even where concentrations are not reduced.

5) The Agencies announced that guidelines are being developed which could result in a better reflection of the actual earnings performance of the loan portfolio. These guidelines would allow a depository institution to return certain non-performing loans to accrual of income status (so-called "loan splitting" proposal) -- after taking a write down and ensuring that the remaining portion of the loan is considered good by existing standards. The Agencies are working with the SEC to ensure that this proposal would be consistent with good accounting practices.

6) The Agencies also clarified some other important issues related to nonaccrual loans and reserving policies. These included the clarification that placing of one loan to a particular borrower on nonaccrual status does not automatically mean that all loans to that borrower should be

treated as nonaccrual loans. Also, the Agencies indicated that a formally restructured loan (under FASB 15) may be returned immediately to accrual status based upon the loan's performance prior to the restructuring.

7) Many bankers, borrowers and examiners have cited difficulty in dealing with the complex issues related to valuing real property in troubled markets. As a result, the Agencies issued new guidance to the examiners on the valuation of real estate. Central to this guidance is that the evaluation of loan loss reserves or net carrying values for real estate loans should reflect realistic market analysis over the term of the loan and not be based solely on liquidation type values.

8) There are indications that some banks and thrifts have scaled back their lending activities in response to criticisms by examiners that institutions believe are unwarranted. The Agencies made clear that it is their policy that management of any bank or thrift may request a review of any major supervisory decision. This should foster a better working relationship between institution management and the agencies.

Importance of Communication

As with any large organization, it is critical that the Agencies make a special effort to communicate these policy initiatives to the more than 6,700 field examination professionals. Each of the agencies has committed to a broad and prompt dissemination of this guidance and new policies.

THE CHIEF of STAFF
has seen

cc

Lawrence E. Bathgate II
Chairman

Republican
National
Finance
Committee

1/30/91

John -
This is letter that was sent to Nick Brady as follow up to Thursday - FYI

Larry

310 First Street, S.E., Washington, D.C. 20003 (202) 863-8720

January 29, 1991

The Honorable Nicholas F. Brady
Secretary of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20020

Dear Mr. Secretary:

Attached is a letter responding to your kind offer for our group of Team 100 members to submit to you proposals for regulatory reform. All of us who met with you last Thursday greatly appreciated both the meeting and this opportunity to place our views before you. We have a real sense that you understand the problems facing our economy and are committed to reform. It is heartening to feel we are on your team.

With best personal regards.

Sincerely yours,

Alec Courtelis

Alec Courtelis

Attachment

cc: The Honorable John E. Robson
The Honorable Robert R. Glauber

January 29, 1991

The Honorable Nicholas F. Brady
Secretary of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20020

Dear Mr. Secretary:

We greatly appreciate your having taken such a large amount of your time on Thursday to meet with our group. We felt the discussions were beneficial and hope that you share in that view.

You were indeed kind to offer us the opportunity to respond to you by today and list those regulatory changes that we felt would be of the most immediate benefit. Based on that invitation we urge the following:

(1) Immediately implement regulations stating that any restructured loan that appears to have adequate security or cash flow be allowed to be removed by the banking institution from the "classified or substandard" debt category and the concomitant requirements of loan loss reserves. Further, to the extent that a troubled loan requires a loan loss reserve, we strongly recommend that the amount of that reserve be limited to the portion of the loan that is not adequately secured by collateral or reliable cash flow. This change may be made immediately and without the normal notice and comment period of formal rule making of the Administrative Procedures Act in that it is a procedural rather than a substantive rule. _E.g._, _Strickland v. Lyng_, 643 F.Supp. 310 (D.S.C. 1986); _aff'd_, Mem. Op. (4th Cir. January, 1987).

(2) Make changes in the entire system of appraisal. Specifically, we suggest that you adopt a formula, such as ten times current net cash flow, as the minimum valuation of income producing property. As Deputy Secretary Robson pointed out in our conversations, in a number of areas of the country it is absolutely impossible to perform an adequate appraisal and all the pressure on appraisers is to give a low appraisal. The suggested formula for minimum valuation is easy of application and unquestionably conservative. For the latter of those reasons, the formula should be emphasized as a _minimum_. Further, we recommend that recently adopted regulations, such as 55 Fed. Reg. 34532-550, requiring appraisal on almost all renewals of a loan be modified to exempt from their requirements institutions that are not on the "watch list" or similarly designated as "troubled". While well intentioned, this regulation has had unforeseen negative effects due to the delays engendered by its requirements.

(3) Completely remove the category of "non-performing performing loans". This oxymoronic category has clearly been abused and has caused great damage to the economy and to banks.

(4) Review and revise the examination guidelines dealing with Highly Leveraged Transactions. As noted in our conversations, that definition has swept into the ambit of the regulations on HLTs a number of companies and transactions that were never intended to be covered when it was proposed. Further, the exemption of certain highly leveraged transactions from coverage of the guidelines, particularly those occurring prior to 1987, seems to be fully justified.

(5) Immediate amendment of the regulations requiring that institutions reduce their real estate loan portfolios to no more than thirty percent of unimpaired capital and surplus. E.g., 12 CFR § 563.93. While most of us would agree that regulations requiring balance in portfolios are clearly worthwhile, the immediate implementation of the restrictive regulation now in place has had disastrous effects on the economy. We recommend that you consider a current limitation of thirty-eight percent to be phased down to thirty percent on the basis of a two percent reduction per year.

(6) Adoption of a broad, general regulation stating that, at least with banks that are not troubled or not on the "watch list", examiners are to show some deference to the judgment of experienced bank officers as to the value and quality of outstanding loans. We realize that you cannot control attitude by regulation, but it will be a clear indication to your examiners that there has been an attitudinal shift at the top.

We discussed the loss of sales opportunities by the Resolution Trust Corporation due to its history of taking bids on properties and shopping them to elicit higher bids. This is a disincentive to bidding. We recommend that the RTC set minimum acceptable bids, publish those amounts when soliciting bids and accept the highest bid above the minimum without further solicitation.

There was one further, vital point that is not susceptible to improvement by a mere change in a regulation. The increased and increasing capital requirements on banks, as exacerbated by the capital to loan loss reserve ratio requirements, are forcing banks to take actions to meet short term pressures that are against their long term interests and against the current and future interests of our national economy. The regulatory reforms suggested above can significantly improve this situation, particularly in relation to required ratios of capital to loan loss reserves. However, they will do little to aid banks in meeting required increases in stated capital. For this reason we urge again the adoption of a preferred stock program similar to the one used by the Reconstruction Finance Corporation in 1933. Such a move would greatly aid restoration of public and market confidence. As one example, a system of public offerings of preferred stock with a federal government guarantee of a portion of this equity should be considered.

Mr. Secretary, we agreed with almost all of your comments in our meeting. Of particular importance is your point about the role of the Federal Reserve in assuring liquidity. We are seeking a meeting with Mr. Greenspan on these subjects. However, we are hoping Treasury will lead the way to healing our banking system and toward responsible lending.

Again, thank you for taking the time to talk with us.

Sincerely yours,

Alec Courtelis

Alec Courtelis

Bank Audi

usa

New York

February 1, 1991

THE CHIEF of STAFF
has seen

The Honorable John H. Sununu
Chief of Staff
The White House
Washington, D.C. 20500

Cred C

Dear John:

At our regular Bank Audi board meeting today, one of our directors, Bill Isaac, who was Bill Seidman's predecessor as Chairman of the FDIC, briefed us on some measures currently being considered by Treasury in its plan to reform the banking system. Some of the points Bill made were so compelling to us that we wanted to share his, and our, views with you.

We understand that Treasury will be announcing early next week a plan to reform the financial system, including the deposit insurance program. Some elements of the package, assuming we have good information on it, are very constructive, particularly the proposals to authorize nationwide branch banking and to liberalize the ban on ownership of banks by industrial companies.

However, we are deeply concerned, and believe that you and the President should also be concerned, about the Treasury's reported stance on deposit insurance reform. Treasury has apparently concocted a very complex scheme to reduce the coverage available to depositors at smaller banks, while continuing to preserve the notion that large banks are too big to fail.

The proposed plan would be an administrative nightmare for the government and the banks to implement and would be nearly impossible for consumers to understand. It would clearly cause a shifting of deposits from the smaller banks that are too small to save to the larger banks that are too big to fail.

We urge you to do whatever you can to move this proposal in another direction. In 1984, the Bush Task Group on Regulation of Financial Services recommended a sound, fair, and thoughtful plan for increasing depositor discipline at both large and small banks. That plan has been endorsed by the American Bankers Association. It is mystifying why Treasury would not embrace this proposal.

Kind regards,

Joseph G. Audi
President

Peter J. Tanous
Executive Vice President

600 Fifth Avenue 23rd Floor New York, NY 10020 Tel. (212) 307-5577 Telex: 421898 AUDIBK

P.02

FEB-1-91 FRI 15:25

THE WHITE HOUSE
WASHINGTON

Date: January 9, 1991

TO: HOLLY WILLIAMSON

FROM: KATIE WINKELJOHN

Hollis rec'd identical info and responded directly

Governor Sununu would like Hollis McLaughlin to take a look at the attached that he received from Congresswoman Nancy Johnson and either respond to her concerns or give the Governor some input so he can respond to her.

Many thanks.

CONGRESSWOMAN NANCY L. JOHNSON
1 GROVE STREET
NEW BRITAIN, CT 06053
(203) 223-8412
DISTRICT OFFICE

following your phone call

THE CHIEF of STAFF has seen

FAX COVER SHEET

TO:
ATTENTION: Gov. John Sununu
LOCATION: White House.
FAX # : 202-456-2397

FROM:
NAME: Cong Nancy L. Johnson
DATE: 1/4/91
FAX # : (203) 827-9009 OFFICE # : (203) 223-8412
TOTAL NUMBER OF PAGES (INCLUDING COVER SHEET): 11

SPECIAL INSTUCTIONS:

Citytrust

CITYTRUST
961 MAIN STREET
BRIDGEPORT, CT 06601
MAIL CODE: 1-B-3-570

TELECOPY COVER LETTER

DATE: 1/4/91

TIME: ______

PLEASE DELIVER THE FOLLOWING PAGES TO:

NAME: Congresswoman Nancy Johnson

FIRM: ______

SENDER: George E. Taylor, Chairman

ADDRESS: EXECUTIVE OFFICE

We are transmitting 7 pages (including this cover sheet).

MACHINE: FUJITSU DEX 2400 No. (203) 384-5022

If you do not receive all the pages, please call (203) ~~384-5293~~ 384-5020 or 384-5284 as soon as possible.

FDIC PRESENTATION

Connecticut banks and the FDIC face a common problem that has created different types of concerns for each of us.

Our intent is to suggest a form of solution that deals with the problem in a way that takes into consideration and addresses these differing concerns.

I. The Problem

A deteriorating capital position of Connecticut banks that has been caused primarily by a disastrous downturn in the real estate market and which could be further impacted by other problems looming in the future of the state's economy.

A. Banks

The concerns of and implications for banks are obvious.

- Rapid erosion of capital robs banks of the ability to deal with problem credits in a rational way and over a reasonable time.
- There is great pressure to liquidate productive assets in uneconomic ways in order to place short term band-aids on capital deterioration. These actions are counterproductive and will actually accelerate deterioration of capital.
- In the meantime, banks are not able to meet the legitimate credit needs of customers, thereby intensifying and prolonging the economic troubles of the region. This situation is known as the "credit crunch."
- A recent survey by the Connecticut Business and Industry Association shows that 82 percent of the respondents said they believed there was a credit availability problem today.
- The bleakest economy and the most depressed real estate market in several decades make it extremely difficult to dispose of OREO properties.

- Connecticut is faced with a budget deficit equivalent to 25% of its operating budget. The magnitude of this deficit will necessitate increased taxes, which will create an even more unfavorable business climate.

- The state's unemployment has been increasing from a low of 2.8% in mid-1988 to 4.7% in November, 1990. With reduced job growth over the next several years, the unemployment rate is forecasted to rise above 7.5%.

B. FDIC

The weakened state of the Connecticut economy and deterioration of the financial strength of the banks could lead to problems for the FDIC. Among them are:

- Lack of public confidence in the banking system and the FDIC fund.

- There are a large number of banks (and a high percentage of the total) in Connecticut, which up to now have been reasonably well run, that are facing technical insolvency sometime in the near future.

- The size of the problem and number of banks affected make it highly questionable whether enough healthy institutions exist to buy the problem banks.

- Asset collection and management problems of staggering proportions.

- We can readily conceive of a situation with the current economic downturn that could lead to a large number of bank failures. The cost to the fund could be in the billions of dollars and could be a serious threat to the integrity of the fund.

II. The Solution

A. General

- Provide support without cost to the insurance fund to those banks whom time will heal (i.e. those with the integrity and ability to work through their problems efficiently and at a reasonable rate and who have an underlying profitability to return to, if given time).

  - Encourage them to work out their asset problems in an efficient and economic way while preserving their economic engines by continuing to meet the deposit and credit needs of their customers.

- Remove the barriers to consolidation. A capital improvement program would facilitate mergers of financial institutions. Reducing their number would lead to greater economies of scale, increased efficiencies, and ultimately stronger and better capitalized institutions. Such a program would also eliminate those institutions that are inefficient in supplying the credit needs of the community.

- Protect the integrity of the fund by investing it (on a secured basis) in situations that could otherwise take a larger and permanent bite out of the fund by way of deposit coverage.

  - By such investment in proper cases the FDIC would also be utilizing and extending the usefulness of in-place workout groups and the managements administering them rather than having to gather, train and manage its own workout forces. The experience of the past several years has shown that a government takeover of assets from insolvent institutions is the most costly method to the taxpayer of disposing of these assets.

- The outstanding success of the open bank assistance programs of the R.F.C., the net worth assistance program, and the special agricultural/energy programs offer us guidance on the structure of our proposal.

- This would be a "self help" program. We are not looking for preferential treatment. Our goal is to preserve the health of the banking system, stop the deterioration of the Connecticut economy, and restore public confidence in the banks. At the same time, we believe this will be by far the least expensive method for the taxpayers and the FDIC.

B. Specific

The method to achieve the solution using the banks' funds (not the FDIC's funds):

- Revitalize the program provided by Section 13 of the Federal Deposit Insurance Act along the following lines:
  - FDIC would purchase capital instruments of the banks bearing a stated dividend rate.
  - Banks would either purchase Treasury Bonds in an amount up to the amount of these instruments or loan the money to the FDIC directly at interest rates at least as great as the capital instrument's dividend rate.
  - The Treasury Bonds would then be pledged to secure the instruments, and the Treasury proceeds would be used to fund their purchase. Or if no bonds were used, the FDIC would have the right to set off the loan to the FDIC against the capital instruments in the event of a failure of the bank.
- Participation in such a program should be conditional and based upon an institution's meeting certain criteria. We suggest that to qualify for receipt of capital instruments, an institution be required to:
  - Demonstrate that it has adequate liquidity.
  - Show that it has the ability to attract private capital within a reasonable time frame after the issuance of the capital instruments.
  - Display a reasonable probability of returning to profitability and payoff the capital instruments within a reasonable time period.

- Possess the management capability to meet these objectives.

o Institutions participating in this program should also have to comply with certain restrictions after the capital instruments have been issued. Some of the restricitons we suggest are:

  - No dividends should be paid until the capital instruments are retired.

  - Any barriers to consolidation should be removed by eliminating bylaw provisions which reduce the marketability of the institution.

  - There should be restrictions on management remuneration (e.g., elimination of "golden parachutes" and other management contracts as well as limits on management compensation).

  - There should be consistent efforts to raise external capital.

o Infusion of capital into participating institutions is a necessity, and they should agree to raise capital within reasonable time frames as market conditions permit.

  - Mutual institutions participating in the capital instrument program must agree to convert to a stock form of ownership when market conditions improve to the point where the conversion will raise reasonable amounts of capital.

  - Stock institutions participating in the program must recapitalize by obtaining private capital or seeking merger partners.

o An alternate capital infusion program could be a preferred stock purchase by the FDIC. Either the capital instrument program or the preferred stock program could be implemented immediately since there is a precedent and no new legislation would be required. However, one necessitates tapping the FDIC fund and the other does not.

- Participation in the plan should not be limited to those institutions with capital levels below three percent.
  - Participation should be available to any institution willing to comply with the criteria for issuance and abide by the restrictions after issuance.
- The plan should be available to allow banks to restore their losses up to the attainment of an 8% capital level.

III. Summary

This bank funded assistance program:

- Will not cost the taxpayers or the FDIC any money.
- Will encourage banks to resume responsible lending.
- Will help stabilize the real estate market.
- Will prevent the destruction of existing customer relationships.
- Will stabilize our economy.
- Will aid in an orderly recovery of the banking system in Connecticut.
- And will help restore public confidence in the FDIC fund.

This situation is extremely dire. A number of banks face technical insolvency in the very near future. Because there is a precedent for bank funded capital instrument programs, and no new legislation would be required, such a program could be implemented immediately. But time is now of the essence.

# # #

....FINAL DRAFT....FINAL DRAFT....

The New England Council, Inc.

581 Boylston Street Boston, Massachusetts 02116 (617) 437-0304 • 1455 Pennsylvania Avenue, N.W., Suite 1000, Washington, D.C. 20004 (202) 639-8955

December 27, 1990

name
Branch
City, *state* *Zip Code*

HELP SAVE NEW ENGLAND'S ECONOMY!

Dear *sal*:

Representing over ten thousand businesses, we the undersigned are asking for your immediate attention to a crisis threatening our prospects for future business growth and jobs creation.

New England is gripped by an economic recession more severe than at any time in the past two decades. Throughout the region, new business formations have been declining since 1987 while the number of business failures has increased. The traditional pillars on which our economic primacy of the past decade was built - a strong defense industrial base, a high technology industry that dominated the market, and aggressive, creative banking and insurance sectors that fueled our economic growth - are all going through a painful re-adjustment period.

It is this last item to which we draw your urgent attention. Talk of an economic recovery is only speculative at best if the region's banking system continues to erode. As business leaders, it is implicit that our prospects for growth are tied to working capital and credit availability.

To address this concern, we offer you a list of recommendations to strengthen the banking community - and through it, New England businesses - and seek to talk further to you about what is perhaps the region's number one concern. They require no legislation or federal funds, and could be put in place immediately. Perhaps, most desirable of all, we believe that, if implemented, all depositors, taxpayers and borrowers will be protected from the day they may be called upon to bear the cost of a decimated banking system. Our recommendations are to:

1. Establish a regulatory pilot program directed toward New England;

2. Allow area allowances for dividing non-performing loans into "good" and "bad" loans;

3. Create FDIC capital investment instruments, such as preferred stock or RFC-type certificates, which could be used as transition capital;

4. Accelerate and make readily accessable open bank assistance to distressed New England area banks, to provide operating capital; and

5. Allow same-market mergers and New England-wide branching to reduce administrative costs even where external capital infusion is not immediately available.

In addition, we also believe the following three-step "self help" plan addresses the problem:

1. Allow the FDIC to purchase capital instruments of the banks, designated as Net Worth Certificates, bearing a stated dividend rate;

2. Banks would either purchase Treasury Bonds in an amount up to the value of the New Worth Certificates of loan the money to the FDIC directly at interest rates at least as great as the certificate's dividend rate; and

3. The Treasury Bonds would then be pledged to secure the Net Worth Certificates and the Treasury proceeds would be used to fund the purchase of the Certificates. If no bonds were used, the FDIC would have the right to set off the loan to the FDIC against the Net Worth Certificates in the event of a failure of the bank.

In strong economic times and in weak, capital is the life-blood of an area's economy. Available credit allows businesses to expand and employ more workers and contribute significantly to a community's economic base. When credit tightens - as is now the case throughout New England - the opposite happens. When the amount of available credit decreases in the midst of a region-wide recession, there is a genuine cause for alarm. This is the situation prevailing in New England.

Federal bank regulators, in response to the S&L crisis, began a region-by-region application of rigid credit standards. For a variety of reasons, New England was targeted first. But coming as it did during a cyclical recession, these policies have further hurt New England's economy. We are concerned that the failure to address this situation immediately will result in widespread business closures and an escalation of unemployment.

The tightened supervisory standards on New England financial institutions have been devastating not only to banks throughout the six state area, but also to businesses and the region's economy. The impact of these actions has forced banks to shrink rather than grow; close rather than operate; and reduce the amount of capital available to New England businesses.

We also recognize political reality. We understand that the S&L crisis and the failure of a significant number of financial institutions throughout the nation to impose prudent standards on their loans creates a difficult situation for Members of Congress relative to seeking a relaxation of guidelines meant to protect depositors' funds. But, we the undersigned, and our member firms, share the conviction that economic resurgence must have as a key ingredient available credit to allow our businesses to be competitive and grow.

It is our strong hope that you will encourage congressional hearings as early in January as possible either in Washington or as a regional field hearing in New England to discuss the regional impact of the credit crunch. The organizations listed below would be pleased to offer their assistance in coordinating field hearings in the region.

In closing, we want to restate our main concern: New England's economy is reeling and desperately needs help immediately. Businesses are closing, thousands are losing their jobs and hopeful signs of a turn-around are diminishing. Only by shoring up the banking sector, and working with its regulatory agencies, can New England business realize the increased amounts of available capital necessary to fuel the engines of an economic recovery.

But, in order to do so, we need the active support of the region's congressional delegation. Therefore, we urge your immediate attention to this situation and request a meeting with you as soon as it can be arranged.

Thank you very much for your attention to our concerns. We look forward to seeing you soon.

Sincerely,

Nicholas P. Koskores, Pres.
The New England Council

John Crosier, Pres.
Business & Industry Association
of New Hampshire

Timothy Moynihan, Pres.
Greater Hartford
Chamber of Commerce

John Gould, Pres.
Associated Industries
of Massachusetts

John Rathgeber, Exec. VP
Connecticut Business
& Industry Association

cc: The New England Governors

Withdrawal/Redaction Sheet
(George Bush Library)

Document No. and Type	Subject/Title of Document	Date	Restriction	Class.
01. Memo	From Jackie Kennedy to John Sununu Re: Attached Memo from Chris Gallagher (1 pp.)	1/24/91	P5	

Collection:

Record Group: Bush Presidential Records
Office: Chief of Staff, White House Office of
Series: Sununu, John, Files
Subseries: Issues Files
WHORM Cat.:
File Location: Credit Crunch 1991 [3]

Open on Expiration of PRA
(Document Follows)
By JF (NLGB) on 10/28/05

Date Closed: 1/3/2005	**OA/ID Number:** 29151-006
FOIA/SYS Case #: 1998-0004-F[2] **Re-review Case #:** 2005-0426-S **P-2/P-5 Review Case #:**	**Appeal Case #:** **Appeal Disposition:** **Disposition Date:**
AR Case #: **AR Disposition:** **AR Disposition Date:**	**MR Case #:** **MR Disposition:** **MR Disposition Date:**

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P-1 National Security Classified Information [(a)(1) of the PRA]
P-2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P-3 Release would violate a Federal statute [(a)(3) of the PRA]
P-4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P-5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P-6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

PRM. Removed as a personal record misfile.

Freedom of Information Act - [5 U.S.C. 552(b)]

(b)(1) National security classified information [(b)(1) of the FOIA]
(b)(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
(b)(3) Release would violate a Federal statute [(b)(3) of the FOIA]
(b)(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
(b)(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
(b)(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
(b)(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
(b)(9) Release would disclose geological or geophysical information

F.Y.I

THE WHITE HOUSE

WASHINGTON

January 24, 1991

THE CHIEF of STAFF
has seen

MEMORANDUM TO Governor Sununu

FROM Jackie Kennedy

Chris Gallagher called me this morning, he "does not like to come into DC without you knowing he's here or has been here".
*See attached

All of the New England Congressional delegation was present with the exception of Rudman and the Senior Kennedy.

Bottom line is all recognize there is a problem and are all ready to work as a non partisan body.

The hold up, if any, that Seidman has is that he cannot get anything cleared from Treasury, Brady and Glauber. He's not asking you to do anything just to be aware that they are all working together on this. More information will follow.

GALLAGHER, CALLAHAN & GARTRELL
PROFESSIONAL ASSOCIATION
214 NORTH MAIN STREET
P.O. BOX 1415
CONCORD, NEW HAMPSHIRE 03302-1415

TELEPHONE
603-228-1181
TELECOPIER
603-224-7588
603-226-3477

DATE: 1/24/91

TO: Jackie Kennedy

FAX #: 202-456-2397

FROM: Chris Gallagher

RETURN FAX #: 603-226-3477

CONTACT FOR VERIFICATION: Janet Ext: ____

TOTAL NUMBER OF PAGES INCLUDING THIS FAX COVER SHEET: 4

TIME SENT ______ AM / PM

IF YOU DO NOT RECEIVE THIS FAX PROPERLY, PLEASE CONTACT US AT (603) 228-1181.

COMMENTS/INSTRUCTIONS:

Dear Jackie:

In order to avoid tying up your fax machine, I will Fed Ex the background material provided to the New England members. This program and fact sheet summarizes the substance of the meeting.

CCG

CLIENT #: ______

Janet Benson
(Signature of Fax Operator)

(Rev. 2/15/90)

The New England Council, Inc.
1455 Pennsylvania Avenue, N.W., Suite 1000, Washington, D.C. 20004 (202) 639-8855 • 581 Boylston Street Boston, Massachusetts 02116 (617) 437-0304

NEW ENGLAND'S CREDIT SHORTAGE

A Briefing
for
Members of the New England Congressional Delegation

January 23, 1991
8:00 a.m. - 9:30 a.m.
188 Russell SOB

AGENDA

Opening Remarks

W. N. "Rink" DeWitt
Past Chairman
The New England Council

Chairman
BankEast

Economic Overview

Nicholas S. Perna
Chief Economist & SVP
Shawmut National Corporation

Options for Strengthening New England's Banks

Sheldon L. Pollock
Chairman & CEO
North American Bank and Trust Company

Christopher C. Gallagher
Legislative Counsel
New Hampshire Bankers Association

Discussion

FACT SHEET

Background

o Capital is the life-blood of an area's economy. Available credit allows businesses to expand and employ more workers and contribute to a community's economic base. When credit tightens-as is now the case throughout New England-the opposite happens. When the amount of available credit decreases in the midst of a region-wide recession, there is genuine cause for alarm. This is the situation prevailing in New England.

o In the past 2 years, New England has lost 254,000 jobs, a decline of 4 percent. This accounts for 20% of all jobs lost in the United States, although New England only accounts for 5% of the nation's population.

o New business formations in New England have been decreasing since 1987 while business failures have increased.

o Business failures increased by 193 percent in New England in 1990, compared to 14.5 percent nationwide, according to Dun & Bradstreet.

o The Consumer Confidence Index in New England, measured by the Conference Board, plunged to the lowest level ever recorded for any area.

o According to Federal Reserve data, loans to businesses by the nation's largest banks fell nearly $5.2 billion in 1990. In 1989, these loans increased by $18.4 billion.

o According to the National Federation of Independent Businesses, only 33 percent of its members said they were borrowing regularly, a record low.

o A survey taken by the Connecticut Business and Industry Association of its members on this issue revealed that 25 percent of the respondents said they had been turned down for a loan during the first half of 1990. More than 10 percent had a loan called.

Options for Consideration

o Allow the FDIC to purchase capital instruments of the banks, designated as Net Worth Certificates, bearing a stated dividend rate; and o Banks could then loan the money to the FDIC directly at interest rates at least as great as the certificate's dividend rate.

Regulators should also be urged to:

o Utilize procedures now available without new legislation or administrative rule-making;

o Consider open bank assistance programs involving early intervention with FDIC capital;

o Encourage expense reduction analysis through consolidation and asset sales which can be considered as equivalent to outside capital;

o Expedite procedures for multi-agency participation on open bank assistance plans to promote broader opportunities for consolidation;

o Expedite procedures within the agencies to encourage and fast-track proposals for open bank assistance; and

o Establish expedited procedures for Herfindahl-Hirschman Index review and for cooperative and complementary due diligence to encourage outside capital and save time.

Prepared by:

The New England Council
January 23, 1991

REMARKS

by Christopher C. Gallagher
to New England Congressional Delegation Members

Wednesday, January 23, 1991

We have added materials to the packet provided by the New England Council to introduce your respective staff people to the problem, and to outline regulatory actions we believe will help with New England's credit crisis. These approaches are available and needed now, without having to wait for Congressional overhaul of the entire structure of financial institutions, or for legislative proposals to recapitalize the shrinking Bank Insurance Fund. On the basis of public and private assurances from highly placed regulatory sources, we believe that:

1. The regulators realize that New England needs special attention and have the tools in place to do the job now,

2. That in spite of the coordinated efforts of the New England Governors, the regulators will be a lot more responsive, and thus flexible and creative, if they perceive a collective signal from the Hill that such treatment of New England will not be interpreted later as being too soft, or as a retreat from their regulatory responsibilities, and

3. That although we can point to the need for such programs and signals, their form and substance are best left to the delegation and the regulators themselves, depending upon those measures deemed most appropriate by you in giving the signal, and by the regulators in applying their existing procedures to the particular circumstances of each institution with which they are dealing.

In simplest terms, the liquidity problem strangling business in New England, especially smaller business, is based upon the banking situation.

1. Capital is being diverted to loan loss reserves and is not being replenished, either from earnings or outside contributions. Reduced capital requires reduced assets, a process of downsizing which the regional economy can absorb if it occurs on a sporadic basis. Unfortunately, it is occurring in New England on a broad and general scale. Our economy cannot absorb that.

2. The impact on commercial and industrial lending has been the most pronounced. Prudence, buttressed by regulatory oversight, requires that strained institutions in New England <u>balance</u> the highly illiquid real estate assets presently overweighting their portfolios with a significant percentage of highly liquid assets. This liquid counterweight to the illiquid real estate assets leaves little room for the assumption of business commercial risk in bank portfolios.

Big business can float paper. Small business has only the banks to serve its need for capital to operate and expand.

Two things must occur:

1. At the point where the shifting of shrinking capital to loan loss reserves jeopardizes institutional viability rather than enhancing it, regulators must exercise new caution in their efforts to classify banking assets. They must take into account longer term evaluation and liquidation techniques appropriate for loans collateralized by real estate assets. When capital is all but gone, greater flexibility is warranted not tighter regulation, because accelerating capital depletion in these circumstances only hastens the circumstances leading to federal take-overs and federalization of banking assets. When all of a bank's capital has been shifted to loan-loss reserves, there is no benefit to the BIF by further increasing loan-loss reserves. Federal regulators can never admit to such a change in emphasis, but they must be encouraged to do it, just as referees are expected to call a close game differently in the closing minutes, but can never admit that they are doing so.

Secondly, we need:

2. <u>Open Bank Assistance Programs</u> to keep banks open rather than closed. OBA can most easily be understood by comparison to Chapters 7 and 11 in bankruptcy proceedings. As you know, in a Chapter 7 situation, a company is closed. Its assets are liquidated immediately. Under Chapter 11, operations are

allowed by the creditors to continue under an agreed plan on the premise that, in the longer run, the creditors will come out better. OBA is a little like Chapter 11.

In the case of banking, the situation can be analogized in the following way. The FDIC is, in effect, the creditor whose insurance fund, the BIF, will have to make good on the bank's liabilities to its depositors. As with any plan in bankruptcy, each program must be customized to the situation involved, but there have been common threads to these direct OBA plans as they have been used in the past.

Normally, there is a finding that there is a cost-benefit saving to the BIF (and thus the taxpayer) by early intervention and the infusion of capital and other assistance. Naturally, there are certain restructurings or management controls built into the plan. There are trade-offs.

Another occasion for such assistance is a finding of "essentiality", based upon factors such as local economic conditions, the availability of alternative financial services, and the extent to which liquidation would pose a substantial risk to a bank's service area or the financial system itself.

Each OBA plan culminates in a detailed agreement, itself based upon a mix of equity, which takes the place of the potential debt, other guarantees of risk to outside sources of capital, and a whole array of procedures designed to promote and protect the viability of the institution, and the senior position of FDIC's equity. These may take the form of loans, stock, acquisition of assets, guarantees of asset yields and other forms of forbearance with respect to asset evaluation procedures.

To this point, at least, it has been FDIC policy to permit these transactions <u>only</u> in the context of infusions of outside capital. FDIC willingness to offer OBA may stimulate outside capital, but it would seem that, given the present situation in New England, where we are redlined to the prospect of outside capital, the FDIC should also be willing to consider as the equivalent of "capital" substantial savings incurred by consolidations, asset sales or other internal cost savings devices. This approach would encourage voluntary action on the part of banks and bankers to assume a more flexible attitude themselves in the structuring of these programs, and generally needed consolidation and cost savings.

The statutory basis for these transactions is set forth in Section 13 of the FDIA as amended. The policy guidelines have been revised by FDIC as recently as March of 1990, and are provided to your staffs in our backgrounder, along with some recent press clippings we hope will be informative.

Our specific recommendations, and again these are set forth in the materials provided, are as follows:

Regulators should be urged to:

1. Utilize procedures now available <u>without</u> new legislation or new administrative rule-making.

2. When an institution's capital has been depleted and transfers of capital to loan loss reserves can no longer benefit the BIF, the regulatory approach should be modified, with an eye to keeping it operating for the benefit of borrowers and of providing credit.

3. Consider open bank assistance (OBA) programs involving early intervention with FDIC capital before the lines form.

4. Encourage expense reduction analysis through consolidation and asset sales which should be considered as equivalent to outside capital, especially when outside capital does not materialize.

5. Expedite procedures for multi-agency participation in OBA plans to promote broader opportunities for consolidation. (BIF & SAIF) (Agency Liaisons)

6. Expedite procedures at regional levels within the agencies to encourage fast-track proposals for OBA. (Structures and response team).

7. Establish expedited regional procedures both for anti-trust Herfindahl-Hirschman Index review and for cooperative and complimentary due diligence to encourage outside capital.

Implemented soon, these programs and changes in emphasis can remove the uncertainty which lies at the bottom of the continuing asset deflation now plaguing New England. They would end the death spiral, allowing a bottom to form. Until that uncertainty is removed and a bottom formed, we cannot attract investment to New England. Moreover, when and if the bottom is reached, we will need banks to finance our recovery.

If we continue on our present course, too many of our assets will be nationalized, a fate for our economy which, if not worse than death, is awfully close to it.

(Additional Info)

When the strict application of asset classification standards requires transfer of capital legally required for operations, such transfers require a bank to shrink its assets. This procedure means one thing when the bank involved operates in an otherwise healthy market service area. When the entire banking system in the area is operating under similar duress, asset downsizing has a deleterious impact on the area's entire economy. These transfers protect the BIF, nevertheless, by moving the capital cushion away from equity shareholders and toward protecting the fund.

However, once a bank in similar circumstances has its capital depleted, nothing is added to loan-loss reserves to protect the BIF. At this point (and it has been reached by a significant number of New England banking institutions), there is no benefit to BIF resulting from the transfers. Regulators must be urged, when that point is reached, to be extra cautious in their exercise of discretion regarding asset evaluation. At that point, being too strict can be counter-productive.

THE NEW ENGLAND ECONOMY:
A Statistical Overview

January 23, 1991

N.S. Perna
Shawmut National Corporation

EMPLOYMENT SITUATION

	Nonfarm Jobs Nov. 1990			Unemployment (%)	
	% change vs. year ago	# of jobs lost since peak	peak month	Nov-90	Dec-90
Connecticut	-1.2	30,000	Jan-90	5.2	
Maine	-4.3	26,000	Jan-90	6.7	
Massachusetts	-3.6	154,000	Dec-88	7.0	7.4
New Hampshire	-2.6	27,000	Dec-88	7.1	
Rhode Island	-2.3	18,000	Jun-89	7.1	
Vermont	-2.9	10,000	Jan-90	6.3	
New England	-2.8	239,000	Jan-89	6.5	
United States	0.8	662,000	Jun-90	5.9	6.1

PERSONAL INCOME (% change)

	90:Q2/89:Q2	1988/1987
Connecticut	2.9	9.7
Maine	4.2	9.5
Massachusetts	3.1	9.8
New Hampshire	2.5	10.6
Rhode Island	4.5	8.6
Vermont	4.1	9.2
New England	3.2	9.7
United States	5.9	8.1

BUSINESS INCORPORATIONS & FAILURES

1st 9 months of 1990: % change vs. year ago

	Incorporations	Failures
Connecticut	-7.1	153.9
Maine	-15.5	39.2
Massachusetts	-11.3	261.0
New Hampshire	-10.2	162.2
Rhode Island	-8.7	163.4
Vermont	-5.5	60.6
New England	-9.8	192.8
United States	-4.0	14.5

IMPACT OF CREDIT CRUNCH

% of Connecticut businesses reporting:	Apr. 90	Oct. 90
Financing more difficult to obtain	76.2%	82.7%
for working capital	63.1	77.1
for equipment	59.1	85.7
Credit availability negatively affecting Connecticut economy	86.3	97.3

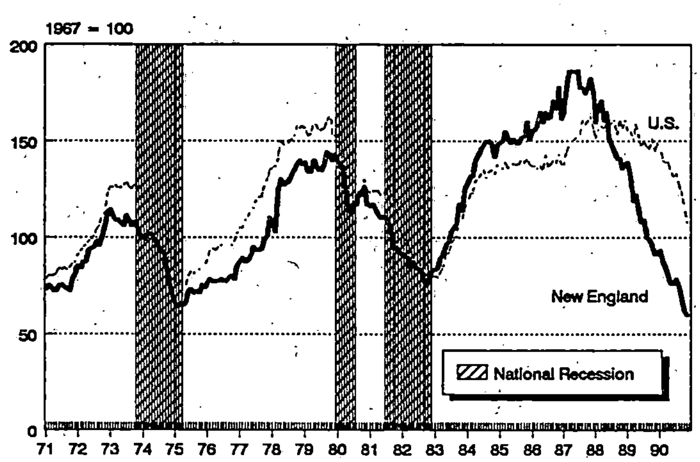
Source: Connecticut Business and Industry Association

Loans at Large Weekly Reporting Banks

(12/26/90 vs. 12/27/89 % change)

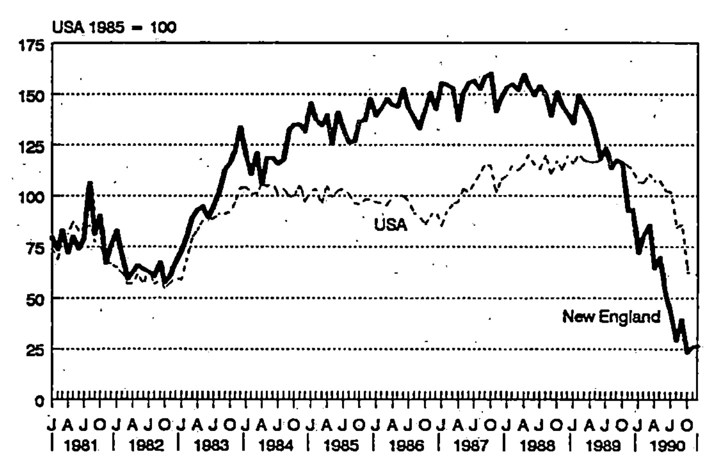
	1st District	USA
Total Loans, leases, & securities	-15.3	2.6
Commercial & Industrial	-18.0	1.2
Real Estate	-23.8	7.7
U.S. Treasuries & Agencies	31.5	14.5
Muni's	-71.0	-22.8

Help Wanted Advertising



through November 1990

Consumer Confidence



through December 1990

NEW ENGLAND OUTLOOK

	Actual			Forecast		
	1988	1989	1990	1991	1992	1993
New England						
Jobs	2.4	0.2	-1.9	-2.5	0.1	1.4
Unemployment	3.1	3.9	5.6	7.4	6.8	6.1
Income	9.7	6.9	3.2	2.6	4.1	4.9
Housing Starts	-15.7	-33.7	-35.2	-15.3	24.6	15.2
Connecticut						
Jobs	1.8	0.3	-0.5	-2.0	-0.1	1.2
Unemployment	3.0	3.6	5.2	7.1	6.6	5.8
Income	9.6	6.6	3.2	3.0	4.0	5.0
Housing Starts	-23.4	-39.6	-36.5	-6.5	20.5	11.1
Massachusetts						
Jobs	2.1	-0.3	-2.4	-2.8	0.0	1.5
Unemployment	3.3	4.0	6.0	8.2	7.6	6.6
Income	9.8	6.5	2.9	2.2	3.7	4.6
Housing Starts	-18.0	-30.5	-33.4	-20.7	18.4	15.8
Rhode Island						
Jobs	1.7	0.4	-1.5	-2.3	-0.1	0.9
Unemployment	3.1	4.1	6.5	7.0	6.6	6.1
Income	8.6	6.9	4.5	3.6	4.7	5.0
Housing Starts	-14.8	-26.2	-28.1	-21.0	30.8	11.2
Vermont						
Jobs	4.3	2.1	-1.9	-3.5	0.0	1.4
Unemployment	2.7	3.6	4.8	6.9	6.8	6.4
Income	9.2	8.9	4.2	2.5	4.5	5.3
Housing Starts	13.4	-26.1	-35.9	-18.0	23.2	12.2
New Hampshire						
Jobs	3.2	-0.5	-3.4	-2.1	1.0	2.2
Unemployment	2.5	3.5	5.3	6.5	5.4	4.5
Income	10.6	6.5	2.4	2.8	4.7	5.5
Housing Starts	-16.1	-42.2	-46.6	-16.3	54.4	29.8
Maine						
Jobs	5.2	3.2	-1.9	-2.5	0.6	1.3
Unemployment	3.6	4.1	4.8	5.7	5.6	5.4
Income	9.4	9.5	3.8	2.8	5.3	5.6
Housing Starts	-0.1	-29.8	-31.1	-7.1	24.2	10.9

Source: New England Economic Project

All figures are % change from previous year, except for unemployment which is % level.

GALLAGHER, CALLAHAN AND GARTRELL
PROFESSIONAL ASSOCIATION
P. O. BOX 1415
CONCORD, NEW HAMPSHIRE 03302
TELEPHONE 603-228-1181

OPEN BANK ASSISTANCE BACKGROUNDER

THE PROBLEM

One year ago, the overall political world of financial institutions provided a foundation for the situation in New England today. Consider the issues.

- Inflation - thought to be moving ahead unchecked.

- The Deficit - moving out of control with little hope for fiscal management.

- Interest Rates - had to be kept up; to control inflation, allow funding of the deficit and maybe to provide a cushion later for the soft landing everyone hoped would occur at the end of the long expansion of the 80's.

- Regulators - with blame for the S&L debacle up for grabs, and visions of Danny Wall's experience on the Hill, they looked forward to a one year proving process before financial institutions restructuring was to occur, including agency restructuring.

  Insurance Funds - were obviously under-funded and would need recapitalization in some form. Note that a percentage assessment of bank deposits had been floated early as a trial balloon and, having been labeled by Chairman Seidman himself as the "reverse toaster" theory of taxation, was quickly punctured---part of a degenerating dialogue between him and the White House.

New England became the first stop in an area by area, region by region, approach by the regulators; to cool inflation without lowering interest rates, to shut down the excesses of the 1980's, to preserve bank insurance funds from meltdown and to prove to Congress that they could be tough and deserved survival when the time for restructuring arrived.

Using classic techniques for exerting control with limited resources, they hit New England hard, employing what we have earlier termed the "random intimidation method", to induce new levels of bank caution. It worked. Congress might have protested more vehemently, but for many reasons, all of them understandable, it didn't.

In summary, suffice it to say that one year ago, past events, existing rage and confusion, and future restructurings combined to impose enormous pressure on the regulators to do in New

England exactly what they did. They looked to Congress for a signal. No signal was given, or at least it appeared the signal was "thumbs down". The impact is now clear to all. As stated in the New England FRB publication, "the earliest Christians got the hungriest lions". The B.N.E. situation brought all this to a head. Now regulators and elected officials are asking what can be done to ameliorate the situation. Time is short for New England. We must use it well.

The political process has not changed. The regulators are still looking for a signal from the Hill. How that signal is given, and how much is public or private is best decided by Congress. Led by Governor Gregg of New Hampshire, the New England Governors acting as a group have accomplished a great deal by obtaining private and public commitments from federal regulators to be more flexible, creative and understanding of the impacts of the area regulatory crackdown on the area's already weakened economy. At the bottom line, however, what matters to federal regulators is what matters to Congress. If Congress tells them what it wants, they can and will respond, with the tools they have at hand, both to justify their present existence and to establish a foundation for their future existence and funding.

THE PRESENT SITUATION

1. FDIC Insurance - (THE BIF)

The BIF must be recapitalized either through the Treasury, the Banks or some combination thereof. Congress will be asked for the funds. When asked, it is reasonable for a member from New England to ask, "How wisely and well did you spend the funds you had? Did you simply close banks, or did you apply cost-benefit techniques, which ultimately benefit the taxpayer while keeping an area's economy operating?"

2. Restructuring Legislation

When bank regulatory agencies seek to justify their continued existence, the key question should not be how tough they were. Rather, it should be how smart they were when it became clear that a massive credit crunch, inseparable from the regulatory crackdown (whatever its cause), had occurred in conjunction with their approach in New England---and its consequences, which may occur elsewhere.

THE NEW ENGLAND SITUATION

It is clear that by the time statutory restructuring occurs, and probably before recapitalization of the BIF, New England may be beyond the point of statutory relief. The regulators have signaled publicly and privately that they are ready to help now, and that support from Congress would be welcome. New England needs that support. When offered, here's what regulators can do now, even without statutory or regulatory changes.

1. <u>Asset Evaluation and Loan Classification</u>

The normal circumstances envisioned by today's regulatory structures assume isolated supervision of an individual bank, without particular reference to the external impact of that regulatory action. The procedures are designed to ensure that a bank's reserves are adequate to cover the risks posed by the bank's assets, and that there is sufficient capital to protect the federal insurance funds from undue risk if the bank fails. In the normal situation, when faced with a weak institution in an otherwise healthy market area, these objectives are quite consistent. When weak assets are found, increases in loan-loss reserves are demanded. They come from earnings, or if there are none, from capital. In effect, the bank's equity is transferred on the asset side of the balance sheet from its owners, the stockholders, to its insurers, the federal government.

In the present situation in New England, there is an area-wide credit crunch caused by severe contractions in funds available for commercial lending. In many of our larger financial institutions, there is a depleted capital position. Under these circumstances, however appropriate it may be to require that an individual institution add to its loan loss reserves while depleting its capital, this process cannot be viewed in the isolated context of a single bank. The present situation in New England requires a more cautious regulatory approach.

1. When the creation of loan loss reserves, based on very strict classification of asset values, causes capital to fall below required regulatory capital to asset ratios, the bank must shrink itself. When this occurs on an area basis, the result is no longer a "theoretical death spiral", it becomes the present situation in New England. The transfer of equity from capital to loan loss reserves is also protecting the federal insurance fund. If that protection is the regulators' primary object, such strictness is understandable; however,

2. When adding to loan loss reserves from capital reaches the point where the bank's capital is almost entirely depleted, we have a very different situation. First, the cushion protecting the federal insurance fund is virtually gone anyway. Second, events are moving to the point where the bank's assets will literally be "put" to the FDIC. FDIC will be obliged to "federalize" them, a process which not only makes regional matters worse, but which further drains the insurance fund itself. In this context, overzealous regulation becomes counter-productive.

It is clear that in today's New England economy the process of forced transfers from capital to loan loss reserves can reach a point of diminishing returns both to the FDIC fund, and to the area's economy. At that point, the process of <u>added constraint as capital shrinks</u> should operate in just the opposite manner---i.e. regulators should be <u>more cautious</u> when capital has diminished and earnings and outside capital are not available to augment it. The absence of benefit to the insurance funds and the dangers of adverse impact to our area's economy should cause the regulators to proceed more carefully.

Regulators, like referees, will never admit that they can call the game differently, depending on the circumstances. Yet, they must be urged to do so when continued strict application of a strict classification process will cause many institutions to close; when given time, they can work their way through their problem assets. If that sounds like what happened in the Southwest, it isn't. New England's banks and economy are not comparable to the S&L situation in the Southwest. There is no evidence of fraud or negligence in our New England banking structure. Mistakes were made to be sure, but that period of over-expansion has long passed. The laws governing the FDIC recognize this point of diminishing returns. They provide for the exercise of discretion and even provide for early intervention with federal infusions of capital in the form of Open Bank Assistance.

<u>OPEN BANK ASSISTANCE (OBA)</u>

In order to fully understand Open Bank Assistance (OBA), it is necessary to realize that it is not a clearly articulated procedure, it is a <u>process</u>. It requires threshold findings, either of:

> <u>Essentiality</u>, a test which considers factors such as local economic conditions, the availability of alternative financial services, and the extent to which liquidation and "federalization" of a bank's assets would disrupt, or pose a substantial risk, to a bank's service area or the financial system itself, or
>
> <u>Cost-benefit savings</u>, to the Bank Insurance Fund (BIF) accompanied by conclusions about the insured bank institution's (IBI's) viability and an appropriate restructuring plan.

OBA is similar to an advance reorganization plan in bankruptcy, structured and accepted by creditors as a plan to provide a better return on their outstanding debt than what would be provided by an immediate shutdown and liquidation. In the case of OBA, through early intervention the creditor agrees to a plan which will provide a better chance of being repaid. With OBA, the creditor is the FDIC. Each plan is tailored to the individual circumstances of the institution or institutions applying for OBA.

As a general category, OBA includes all forms of assistance by the FDIC designed to maintain an institution as "open" rather than "closed". In the past, it has included FDIC loans, cash assistance, deposit placements, indemnification against losses on assets, acquisition of assets, guarantees of asset yields and the purchase of stock. Normally, OBA is provided in conjunction with infusions of capital from outside sources. Chairman Seidman, however, appears to be amenable to considering proposals which do not include outside private capital infusions, but by their nature result in substantial cost savings, which can be deemed equivalent to outside capital.

OBA HISTORY

The original OBA program was really the Reconstruction Finance Corporation program, which existed from 1932 until June of 1957. Without reconstituting that program, OBA is provided for in the Federal Deposit Insurance Act of 1950. Section 13(c) allows the FDIC to provide assistance when the continued operation of a bank is essential to providing adequate banking services in the community. In 1982, the Garn-St. Germain Depository Institutions Act allowed the FDIC to prevent the failure of insured banks if the cost of assistance was less than the cost of liquidating the bank. At that point, therefore, there were two tests available to act as a threshold for OBA; either "essentiality" or "cost benefit".

In 1986, the FDIC issued its own policy criteria for OBA. FIRREA amended Section 13 to include institutions insured by the SAIF. Following FIRREA, in March of 1990, the FDIC issued a new statement of policy which replaces its 1986 statement. An annotated copy of the policy criteria for OBA for FDIC insured banks is attached hereto as Exhibit A.

NEW ENGLAND OBA

Because New England is, in many respects, "redlined" with respect to outside capital, and the earnings of troubled banks are simply unable to augment capital internally, infusion of FDIC capital is needed to attract outside capital. The expressed regulatory rationale for the Bank of New England (BNE) bridge bank take-over provides the basis for Congressional encouragement and reassurance to federal regulatory agencies to continue to approach individual institutional regulatory measures in the broader context of the New England regional economy. Moreover, although BNE required a takeover because of the run, the notion of capital infusion before closure and cost-benefit to the fund is critical to breaking the capital "death spiral" confronting New England banks. The key is to provide capital from the FDIC and by doing so to faciliate capital from the outside. Where such capital is still not available, substantial savings generated by consolidations, or other cost cutting techniques, should be treated as the equivalent of such outside capital.

REGULATORS SHOULD BE URGED TO:

- Utilize procedures now available without new legislation or new administrative rule-making.

- Consider open bank assistance (OBA) programs involving early intervention with FDIC capital.

- Encourage expense reduction analysis through consolidation and asset sales, which should be considered as equivalent to outside capital when even with OBA outside capital does not materialize.

- Expedite procedures for multi-agency participation in OBA plans to promote broader opportunities for consolidation.

- Expedite procedures at regional levels within the agencies to encourage and fast-track proposals for OBA.

- Establish expedited regional procedures both for Herfindahl-Hirschman Index review and for cooperative and complementary due diligence to encourage outside capital.

With careful, cooperative and creative response to New England's banking situation through early intervention, open bank assistance and appropriate regulatory procedures, the economic condition now prevalent in New England can be stabilized and even turned around.

Christopher C. Gallagher

EXHIBIT A

Excerpted from
RESOLUTION TRUST CORPORATION
OPEN BANK ASSISTANCE
A Study of Government Assistance to Troubled Banks
From the RFC to the Present;
Office of Research and Statistics, May 1990,
Pages 49-56

FDIC STATEMENT OF POLICY ON ASSISTANCE TO OPERATING INSURED BANKS AND SAVINGS INSTITUTIONS

(March 27, 1990)

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") amended Section 13 of the Federal Deposit Insurance Act, as amended (the "FDIA"), 12 U.S.C. § 1823, to broaden the authority of the Federal Deposit Insurance Corporation (the "FDIC") under Section 13(c) of the FDIA to provide assistance to operating savings associations that are members of the Savings Association Insurance Fund (the "SAIF"), in addition to assisting operating banks that are members of the Bank Insurance Fund (the "BIF").

Given the importance of the statutory revisions to Section 13 of the FDIA, the Board of Directors of the FDIC has concluded that the FDIC's current policy for assistance to operating insured banks (the "Operating Bank Assistance Policy Statement"), which was published in the Federal Register on December 8, 1986,[1/] must be revised. This policy statement replaces the Operating Bank Assistance Policy Statement.

Certain criteria in the Operating Bank Assistance Policy Statement have been revised or removed to accord with the FDIC's experience since 1986 with assistance transactions under Section 13(c) of the FDIA.

I. Introduction

Under Section 13(c) of the FDIA, the FDIC may provide financial assistance to operating insured banks and savings associations: (1) to prevent the "default" of insured depository institutions or to assist insured depository institutions that are "in danger of default,"[2/] or (2) if, when severe financial conditions exist that threaten the stability of a significant number of insured institutions or of insured institutions possessing significant financial resources, to lessen the risk to the FDIC posed by such insured institutions under such threat of instability.

1/ 51 Fed. Reg. 44122 (1986).

2/ The terms "default" and "in danger of default" are defined in Section 3(x) of the FDIA, 12 U.S.C. § 1813(x).

In order for the FDIC to provide assistance to any operating insured bank or savings association, the FDIC Board of Directors must determine that either: (1) the amount of the assistance is less than the cost of liquidating (including paying the insured accounts of) the institution or (2) the continued operation of the institution is essential to provide adequate depository services in its community.3/

Assistance to operating insured banks and savings associations may be provided directly to the institution in danger of default, to another institution qualified to merge with or acquire the failing institution, or to a holding company or other qualified person or entity to facilitate its acquisition of the institution.

Proposals for assistance for operating banks and savings associations under Section 13 of the FDIA will be reviewed by the FDIC under the criteria listed in Section III of this policy statement.

Prior to FY 1992, proposals for assistance with respect to operating savings associations may be funded by the Resolution Trust Corporation (the "RTC"). Under Section 11 of the FDIA, until the SAIF has adequate funding (which will not be until FY 1992), the FDIC may request that the RTC, with RTC Oversight Board approval, provide necessary funds for the SAIF's financial operations.

II. Section 13(k) (5) of the FDIA

Section 13(k) (5) of the FDIA (12 U.S.C. § 1823(k) (5)) provides that the FDIC shall consider proposals for financial assistance by eligible SAIF members before grounds exist for appointment of a conservator or receiver for such institutions. Proposals under Section 13(k) (5) must meet the nine criteria of the statute, as follows:4/

3/ *See* Section 13(c) (4) (A) of the FDIA, 12 U.S.C. § 1823(c) (4) (A).

4/ The nine criteria for proposals submitted under Section 13(k) (5) of the FDIA are listed in subsections (k) (5) (A) (i) (I) - (III) and (A) (ii) (I) - (VI) of Section 13 of the FDIA, 12 U.S.C. § 1823(k) (5) (A) (i) (I) - (III) and (A) (ii) (I) - (VI).

(1) Grounds for the appointment of a conservator or receiver exist or likely will exist in the insured unless the institution's "tangible capital" is increased.5/

(2) It is unlikely that the institution can achieve positive tangible capital without assistance.

(3) Assistance by the FDIC likely would lessen the risk to the SAIF.

(4) Before the enactment of FIRREA, the institution was solvent under applicable regulatory accounting principles but had negative tangible capital.6/

(5) The negative tangible capital position of the institution is substantially attributable to supervisory transactions initiated by the Federal Home Loan Bank Board (the "FHLBB") or the Federal Savings and Loan Insurance Corporation ("the "FSLIC").

(6) The institution is a "qualified thrift lender"7/ or would be a qualified thrift lender if commercial real estate owned and nonperforming commercial loans acquired in supervisory transactions initiated by the FHLBB or the FSLIC were excluded from the institution's total assets.

(7) The appropriate Federal banking agency has determined that the institution's management is competent and in compliance with applicable laws and regulatory directives.

(8) The institution's management did not engage in insider dealing, speculative practices, or other activities that jeopardized the institution's safety or soundness or contributed to its impaired capital position.

5/ "Tangible capital" is defined in Section 5(t) (9) (C) of the Home Owners' Loan Act, as amended (the "HOLA"), 12 U.S.C. § 1464(t) (9) (C).

6/ See Section 13(k) (5) (A) (ii) (I) of the FDIA, 12 U.S.C. § 1823(k) (5) (A) (ii) (I).

7/ See Section 10(m) of the HOLA, 12 U.S.C. § 1467a(m), which was amended by Section 301 of FIRREA.

(9) The institution's offices are located in an "economically depressed region".[8/]

Applicants under Section 13(k) (5) generally will be required to meet all fourteen criteria listed in Section III of this policy statement, in addition to the aforementioned statutory criteria in Section 13(k) (5). However, with respect to criterion (5) in Section III of this policy statement, the FDIC will presume that management is adequate, based on the determination of the Office of Thrift Supervision, but will retain discretion to review the merits of individual directors and senior ranking officers.[9/]

Assistance proposals with respect to SAIF member institutions under Section 13(k) (5) that do not meet all nine of the aforementioned criteria may be submitted to the FDIC for consideration under Section 13(c).

III. Criteria for the FDIC's Consideration of Proposals for Assistance to Operating Insured Banks and Savings Associations

An assistance proposal for an operating insured bank or savings association should meet the following criteria (except where there are compelling reasons to the contrary):

(1) The cost to the FDIC of the proposal clearly must be less than other available alternatives and still provide for a reasonable assurance of the future viability of the institution.[10/]

8/ See Section 13(k) (5) (C) of the FDIA, 12 U.S.C. § 1823(k) (5) (C). The FDIC has issued an interim rule at 12 C.F.R. Part 357 (See 55 Fed. Reg. 11160 (1990)) that identifies eight states that qualify within the definition of an "economically depressed region" under Section 13(k) (5) (C). Those states are: Alaska, Arizona, Arkansas, Colorado, Louisiana, New Mexico, Oklahoma, and Texas.

9/ See Section 13(k) (5) (A) (ii) (IV) of the FDIA, 12 U.S.C. § 1823(k) (5) (A) (ii) (IV).

10/ The FDIC bases its cost analysis on an estimation of two factors: (a) the amount by which the liabilities of the institution exceed the value of the institution's assets, and (b) the portion of this deficit that would be incurred by the FDIC (or the RTC under Section

(2) The proposal must provide for sufficient tangible capitalization, through capital infusions from outside private investment sources, to meet the regulatory capital standards of the appropriate Federal banking agency.11/

(3) The proposal must ensure that the assistance will benefit the institution and the FDIC and not be diverted to other purposes. If the assisted institution is a subsidiary of a holding company, the proposal should be structured so that assistance is not given to the holding company, except where compelling reasons require it, and then only when the holding company acts solely as a conduit for immediately providing the entire amount of assistance to the failing insured depository institution.12/

(4) If the assisted institution is a subsidiary of a holding company, the proposal should be structured so that

---

11(a) (6) (H) of the FDIA, 12 U.S.C. § 1821(a) (6) (H)), in the event of a payoff. In calculating the cost of the assistance, the FDIC must include (a) the immediate and long-term obligations of the FDIC (or the RTC under Section 11(a) (6) (H) of the FDIA) with respect to such assistance, including contingent liabilities, and (b) the Federal tax revenues foregone by the Government, to the extent reasonably ascertainable. The FDIC estimates the value of the institution's assets based on available examination data and prior experience in collecting failed institution assets. In applying the cost calculation, the FDIC considers the premium that may be received for a closed institution in a purchase and assumption transaction and the administrative costs of paying off depositors. The FDIC also may consider other factors such as interest on funds it advances and the cost of maintaining a liquidation operation.

11/ The regulatory capital requirements of the respective Federal banking agencies are stated in: (1) for the Office of the Comptroller of the Currency, 12 C.F.R. § 3.6; (2) for the Board of Governors of the Federal Reserve System, Appendix A to Regulation Y, 12 C.F.R. Appendix A to Part 225; (3) for the FDIC, 12 C.F.R. Part 325, including Appendix A to Part 325; and (5) for the Office of Thrift Supervision, 12 C.F.R. Part 567, as published in 54 Fed. Reg. 46845 (Nov. 8, 1989).

12/ *See* Sections 13(c) (3) and 13(c) (9) of the FDIA, 12 U.S.C. §§ 1823 (c) (3) and 1823(c) (3) (9).

available resources from the holding company and its other insured subsidiaries and/or nondepository subsidiaries are used to make a significant contribution towards minimizing the financial exposure of the FDIC.

(5) The proposal must provide for adequate managerial resources. Renegotiation or termination of management contracts is to be completed prior to the granting of assistance. Continued service of any directors or senior ranking officers who served in a policy-making role of the assisted institution, as may be determined by the FDIC, will be subject to approval by the FDIC. Further, the FDIC may review and object to any or all parts of any new compensation arrangements (including termination clauses) covering these individuals during the period assistance is outstanding.

(6) The FDIC will consider on a case-by-case basis whether the proposal shall provide the FDIC with an equity interest in the resulting institution.[13/]

(7) It is preferable that any proposal for FDIC assistance provide for repayment of such assistance in whole or in part.

(8) The FDIC will consider on a case-by-case basis whether to acquire or service assets of assisted institutions. Generally, assistance proposals should provide for the surviving institution to service all assets of the assisted institution. Under appropriate circumstances, the FDIC may consider such incentives as bonus fees, gain-sharing, and loss-sharing arrangements on distressed assets.

(9) Fee arrangements to attorneys, investment bankers, accountants, consultants, and other advisers incident to requests for financial assistance must be disclosed to the FDIC and will be evaluated in determining the cost of the assistance package. Excessive fees must be avoided. In no case should payment of any fee be contingent upon approval or receipt of financial assistance.

13/ *See* Section 13(c) (4) (B) of the FDIA, 12 U.S.C. § 1823(c) (4) (B). The FDIC is prohibited under Section 13(c) (4) (B) from purchasing the voting or common stock of an insured institution; however, this restriction does not preclude the acceptance by the FDIC of non-voting preferred stock, warrants or other forms of equity or equity-equivalent arrangements.

(10) The FDIC shall consider assistance proposals within a competitive bidding process. The FDIC may solicit interest from qualified entities.

(11) An institution seeking open institution assistance must consent to unrestricted on-site due diligence reviews by any potential acquiror that is determined by the FDIC to be qualified after consultation with the appropriate Federal banking agency.

(12) Applicants must establish quantitative limits on all financial items in the proposal. For example, if applicants request indemnification from the FDIC for certain categories of contingent liabilities, assistance proposals must include ceilings on the FDIC's financial exposure for the respective categories of contingent liabilities.

(13) The financial effect on shareholders and creditors of the failing institution must approximate the effect that would have occurred had the assisted institution closed.

(14) If the assisted institution is a subsidiary of a holding company, the proposal should be structured so that the impact on directors, management, shareholders and creditors of the holding company approximates the situation that would be expected had the assisted insured institution subsidiary failed (holding company creditors therefore may be required to subordinate and/or renegotiate the terms of their debt).

IV. Other Information

Any proposal requesting assistance in accordance with this policy statement should be addressed to the appropriate FDIC regional office of the Division of Supervision and should provide the amount, terms, and conditions to the assistance requested as well as the details of the financial support to be provided. This information must be presented in sufficient detail as to permit the FDIC to estimate the maximum cost that will be incurred as a result of the proposal.

A copy of any proposal requesting assistance in accordance with this policy statement should be provided to the Assistance Transactions Section, Division of Supervision, FDIC, 550 17th Street, N.W., Washington, D.C. 20429, the institution's chartering authority, and, if approvals under the Bank Holding Company Act are required, the appropriate Federal Reserve Bank.

By Order of the Board of Directors. Dated at Washington, D.C., this 27th day of March, 1990.

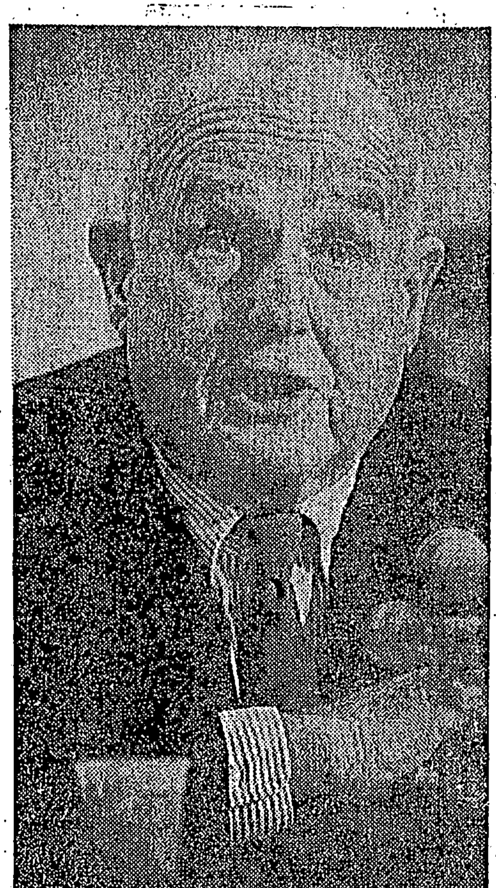
FEDERAL DEPOSIT INSURANCE CORPORATION

Hoyle L. Robinson
Executive Secretary

(SEAL)

THE WASHINGTON POST
SATURDAY, JANUARY 12, 1991

FDIC Chairman Proposes Creation Of Fund to Shore Up Weak Banks



L. WILLIAM SEIDMAN
... meets with New England governors

By Christopher B. Daly
Special to The Washington Post

BOSTON, Jan. 11—The nation's top banking regulator sought to reassure New England governors about their troubled banks today and called for creating a special new fund, drawing on public and private capital, to shore up weak banks before they fail.

L. William Seidman, chairman of the Federal Deposit Insurance Corp., also promised during a meeting with the six regional governors that he would explore ways to ease the region's credit crunch and prevent the problems of the banks from damaging the New England economy.

Seidman also used the meeting to promote a banking industry plan that is rapidly gaining favor in Washington: pumping money into troubled banks to keep them from going broke.

The proposal is similar to what the government did to keep banks in business during the Great Depression, when an agency called the Reconstruction Finance Corp. was set up to buy stock in ailing banks.

Several variations on the plan are being discussed by congressional, administration and banking industry leaders as a way to take some of the burden of bank failures off the FDIC. The cost of cleaning up 800 bank failures in the last four years is rapidly depleting the FDIC fund.

Even under optimistic economic forecasts, the FDIC will have only $4 billion left by the end of this year. If the recession proves to be worse than expected, the FDIC could run out of money, forcing the taxpayers to start picking up the tab for bank failures.

To avoid the need for a taxpayer bailout of the FDIC, Seidman said the banking industry and the government should set up a fund to invest capital in troubled banks. The money would make up for losses the banks have suffered on bad loans, enabling them to remain in business.

Leading advocates of the plan include the Association of Bank Holding Companies, a trade group headed by President Bush's old college roommate, former U.S. representative Thomas (Lud) Ashley. Ashley said the proposals have gained support rapidly in the last few weeks and are still evolving as government

See FDIC, C8, Col. 1

1

EXHIBIT B

Seidman Proposes New Fund

FDIC, From C1

and private officials suggest ways to bolster the banking system.

The basic idea, according to Ashley, is to require all banks to pledge a small amount—perhaps one-half of 1 percent of their assets—to invest in troubled banks. The investment fund would be administered by the FDIC, which would decide which banks might be saved with an investment of new capital and which ones were so sick they would have to be taken over.

Seidman has been floating the idea that the FDIC might provide part of the cash to invest in troubled banks. He said it would be cheaper to put a small amount of new capital into a troubled bank than to let it go broke and dump all its troubles on the FDIC.

That strategy would represent a fundamental change in the mission of the FDIC. The agency now is dedicated to protecting depositors, but it would be bailing out bank owners under the new approach.

In yesterday's sessions, the plan drew favorable responses from the New England governors, who met amid the gloom of a regional economic recession and banking crisis.

"It's an idea I like in concept," said Massachusetts Gov. William Weld. Weld, the host for the meeting, said the idea was appealing because such a fund would be stronger than either the public sector or private sector working alone.

Seidman told the governors there are several healthy banks interested in buying the Bank of New England, which had to be taken over by the FDIC last Sunday. Seidman met earlier in the day with Lawrence Fish, who was installed by regulators as president of Bank of New England last year and is continuing to run it.

The governors expressed unanimous support for Seidman's handling of the Bank of New England, but they lobbied hard for increasing commercial lending in the region, through pouring cash into the banking system or loosening regulations. New Hampshire Gov. Judd Gregg has been among those complaining loudest about a scarcity of credit.

Seidman said the need for more credit was "obvious" and acknowledged that some bank regulators, reacting to the excesses of the 1980s, have been "overzealous," prompting bankers to become overly cautious about making loans.

Connecticut Gov. Lowell Weicker praised Seidman for his expertise and swiftness, saying: "He is not the problem; he is trying to treat the symptoms."

Also in attendance at the 90-minute lunch meeting in Weld's office were governors Bruce Sundlun of Rhode Island, John McKernan of Maine and Richard Snelling of Vermont.

Staff writer Jerry Knight contributed to this report from Washington.

FDIC Is Likely To Buy Shares In Weak Banks

By BARBARA A. REHM

The ballooning number of problem banks and a shrinking deposit insurance fund are driving the Federal Deposit Insurance Corp. to consider buying newly issued stock of troubled banks.

Through a trust fund capitalized by the banking industry, the FDIC would seek to support banks before they fail, adding to the. the shrinking Bank Insurance Fund's burden. The concept has the active interest of bankers. led by the Association of Bank Holding Companies. but they disagree with the FDIC on a major point.

ANALYSIS: Follow-up on the news

The FDIC's chairman. L. William Seidman, and his top staff members met with bankers Tuesday afternoon and concluded that the stock-purchase idea – which some critics are likely to complain amounts to a nationalization – is the best alternative. More meetings with industry leaders are planned and changes could be made. but a go-ahead is likely in light of the chairman's support.

Bankers Would Be on Board

Under current thinking, the trust fund would be established as a subsidiary of the FDIC and would be capitalized at $1 billion to $5 billion. Some bankers would sit with government officials on the fund's board. which would determine which banks receive assistance.

The trust's seed money would come from banks – either through deposit-insurance premiums or a special FDIC assessment. Under law, the FDIC can borrow $10 for every $1 it holds, so the FDIC could borrow $9 billion to $45 billion on the contemplated capital, explained John Bovenzi. Mr. Seidman's deputy.

A Direct Investment

That borrowed money would then be invested in banks that are unable to attract private capital.

The FDIC is leaning toward borrowing the money from commercial banks because that would keep Uncle Sam largely out of the plan's funding, according to agency officials. But the FDIC could also turn to the Federal Financing Bank, to which the FDIC won access under the thrift bailout law. Loans from this government facility would carry a lower interest rate than private bank borrowings.

The FDIC would repay the borrowed funds when it sold its

See **FDIC** *page* **6**

Continued from *page* **1**

bank stocks after recapitalized banks recovered.

All this could be done without congressional action.

Recapitalizing the FDIC is being dealt with separately. Agency officials just a few weeks ago were insisting that the fund needed a $25 billion infusion. But now they are talking about a smaller amount.

If the stock-purchase plan works, the logic goes, then the demands on the FDIC will be smaller and the fund will not need so much cash.

Mr. Seidman is forecasting that the FDIC will end this year with $4 billion.

"We could set up a [stock purchase] program without legislation," Mr. Bovenzi said. "We've got the ability to assess the industry and we can make capital investments in banks – and we've already got the authority to borrow."

Total Still Unknown

The range of borrowings is so wide – $9 billion to $45 billion – because the government has not decided how many banks it plans to prop up and how much that will cost.

"No one has come to grips yet with how much money will be needed."

W. Roger Watson
Federal Deposit Insurance Corp.

"No one has really come to grips yet with how much money will be needed," the agency's research director, W. Roger Watson, said in an interview.

Two thorny issues remain unresolved:

- How banks would qualify for capital injection. Eligible banks would generally be solvent but unable to attract private investors, probably because of a weak economy. These banks would have to have smart, trustworthy managers, FDIC officials explained.
- Whether to leave bad assets in the bank or remove them for separate workout. The FDIC – but not bankers – wants nonperforming assets to stay in the banks and be worked out by the people who made the loans.

Mr. Seidman said this week that assets lose value as soon as they are stripped from an originating institution. Lower asset values force the FDIC's cost of resolution up. "We've got quite a lot of bad assets dumped on the market now," the chairman added.

The bankers working on this plan with the FDIC are just as adamant that the banks would have a better chance of attracting private capital if their bad assets were yanked.

The main argument against the trust fund is likely to be that it partially nationalizes the banking system. FDIC officials concede this effect, but insist the plan is better than standing by and letting hundreds more banks fail. □

For FDIC, Bolstering the Economy Was Key

Washington Bureau

WASHINGTON — By guaranteeing all deposits in Bank of New England Corp.'s subsidiaries, federal regulators sent a clear signal that they are more intent on shoring up the economy than experimenting with any new plan to impose "market discipline" on the deposit insurance system.

Under Federal Deposit Insurance Corp. guidelines, regulators could have allowed depositors with more than $100,000 in any one account to face losses. But in an interview on Monday, FDIC Chairman L. William Seidman said these were the priorities:

"One, stabilize the financial situation in the area and assure depositors they were going to get their money; and two, bring in additional banking capacity in New England to deal with the credit crunch there."

Analysts and regulators said that maintaining availability of credit was a key consideration as bank regulators mulled what to do with the faltering Boston-based holding company during the closed-door meetings last weekend that led to the seizure.

Regulators' options were whittled to keeping the banks open with federal assistance or establishing bridge banks – government-chartered entities that

See FDIC page 17

Continued from page 1

hold insolvent institutions' assets and liabilities until the units can be sold or otherwise disposed of.

The bridge idea won because it could be done faster, with less interference by holding company shareholders or creditors.

And it would aid the region's economy by giving the three subsidiary banks – Bank of New England, Connecticut Bank and Trust Co., and Maine National Bank – the ability to keep on lending.

Massive Withdrawals

The sense of urgency was heightened by massive depositor withdrawals at the end of last week. On Monday, depositors again lined up at financial institutions in Boston and Providence, adding to the confusion that began last week with the closing of privately insured banks and credit unions in Rhode Island and rumors of Bank of New England's pending failure.

"What we were most worried about was the contagious effect if the run continued here and the government didn't step up," said Paul Homan, special adviser to the Comptroller of the Currency. "It might have had a spillover effect on other banks in the region, indirectly, not directly. Obviously, the Rhode Island problem was having an effect on Massachusetts."

"It is an absolute zoo, and it has been absolutely bizarre up there since Friday," said Edward E. Furash, a Washington-based consultant who has been advising client banks in New England. "Banks up there have hundreds of customers at the door, and people are running from one bank to another to decide which bank is safer."

Reaction on the Hill

News of the bailout was received with an air of skepticism on Capitol Hill, where a number of staff members involved with banking legislation said regulators waited too long to close the institution.

"Why did they have to wait until we had TV pictures of people standing in line to get their money out of the bank?" asked one House aide.

"Everybody knew Bank of New England was brain-dead," said another staff member. "There's a real question about why they waited so long."

'Autopsy' Promised

House Banking Committee Chairman Henry B. Gonzalez, D-Tex., promised a "top to bottom autopsy" of the New England failure, and said the case may offer important guidelines for Congress as it considers banking legislation this year.

The thrift-bailout law of August 1989 authorized bank regulators to assume that a bridge bank has 5.5% capital – even if it has no capital at all – so that the bank can continue to make loans. Regulators said Monday this arrangement allows the Bank of New England units to lend up to 15% of a 5.5% capital base – even though the FDIC injected only $750 million into the banks, bringing capital to about 3%.

Also, for the first time, the FDIC used its power to force a bank to pay for the losses of affiliated, troubled banks. In this case, the FDIC demanded immediate payment of $1.44 billion from the Maine National Bank to pay for Bank of New

Much attention was devoted to keeping an eye on withdrawals from Bank of New England and other institutions in the region.

This story was reported by Barbara A. Rehm, Bill Atkinson, Linda Corman, and Robert M. Garsson. It was written by Robert Trigaux.

England's losses. The Connecticut Bank & Trust Co. was brought down when the FDIC canceled unsecured loans the bank had made to BNE.

Others Under Pressure

Following the seizure, banking experts warned that regula-

See **FDIC** *next page*

Continued from *page* **17**

tors will put still more pressure on the region's largest banks to avert another crisis. Shawmut National Corp., Fleet/Norstar Financial Group, and Bank of Boston Corp. all have been racked by real estate problems.

"In those cases you are going to see a lot more regulatory participation in the management of the bank," said James M. Howell, president of the Boston-based Howell Group and former chief economist of Bank of Boston. "I'm optimistic it will not get to the point [of taking the banks over]; but it may mean credit will be tightened even more."

"What [the regulators] want to do is minimize surprises, and minimize and preclude a disaster," said Michael Turillo, a bank consultant in Boston for KPMG Peat Marwick. "You don't have to be a rocket scientist to see the pot is boiling."

Other East Coast institutions that are undoubtedly on the regulators' watch list because of losses and real estate troubles include Baltimore-based MNC Financial Inc., Miami-based Southeast Banking Corp., and Newark-based Midlantic Corp.

New England regional economists don't expect the economy to emerge from a recession for at least six months, and even then they predict the economy will only be crawling along.

Execs Go to Washington

The events that precipitated Sunday's takeover of Bank of New England by the FDIC began Thursday, said a regulatory source. On that day, Bank of New England chairman Lawrence Fish and vice chairman Tim McNamar came to Washington and met separately with Comptroller of the Currency Robert L. Clarke and Mr. Seidman.

They told the regulators that even if they accepted a bondholders' proposal to swap debt for equity, the bank would become insolvent.

The bankers then proposed two options: One called for the FDIC to offer assistance in tandem with the debt-for-equity swap. The second was simply a statement from the FDIC that it was actively negotiating for a sale of the bank and that all deposits would be protected.

Late Friday afternoon, the FDIC and the Comptroller's office agreed to meet Saturday morning to review alternatives for addressing the bank's insolvency. Mr. Clarke met with FDIC officials and considered three options: offering some FDIC assistance in tandem with the bondholders' debt for equity swap, straight open-bank assistance, and the bridge banks.

At a board meeting on Saturday afternoon, the FDIC weighed the options and decided to wait until Sunday to decide what action to take.

'Looked at Every Alternative'

Asked if he seriously considered paying off depositors – the most drastic FDIC option – Mr. Seidman said: "We looked at every alternative, really, very seriously."

Having verified the fourth-quarter losses at Bank of New England's banks by about noon Sunday, the senior deputy comptroller, Dean S. Marriott, prepared to declare the national banks in Massachusetts, Connecticut, and Maine insolvent.

On Sunday afternoon the FDIC board gave its final approval to creating a bridge bank and infusing the company with $750 million.

Treasury officials, including Under Secretary for Finance Robert R. Glauber, were briefed on the plan to take over the bank. Sources said Mr. Glauber disapproved of the proposal to cover all the uninsured deposits but eventually deferred to the other regulators.

Cash Loaded on Trucks

Federal Reserve staff in both Washington and Boston worked through the weekend. The 200 staff members in Boston included about 100 members of the

Shareholders and bondholders are just about the only ones losing money.

cash department, check department staff, lawyers, and about 10 senior managers, said a Boston Fed source. The cash department staff was, "packaging up cash and putting it on trucks," he said, in the event banks needed additional liquidity for customer withdrawals.

Much attention was devoted to keeping an eye on withdrawals from Bank of New England and other institutions in the region.

Getting a reading on the amount of funds being withdrawn is particularly difficult in banks of BNE's size, said the Boston Fed source. By last Friday, the bank had reportedly suffered a run approaching $1 billion.

'War Room' in the Capital

In Washington, senior staff played a sort of war situation-room role, acting as a clearing house for information. In particular they were keeping an eye on whether withdrawals were spreading beyond Massachusetts to other New England states.

Also over the weekend, the Boston Fed requested and obtained through the Fed board in Washington the temporary transfer of about a dozen additional examiners from other Fed districts to help out in New England.

Intensive meetings continued Monday in Boston. Besides monitoring withdrawals from other banks, the Fed was expected to be negotiating an agreement with the FDIC as to when the New England bank's borrowings from the discount window would be paid back.

Thanks to the widespread guarantees in the seizure, about the only people losing money are the company's shareholders and bondholders. □

1991 New Hampshire Business Outlook

Plan to save region's banks offered

Governors ask federal regulators to pump money into ailing institutions

By John Milne
GLOBE STAFF

CONCORD – Gov. Judd Gregg is backing a proposal that federal banking regulators pump money into New England banks before they fail. The regulators are considering the proposal as part of a reorganization of the region's banking system – which would mean that less healthy institutions will be doomed to reorganization or merger.

Gregg and other New England governors offered this deal, drawn up by regional bankers and business leaders, to L. William Seidman, chairman of the US Federal Deposit Insurance Corp. during a closed-door meeting earlier this month. Seidman appeared to accept the proposal in principle, endorsing a variant of the plan that included raising private funds to provide that money.

Neither Gregg nor the regulators would discuss specifics. Gregg said he would present a detailed proposal within a month. This description was provided by sources who had been briefed by participants in the discussions, and members of the banking and business communities said last week this deal is emerging as their proposal to solve the crisis.

Gregg's press secretary, Brian P. Grip, hinted last week that the discussions had been to the liking of New Englanders. "Every key point that the governor was hoping to accomplish was well received and acknowledged by Mr. Seidman," he said. "This will probably, in retrospect, be recognized as one of the most important meetings to take place since the crisis began."

Last week US Sens. Warren B. Rudman and Robert C. Smith sent a letter to Seidman offering their support of the concept of providing money to ailing banks. "It is this kind of constructive action that will help pull the regional economy out of its current recession," they wrote.

Gregg, in the meeting, generally endorsed a proposal sent to Seidman on Jan. 7 by Nicholas P. Koskores, president of the New England Council, a Boston-based business group.

"I urge you to work with those financial institutions where technical insolvency has occurred or is a distinct possibility and take action now to aid in the recapitalization of the banks," Koskores wrote. "Clearly, a means test should be applied so that only those institutions that are practicing sound management techniques and stand a strong chance of re-emerging as a healthy bank would be eligible for this assistance."

Unhealthy banks to vanish

Gregg was, in effect, offering the regulators a deal, said bankers and business leaders who helped draw up the proposal. Pick one or two potentially healthy banks as pilot projects, he said, and provide money for new investment and to prop up the bank's balance sheet.

In exchange, the executives said industry leaders acknowledged that the banks that are declared less healthy will have to vanish.

Seidman had come to Boston after the FDIC took over operations at the $23 billion Bank of New England. The FDIC has said it may have to spend $2.3 billion to cover depositors' losses.

The agency, Seidman said, is considering ways to "provide capital to banks that are capital short but are otherwise viable so they can continue to operate without the restraints of low capital." He suggested, however, that bailout money could come from private funds.

The plan is by no means a sure thing. Members of Congress and some banking associations have expressed concern over the use of tax money to prop up banks that have not failed. The plan is risky in a re-

Proponents say the plan is more cost-effective than simply waiting for banks to fail, and the longer the waiting takes, the longer it will take New Hampshire ... to escape recession.

Plan to save region's banks offered

cession. Aid might be provided, and the bank might fail anyway. Proponents say the plan is more cost-effective than simply waiting for banks to fail, and the longer the waiting takes, the longer it will take the New Hampshire economy to escape recession.

Businesses are organizing to urge this solution on the regulators and are seeking help from the New England congressional delegation, said Christopher C. Gallagher, lawyer for the New Hampshire Bankers' Association and one of the participants.

The executives argue that the credit crunch is not only the problem of the region's banks but a symptom of an ailing economy. Their proposal reflects the belief that this is a regional economic problem requiring an economic, not a regulatory solution, argued another participant, John Crosier, president of the Business and Industry Association of New Hampshire.

'Beyond conventional solutions'

"We have a situation which is beyond conventional regulatory solutions. The regulators have been looking narrowly, starting at Bank A, trying to fix things up, then going to Bank B and doing the same thing," he said. "If we continue to pursue this regulatory remedy, we will keep shrinking credit and keep pursuing the damned death spiral."

Added Robert Clarke, US comptroller of the currency, in hearings before Congress: "A further loss of confidence in the banking system could have induced additional bank failures." And Gregg has declared the credit crunch the worst crisis the state faces, worse than budget shortfall or recession.

Barretto Granite Co. of Milford offered a case in point: On the Thursday before Christmas, the healthy company had to lay off 56 employees, nearly half its work force, because of the collapse of Bank of New England.

Barretto owns a quarry in Milford that has been worked since 1810. The family-owned company had its healthiest balance sheet in a decade, with $3 million in pending orders for 1991.

It could not borrow money for spring production, vice president John F. Barretto Sr. said in a statement, "as a direct result of action by the FDIC in declaring the company's funding bank, New England Allbank of Gardner, Mass., insolvent."

Bankers said retailers, auto dealers and companies such as Barretto

BANKS, Page NH 15

BANKS

Continued from Page NH 9

that have heavy borrowing schedules face significant hurdles in getting financing. Another group of borrowers that will have problems is the entrepreneur, the builder of the better mousetrap. Lawrence Connell, the new president of New Hampshire Savings Bank, said recently that if an entrepreneur showed up, no matter how good the idea was, "I'd have to tell him that we can't make the loan."

"With other New England banks showing signs of potential insolvency and the growing threat to public confidence in the banking system, steps must be taken now to prevent those institutions from reaching the position where an FDIC takeover is necessary," Koskores said.

The solution involves what one participant called triage, the doctors' wartime practice of first saving soldiers who could quickly return to battle, postponing help for the more badly wounded, and letting the most severe casualties die.

That means providing help quickly, Gallagher said. "You have to bring that assistance to the table before banks reach the point of no return, so they can attract some capital." If, for example, the FDIC were to use its assistance program for open banks to help some of these institutions cover their bad loans, officials could then attract additional investment that could help the bank grow.

One group of bankers, the Association of Bank Holding Companies, is considering establishing a $25 billion bank fund by assessing the industry 1 percent of deposits. But that money would be used to keep banks open in addition to helping depositors when the institutions close. "We're talking about providing working capital, so they don't fail," said association president Thomas Ashley.

Some banks are being forced to do that already. Manchester-based Numerica Savings Bank has agreed with the Office of Thrift Supervision to hire BEI/Golembe Capital Markets to help raise new money. In a statement, the bank said, "This capital, if raised, is likely to result in a substantial dilution to existing stockholders" – meaning a substantial loss.

This is the kind of pattern that banks may have to use to survive, Gallagher said. Other possibilities are mergers or takeovers. The business officials are arguing that "if we can use other funds to help build confidence, to show that the bottom has been reached, that will stimulate or attract other capital to share the risks," he said.

But changes in the state's banking system are inevitable, all agree.

"There has to be quite substantial consolidation in the banking system in New England," said Richard F. Syron, president of the Federal Reserve Bank of Boston. "There is just plain excess capacity, given the market that is there."

The FDIC has this legal power, but its limited funds are already under great pressure to meet its insurance obligations. A more logical place to put a new mechanism might be in the Federal Reserve system. The capital stock of each of the 12 regional Federal Reserve Banks is owned not by the government but by the commercial banks in the region. These federal banks have more than $5 billion in capital and more than $35 billion in non-interest bearing reserve deposits that belong to their member commercial banks. The Federal Reserve Banks have aggregate assets exceeding their liabilities for issued Federal Reserve Notes by more than $50 billion. They make an annual profit of more than $20 billion, most of which the Federal Reserve Board requires them to pay to the U.S. Treasury after a small dividend to member banks, which, as the Fed's only stockholders, have an equitable claim to a larger share.

Some of these funds could be used to pay a market rate of interest to member banks on their reserve deposits, thus augmenting bank capital by up to 3 billion pre-tax dollars a year and to make direct equity investments in member banks that need more equity than they can now raise from the private markets. Because of the gearing ratio and the fact that most such investments could later be resold at little or no loss, they would be more efficient and less costly than having to put much larger amounts into the FDIC fund to pay off insured depositors after a number of large banks fail for lack of capital.

In the next year or two, Congress will take up legislation to rationalize our banking system and to reform the Federal Deposit Insurance system. As part of that effort, the Federal Reserve Board should encourage the formation of banking institutions of sufficient size and efficiency to enable our economy to grow and to compete worldwide. To accomplish this, not only mergers but infusions of additional capital will be required. The Federal Reserve could inject part of the needed capital through the purchase of new nonvoting bank securities. To provide an adequate capital base to maintain liquidity and improve the efficiency of our banking system, an increase of $20 billion to $25 billion in bank equity capital from public and private sources would be appropriate.

As in 1933, many will ask why "taxpayer dollars" should be invested in bank equity to save bank managements and investors from their own mistakes. But the Fed's capital, its reserve deposits and arguably a larger share of its earnings are not taxpayer dollars; they are private dollars of the member commercial banks. In any event, the faults of private bank managements and investors have been no greater than the faults of the public officials who adopted the fiscal policies that have raised public and private debt to the highest percentages of GNP since the 1930s and who condoned a go-go financial market in which so many different kinds of regulated and unregulated financial institutions have been allowed to pay any interest rate to attract funds and to take any risk to re-lend them at still higher rates.

It will do us precious little good to point the finger at one another while creeping credit contraction creates a catastrophe for us all.

Felix G. Rohatyn is a senior partner of the Lazard Freres investment firm. Lloyd N. Cutler, a Washington lawyer, was White House counsel to President Jimmy Carter.

CCrunch

DRAFT

12/18

DEPOSIT INSURANCE REFORM RECOMMENDATIONS

- Banks and thrifts are exposing the taxpayer to too much loss

- The real protection for the taxpayers is:
  - A **safer** banking system
  - **Healthy banks** earning a fair profit, internationally competitive
  - **Streamlined regulation** of banks
  - **A well-capitalized insurance fund**

- **Safer** means more effective restraints on excessive risk
  - Risk-based premiums
  - More market discipline
  - Better supervision
  - Stronger role for capital

- **Safer** also means geographic diversification through nationwide banking to withstand regional downturns

- Finally, **safer** means more **competitive** banks with more opportunities to make a fair profit to build capital
  - Greater financial activities **outside** of the safety net

- **Streamlined regulation** means a consolidated, simplified, and more efficient regulatory system.

- **A well-capitalized insurance fund** means an infusion of industry funds in front of the taxpayer.

DRAFT

PART ONE: DEPOSIT INSURANCE REFORM
Making Banks Safer

- There are seven general ways to make banks safer:

  I. Assess Risk-Based Insurance Premiums

  II. Reduce Overextended Insurance Coverage

  III. Strengthen the Role of Capital

  IV. Improve Supervision

  V. Limit Risky Activities in Bank

  VI. Allow Geographic Diversification

  VII. Enhance Financial Activities Outside the Safety Net

DRAFT

I. Assess Risk-Based Insurance Premiums

A. Short-term: Vary premiums according to levels of risk-based capital

-- Rewards and creates incentive for higher capital

-- Similar to most insurance products: the higher the deductible, the lower the premium.

-- Endorsed by 1984 Bush Task Force Report

B. Long-term: FDIC pilot project to explore private coinsurance system

-- Foster development of private coinsurance system to enable private market to better price bank riskiness

DRAFT

II.A. <u>Reduce Overextended Scope of Coverage: Insured Deposits</u>

1. Eliminate brokerage of insured deposits (TAB A)

2. Eliminate pass-through insurance for large, sophisticated institutional investors (TAB B)

3. Limit insurance to $100,000 <u>per</u> <u>depositor</u> (TAB C)

4. No insurance and no assessments on deposits in foreign branches of U.S. banks (TAB D)

5. Assess collateralized borrowing because insured in effect

DRAFT

II.B. Reduce Overextended Scope of Coverage: <u>Uninsured Deposits and "Too Big to Fail</u>" (TAB E)

1. No protection of creditors

2. Reduce protection of uninsured depositors

   a. Limit FDIC to <u>cheapest</u> resolution method

   b. Develop mechanism to provide immediate partial payment to uninsured depositors that suffer losses

   c. Prohibit FDIC from invoking systemic risk and "too big to fail" to protect uninsured depositors.

   d. Permit protection of uninsured depositors only after Treasury/Fed determination of systemic risk

   e. Pay for uninsured depositor protection with Treasury line of credit that must be repaid by banks through FDIC

   f. Three-year phase-in

DRAFT

III. Strengthen the Role of Capital

A. Capital-Based Supervision with rewards and penalties (TAB F)

B. Capital-based deposit insurance premiums

-- As discussed above, incentive to build capital

C. Capital-based expanded activities

-- As discussed in Section VII below, well-capitalized banks will be eligible for new financial activities outside of safety net

D. Capital adjusted for interest rate risk

-- Begin with reporting system, and develop standards over time for inclusion in capital

E. Increased reliance on subordinated debt

-- Increase banks' ability to count subordinated debt as capital

F. No current increase in minimum capital requirements

-- But consider increase at later date after Basle minimum capital requirements are fully phased-in

DRAFT

IV. Improve Supervision

A. Simplify and strengthen regulatory structure

- -- Reorganize regulators as discussed in Part Two

B. Adopt rigorous Capital-Based Supervision

- -- As discussed above, link degree of regulatory scrutiny to levels of capital

C. Require annual on-site examinations

- -- Critical for Capital-Based supervision

D. Improve market value reporting

- -- Do not adopt market value accounting
- -- But require regulators to develop reporting system for market values of both sides of balance sheet

DRAFT

V. Limit Risky Activities in Banks

A. Restrict activities of state-chartered banks (TAB G)

1. No activities broader than national bank activities unless:

   a. Fully satisfy capital requirements

   b. FDIC grants permission

2. No direct real estate investment inside banks

3. No activities in bank subsidiaries broader than activities in national bank subsidiaries unless separately capitalized

4. Exception for agency activities

DRAFT

VI. Geographic Diversification: Nationwide Banking and Branching

A. Nationwide banking for bank holding companies (TAB H)

B. Nationwide branching for all national banks

C. Retain state authority to limit branching within states

-- Applies to national as well as state banks

D. Retain a state's authority to limit its own banks from branching out of state

E. Three-year phase-in

DRAFT

VII. Enhanced Financial Activities Outside of Safety Net

A. Allow highly capitalized banks to form financial services holding companies (FSCs) (See chart at TAB I)

-- Encourages simultaneous infusion of capital from outside sources with formation of FSC

B. FSCs could engage in any financial activity outside of insured bank (including securities and insurance) (TAB J)

-- Consumers could purchase range of financial products from one source with one accounting statement

C. Safeguards

1. Separately capitalized affiliates for new activities

2. Functional regulation of each new nonbank affiliate

3. No direct FSC access to federal safety net

4. Funding "firewalls" to protect insured bank from risk, but no managerial or cross-marketing firewalls

5. Strict dividend restrictions on undercapitalized banks

6. Incentives for FSC to infuse capital into weak banks

7. Strict disclosure rules for sales of uninsured products

8. New umbrella holding company supervision (TAB K)

D. Commercial Ownership of FSC (TAB L)

1. Permit commercial ownership of FSC (but not bank itself)

DRA...

PART TWO: REGULATORY REFORM
Simplifying regulatory structure

- Today's complex regulatory structure avoids accountability, creates bureaucratic infighting, and sometimes leads to inconsistent standards.

- Regulatory reform should embrace key principles of the 1984 Bush Task Force, including:

  1. Consolidating federal banking regulation.

  2. Requiring each banking organization to have no more than one federal regulator.

  3. Preserving the Administration's role in banking policy.

  4. Maintaining Federal Reserve regulation of the largest banks, which pose the greatest systemic risk.

  5. Eliminating FDIC regulation of banks, while enhancing its authority to act as insurer.

DRAFT

I. Different Regulators for Large and Small Banks (TAB M)

A. Fed would regulate largest banking organizations plus other banks with important international activities (TAB N)

B. New Federal Banking Regulator (FBR) under Treasury would regulate all other banking and thrift organizations

C. The National Credit Union Administration would be independent or also moved under the FBR (TAB O)

DRAF

II. <u>One Insurer and Resolver</u> (TAB P)

A. <u>Move Credit Union Insurance Fund under FDIC</u> (TAB O)

B. <u>Reorganize FDIC Board</u>

1. Replace OTS and OCC directors with FBR director
2. Eliminate one independent director
3. Result is 3-person board as it was before FIRREA

C. <u>Reorganize RTC Board and Merge with Oversight Board</u> (TAB Q)

1. FDIC board would be RTC board with two additions
2. Secretary of Treasury
3. HUD Secretary
4. FDIC Chairman would be RTC Chairman

D. <u>Alternative -- Split out RTC from FDIC and establish new board with full-time Chairman but Administration participation</u>

DRAFT

PART THREE: RECAPITALIZING THE BANK INSURANCE FUND

- The Bank Insurance Fund (BIF), which insures deposits in all commercial banks, has declined since 1987 by over 50% to about $9 billion.

- As part of the reform package, we will propose a recapitalization plan for BIF.

- Banking industry groups have publicly stated that they will support an industry funded plan.

- The recapitalization plan should:
  - -- Provide sufficient resources to BIF
  - -- Rely solely on industry funds, and not on the taxpayer
  - -- Have the smallest possible impact on the banks

- A number of options are under consideration, including:

  1. A substantial special premium assessment, either over time or up front.
     - -- A 100 basis point assessment, for example, would produce $25 billion for BIF.
     - -- The FDIC believes that such an assessment would not materially increase bank failures or exposure to the fund.
     - -- This assessment could also be structured as a prepayment of premiums, which would allow the banks to book the charge as an asset to be written off over several years.

  2. An infusion of new equity into the fund by the banks.
     - -- The banks could purchase $25 billion of "preferred stock" in the fund, to be used only if the fund's other resources are exhausted.
     - -- The banks would hope that part or all of the stock could remain on their books as an asset.

- We are working with industry groups and the FDIC to reach a mutually agreeable solution, if possible.

Withdrawal/Redaction Sheet
(George Bush Library)

Document No. and Type	Subject/Title of Document	Date	Restriction	Class.
02. Paper	The Banking Situation (16 pp.)	n.d.	~~P5~~	

Collection:

Record Group: Bush Presidential Records
Office: Chief of Staff, White House Office of
Series: Sununu, John, Files
Subseries: Issues Files
WHORM Cat.:
File Location: Credit Crunch 1991 [3]

Open on Expiration of PRA
(Document Follows)
By JP (NLGB) on 10/28/05

Date Closed:	1/3/2005	**OA/ID Number:**	29151-006
FOIA/SYS Case #:	1998-0004-F[2]	**Appeal Case #:**	
Re-review Case #:	2005-0426-S	**Appeal Disposition:**	
P-2/P-5 Review Case #:		**Disposition Date:**	
AR Case #:		**MR Case #:**	
AR Disposition:		**MR Disposition:**	
AR Disposition Date:		**MR Disposition Date:**	

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P-1 National Security Classified Information [(a)(1) of the PRA]
P-2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P-3 Release would violate a Federal statute [(a)(3) of the PRA]
P-4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P-5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P-6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

PRM. Removed as a personal record misfile.

Freedom of Information Act - [5 U.S.C. 552(b)]

(b)(1) National security classified information [(b)(1) of the FOIA]
(b)(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
(b)(3) Release would violate a Federal statute [(b)(3) of the FOIA]
(b)(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
(b)(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
(b)(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
(b)(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
(b)(9) Release would disclose geological or geophysical information

The Banking Situation

TWO FOLD PROBLEM:

SHORT RUN PROBLEM: Credit Crunch

LONG RUN PROBLEM: Changing Structure of Banking Industry

I. These are the most important economic issues facing the country today.

- o If banking problem is not solved, items like a "growth agenda" are meaningless.
- o After some point, downward spiral is virtually impossible to stop.

II. To a large extent, solutions to the long run problem exacerbate the short run problem, and vice versa.

- o Need for <u>extreme care</u> in acting.
- o Need for <u>time</u> for solutions to take effect.

III. Solution will require the full attention of the President and the use of substantial political capital.

- o Actions on banking must take complete precedence on President's domestic agenda.
- o President should work with Congressional leadership now to obtain legislative cooperation.

Cal Budg
Options
Pre filtered

The Credit Crunch

How the Problem Starts

- o Existence of Some Real Excesses and Abuses
- o Change in Regulatory Psychology
  - The Regulator
  - The Banker
  - The Politician
- o Creation of New Capital Requirements
- o The Rumor Mill

How It Spreads

- o Underlying Uncertainty in "True Valuation"
- o Feedback Effects
  - Regulatory Psychology
  - Rumors and Markets
- o Self Fulfilling Bearish Prophesies

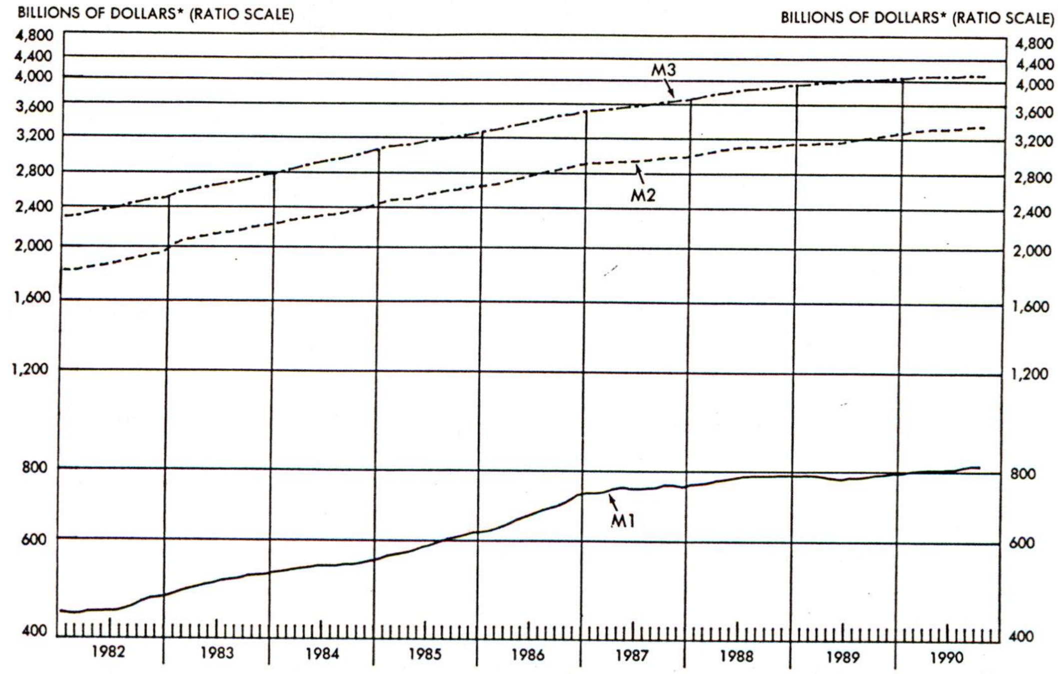
Some Current Evidence

- o Money Supply Growth
- o Composition of Money Supply
- o Net Bank Lending

MONEY, CREDIT, AND SECURITY MARKETS

MONEY STOCK, LIQUID ASSETS, AND DEBT MEASURES

Growth in M2 slowed in October and M3 fell.



* AVERAGES OF DAILY FIGURES; SEASONALLY ADJUSTED
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COUNCIL OF ECONOMIC ADVISERS

[Averages of daily figures, except as noted; billions of dollars, seasonally adjusted]

Period	M1	M2	M3	L	Debt	Percent change from year or 6 months earlier [2]			
	Sum of currency, demand deposits, travelers' checks, and other checkable deposits (OCDs)	M1 plus overnight RPs and Eurodollars, MMMF balances (general purpose and broker/dealer), MMDAs, and savings and small time deposits	M2 plus large time deposits, term RPs, term Eurodollars, and institution-only MMMF balances	M3 plus other liquid assets	Debt of domestic nonfinancial sectors (monthly average) [1]	M1	M2	M3	Debt
1980: Dec	408.9	1,629.9	1,987.5	2,324.2	3,904.1	6.8	8.9	10.2	9.4
1981: Dec	436.5	1,793.5	2,234.2	2,596.8	4,292.1	6.7	10.0	12.4	9.9
1982: Dec	474.5	1,953.1	2,441.9	2,851.6	4,685.9	8.7	8.9	9.3	9.2
1983: Dec	521.2	2,186.5	2,693.4	3,154.7	5,212.6	9.8	12.0	10.3	11.2
1984: Dec	552.1	2,371.6	2,982.8	3,524.1	5,961.9	5.9	8.5	10.7	14.4
1985: Dec	620.1	2,570.6	3,202.1	3,829.5	6,773.5	12.3	8.4	7.4	13.6
1986: Dec	724.7	2,814.2	3,494.5	4,135.5	7,636.2	16.9	9.5	9.1	12.7
1987: Dec	750.4	2,913.2	3,678.7	4,338.7	8,345.1	3.5	3.5	5.3	9.3
1988: Dec	787.5	3,072.4	3,918.3	4,676.1	9,107.6	4.9	5.5	6.5	9.1
1989: Dec	794.8	3,221.6	4,044.3	4,881.2	9,788.9	.9	4.9	3.2	7.5
1989: Oct	788.1	3,181.9	4,018.1	4,841.7	9,687.4	1.5	6.0	2.7	7.4
Nov	789.4	3,201.2	4,031.0	4,858.1	9,750.2	3.4	7.5	3.3	7.4
Dec	794.8	3,221.6	4,044.3	4,881.2	9,788.9	5.5	7.7	3.0	7.0
1990: Jan	794.8	3,231.0	4,048.5	4,882.5	9,829.3	4.0	6.7	2.0	6.8
Feb	801.4	[r]3,255.7	4,064.3	4,890.4	9,887.1	5.4	6.9	2.6	6.6
Mar	804.8	[r]3,271.0	4,069.0	4,906.6	9,955.1	5.6	6.8	2.8	6.8
Apr [r]	807.3	3,279.1	4,074.7	4,918.1	10,010.6	4.9	6.1	2.8	6.7
May [r]	805.4	3,274.4	4,068.4	4,890.5	10,053.6	4.1	4.6	1.9	6.2
June [r]	809.4	3,282.6	4,073.1	4,910.3	10,108.7	3.7	3.8	1.4	6.5
July [r]	809.0	3,287.8	4,077.1	4,920.2	10,166.5	3.6	3.5	1.4	6.9
Aug [r]	815.8	3,305.3	4,091.6	4,931.3	10,230.1	3.6	3.0	1.3	6.9
Sept [r]	822.1	3,319.8	4,093.0	4,957.2	10,291.2	4.3	3.0	1.2	6.8
Oct [p]	820.0	3,321.1	4,089.2	....	....	3.1	2.6	.7	....

[1] Consists of outstanding credit market debt of the U.S. Government, State and local governments, and private nonfinancial sectors; data from flow of funds accounts.

[2] Annual changes are from December to December and monthly changes are from 6 months earlier at a simple annual rate.

NOTE.—See p. 27 for components.

Source: Board of Governors of the Federal Reserve System.

COMPONENTS OF MONEY STOCK AND LIQUID ASSETS

[Averages of daily figures; billions of dollars, seasonally adjusted, except as noted by NSA]

Period	Currency	Demand deposits	Other checkable deposits (OCDs)	Overnight repurchase agreements (RPs), net, plus overnight Eurodollars NSA	Money market mutual fund balances [1] General purpose and broker/dealer	Money market mutual fund balances [1] Institution only	Money market deposit accounts (MMDAs)	Savings deposits	Small denomination time deposits [2]	Large denomination time deposits [2]	Term repurchase agreements (RPs) NSA	Term Eurodollars (net) NSA	Savings bonds	Short-term Treasury securities	Bankers' acceptances	Commercial paper
1980: Dec	115.3	261.4	28.0	28.8	61.6	15.2	0.0	400.1	728.5	260.4	33.5	50.3	72.3	133.5	32.1	98.8
1981: Dec	122.6	231.4	78.2	36.6	150.6	38.0	.0	343.8	823.2	303.0	35.3	67.5	67.8	149.4	40.0	105.3
1982: Dec	132.5	234.1	103.6	39.9	185.2	51.1	43.2	356.7	851.0	327.2	33.4	81.7	68.0	183.6	44.5	113.7
1983: Dec	146.2	238.5	131.6	55.6	138.8	42.8	379.2	305.4	784.1	327.6	49.9	91.5	71.1	211.9	45.0	133.2
1984: Dec	156.0	243.9	146.9	60.6	168.2	62.1	416.8	285.1	886.8	417.4	57.6	82.9	74.2	260.9	45.5	160.8
1985: Dec	167.8	266.8	179.6	73.5	177.2	63.9	513.0	301.2	884.0	437.0	62.4	76.5	79.5	298.3	42.1	207.5
1986: Dec	180.6	302.1	235.5	82.3	208.7	83.8	571.0	370.1	856.2	439.8	80.5	83.8	91.8	280.8	37.2	231.1
1987: Dec	196.7	287.0	259.7	83.2	222.0	89.0	523.8	414.9	917.8	488.8	106.1	91.0	100.6	254.2	44.8	260.4
1988: Dec	211.8	287.0	281.3	83.3	240.9	87.1	500.3	427.8	1,031.0	541.1	121.7	106.0	109.3	272.0	40.6	335.6
1989: Dec	221.9	279.7	285.7	77.4	312.4	102.3	483.7	409.0	1,142.3	558.3	96.9	81.1	117.5	330.3	41.2	347.9
1989: Oct	220.0	280.0	280.8	75.7	302.7	101.1	475.3	406.1	1,135.9	562.7	109.6	80.1	116.2	317.4	40.0	350.0
Nov	220.4	278.8	282.8	75.4	309.0	101.1	480.8	407.9	1,138.5	561.0	108.9	79.3	116.8	318.6	40.5	351.3
Dec	221.9	279.7	285.7	77.4	312.4	102.3	483.7	409.0	1,142.3	558.3	96.9	81.1	117.5	330.3	41.2	347.9
1990: Jan	224.6	277.3	285.4	r81.6	318.6	103.2	485.0	410.2	1,143.0	554.5	93.6	r73.9	117.7	332.3	40.7	343.3
Feb	226.6	280.2	287.0	r82.4	325.3	103.7	489.4	413.6	1,142.6	550.1	96.9	r68.4	118.2	324.9	38.3	344.7
Mar	228.4	279.3	289.5	r81.9	325.9	105.4	494.9	414.6	1,146.4	544.1	95.2	r66.6	119.1	338.9	37.0	342.7
Apr	230.1	277.8	291.8	r79.3	r326.8	106.8	498.8	415.8	r1,148.3	538.3	94.8	r65.5	119.9	330.3	35.8	357.5
May	231.6	274.5	291.5	r83.2	r322.3	107.3	500.0	415.0	r1,150.4	535.4	95.8	r67.2	120.7	316.5	35.3	349.6
June	233.4	274.5	293.8	r82.3	r323.9	107.3	501.2	415.8	r1,149.0	r532.9	98.7	r64.4	121.5	r331.7	34.6	349.4
July r	235.4	274.7	291.2	84.1	327.1	108.9	502.5	416.4	1,150.2	530.6	96.9	64.7	122.4	339.2	32.9	348.7
Aug r	238.4	277.9	291.6	82.7	335.9	114.0	505.6	416.3	1,151.4	524.1	98.3	66.6	123.2	339.2	32.3	345.1
Sept r	241.5	279.7	292.6	81.5	341.9	116.1	507.2	415.9	1,151.6	516.5	94.5	66.5	123.8	349.9	32.3	358.2
Oct p	244.0	276.8	290.9	84.1	344.7	119.8	506.4	414.7	1,153.2	510.0	91.3	66.1	....	....	....	....

[1] Data prior to 1983 are not seasonally adjusted.
[2] Small denomination and large denomination deposits are those issued in amounts of less than $100,000 and more than $100,000, respectively.

NOTE.—Travelers checks of nonbank issuers are a component of money stock but are not shown here.

Source: Board of Governors of the Federal Reserve System.

AGGREGATE RESERVES AND MONETARY BASE

[Averages of daily figures [1]; millions of dollars; seasonally adjusted, except as noted]

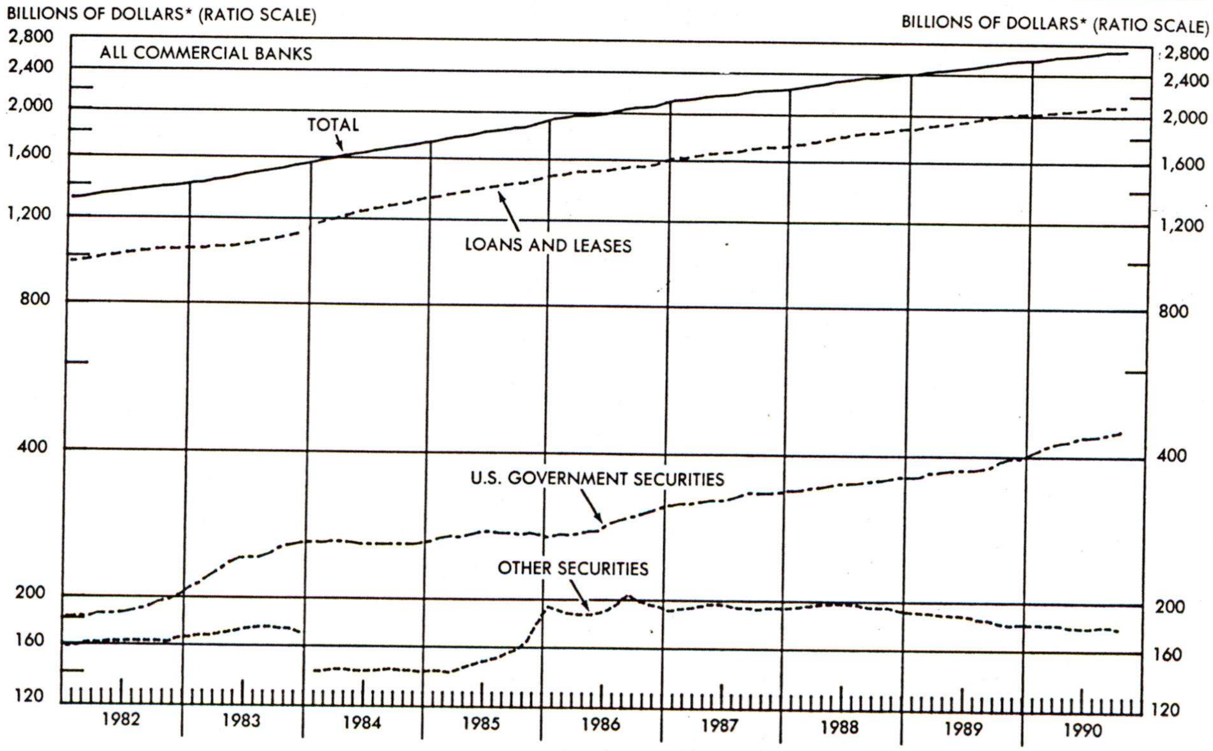
Period	Adjusted for changes in reserve requirements: Reserves of depository institutions: Total	Nonborrowed	Nonborrowed plus extended credit	Required	Monetary base	Borrowings of depository institutions from the Federal Reserve (NSA): Total	Seasonal	Extended credit
1980: Dec	33,401	31,711	31,714	32,887	152,525	1,690	116	3
1981: Dec	35,315	34,679	34,827	34,996	160,936	636	54	148
1982: Dec	37,388	36,754	36,940	36,888	172,947	634	33	186
1983: Dec	39,184	38,410	38,412	38,623	188,275	774	96	2
1984: Dec	42,235	39,049	41,653	41,380	201,673	3,186	113	2,604
1985: Dec	48,373	47,055	47,554	47,336	219,350	1,318	56	499
1986: Dec	58,023	57,197	57,499	56,653	241,427	827	38	303
1987: Dec	58,593	57,815	58,298	57,546	258,055	777	93	483
1988: Dec	60,593	58,877	60,121	59,545	275,238	1,716	130	1,244
1989: Dec	60,033	59,767	59,787	59,110	284,946	265	84	20
1989: Oct	59,640	59,085	59,106	58,620	282,786	555	330	21
Nov	59,646	59,297	59,318	58,701	283,222	349	134	21
Dec	60,033	59,767	59,787	59,110	284,946	265	84	20
1990: Jan	59,896	59,456	59,482	58,880	287,509	440	47	26
Feb	60,215	58,768	59,302	59,227	289,714	1,448	51	535
Mar	60,297	58,173	60,123	59,436	291,820	2,124	78	1,950
Apr	60,275	58,647	60,051	59,379	293,540	1,628	122	1,403
May	59,783	58,448	59,324	58,820	294,401	1,335	244	875
June	59,732	58,850	59,196	58,958	296,276	881	311	346
July	59,322	58,565	58,845	58,460	297,860	757	389	280
Aug	59,746	58,819	58,947	58,879	301,121	927	430	127
Sept r	60,082	59,457	59,464	59,173	304,780	624	418	6
Oct p	59,609	59,199	59,217	58,763	306,539	410	335	18

[1] Data are prorated averages of biweekly (maintenance period) averages of daily figures.

Source: Board of Governors of the Federal Reserve System.

BANK LOANS AND SECURITIES

Total commercial bank loans and leases rose slightly in October. Commercial and industrial loans fell 0.3 percent.



* SEASONALLY ADJUSTED
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COUNCIL OF ECONOMIC ADVISERS

[Billions of dollars, seasonally adjusted [1]]

Period	All commercial banks														
				Loans and leases											
	Total loans and securities [2]	U.S. Government securities	Other securities	Total [2]	Commercial and industrial	Real estate	Individual	Security	Nonbank financial institutions	Agricultural	State and political subdivisions	Foreign banks	Foreign official institutions	Lease financing receivables	Other
1981: Dec	1,307.3	179.3	160.5	967.5	355.4	284.1	182.5	21.4	29.9	33.1	0.0	18.1	7.2	12.7	23.1
1982: Dec	1,400.5	201.7	164.8	1,034.0	392.5	299.9	188.2	25.3	31.2	36.2	.0	14.6	5.9	13.3	26.9
1983: Dec	1,552.3	259.2	169.2	1,123.9	414.2	330.9	212.9	28.0	30.4	39.2	3.3	13.4	9.4	13.7	31.8
1984: Dec	1,722.5	260.2	141.1	1,321.3	473.3	376.4	253.8	34.3	31.3	40.1	46.1	11.2	7.9	16.0	31.0
1985: Dec	1,910.1	270.6	179.3	1,460.3	500.5	426.0	294.7	43.0	32.4	36.1	56.8	9.8	6.0	19.0	35.9
1986: Dec	2,094.2	309.3	194.2	1,590.6	537.5	494.4	315.3	40.6	35.0	31.5	58.5	9.9	5.9	22.4	39.6
1987: Dec	2,239.5	334.4	193.8	1,711.2	567.9	587.4	328.4	35.1	31.9	29.4	52.6	7.9	5.3	24.6	40.7
1988: Dec	2,422.1	361.5	192.2	1,868.4	607.0	671.9	354.9	40.4	30.1	29.8	45.6	8.1	5.0	29.2	46.3
1989: Dec	2,588.8	396.1	180.8	2,011.9	641.6	761.1	375.8	38.8	33.0	30.7	40.1	8.9	3.6	31.8	46.5
1989: Oct	2,570.5	390.9	181.4	1,998.2	642.0	746.7	372.4	40.7	33.2	30.5	41.3	9.1	3.8	31.9	46.6
Nov	2,585.8	396.0	179.9	2,009.9	645.0	754.0	374.4	40.9	33.9	30.5	40.8	8.3	3.7	31.9	46.4
Dec	2,588.8	396.1	180.8	2,011.9	641.6	761.1	375.8	38.8	33.0	30.7	40.1	8.9	3.6	31.8	46.5
1990: Jan	2,594.4	404.7	180.4	2,009.3	637.9	765.9	378.3	39.3	32.5	30.9	38.6	8.1	3.2	32.1	42.5
Feb	2,614.3	414.5	180.5	2,019.4	638.8	774.7	379.5	40.0	32.9	30.8	38.9	7.8	3.1	r32.1	r40.7
Mar	2,635.6	422.3	180.1	2,033.2	644.4	781.8	379.9	37.1	33.8	30.6	38.4	8.4	3.0	r32.4	r43.3
Apr	2,646.7	427.3	180.0	2,039.4	649.0	786.9	378.8	36.1	33.9	30.4	38.2	8.8	3.2	r32.4	r41.8
May	2,653.8	430.6	178.3	2,045.0	648.6	794.6	379.8	34.8	33.9	30.0	37.9	8.7	3.2	r32.7	r40.7
June	2,669.4	438.5	177.9	2,053.0	651.6	800.1	378.4	35.3	34.4	29.5	37.4	7.4	3.2	r32.4	r43.3
July	2,684.7	440.6	177.8	2,066.4	651.7	808.0	378.3	38.8	34.8	29.3	36.6	7.0	3.2	r32.8	r45.9
Aug	2,707.8	441.3	179.2	2,087.3	653.1	811.9	380.1	46.0	35.7	29.2	36.1	8.0	3.2	r32.9	r51.3
Sept	2,708.5	447.1	179.4	2,082.0	651.6	814.7	381.1	43.1	r36.1	29.1	35.4	7.9	3.2	r32.9	r46.9
Oct p	2,710.9	451.6	176.9	2,082.5	649.5	820.6	381.2	41.4	36.1	29.2	34.9	8.9	3.1	33.3	44.3

[1] Data are prorated averages of Wednesday figures for domestically chartered banks and averages of month-end data for foreign-related institutions. Data beginning January 1984 are not strictly comparable with data for earlier periods, largely because beginning January 1984 certain obligations of States and political subdivisions are included in loans rather than in other securities.

[2] Excludes loans to commercial banks in the United States.

Source: Board of Governors of the Federal Reserve System.

SOURCES AND USES OF FUNDS, NONFARM NONFINANCIAL CORPORATE BUSINESS

[Billions of dollars; quarterly data at seasonally adjusted annual rates]

Period	Sources							Uses			Discrepancy (sources less uses)
	Total	Internal [1]	External					Total	Capital expenditures [3]	Increase in financial assets	
			Total	Credit market funds			Other [2]				
				Total	Securities and mortgages	Loans and short-term paper					
1982	300.8	241.9	58.9	48.5	−6.2	54.7	10.4	303.1	256.1	47.0	−2.3
1983	416.9	285.2	131.7	76.5	41.0	35.5	55.2	392.6	270.5	122.1	24.3
1984	491.4	335.9	155.5	91.9	−13.6	105.5	63.7	474.9	369.7	105.2	16.5
1985	455.7	351.8	103.9	49.8	−6.2	56.0	54.1	425.1	341.2	83.9	30.6
1986	524.1	344.3	179.8	124.7	60.5	64.2	55.1	481.2	330.4	150.8	43.0
1987	493.7	372.4	121.3	48.2	18.5	29.7	73.1	466.6	354.1	112.5	27.1
1988	548.2	391.4	156.8	55.1	−15.4	70.5	101.6	494.6	378.3	116.3	53.5
1989	515.2	380.0	135.2	35.3	−45.1	80.4	99.9	486.5	382.2	104.3	28.6
1989: I	511.6	379.9	131.7	18.0	−92.5	110.5	113.6	478.6	377.4	101.2	33.0
II	606.9	379.7	227.2	118.7	3.1	115.6	108.4	568.5	388.3	180.2	38.5
III	465.9	385.5	80.4	1.0	−85.2	86.2	79.3	446.4	385.1	61.3	19.5
IV	476.3	374.9	101.4	3.6	−5.8	9.4	97.8	452.8	378.2	74.6	23.4
1990: I	491.9	370.6	121.3	92.6	−3.1	95.7	28.5	467.8	343.4	124.4	24.1
II^p	496.9	377.4	119.5	58.4	25.5	32.9	61.1	464.0	372.7	91.3	33.0

[1] Undistributed profits (after inventory valuation and capital consumption adjustments), capital consumption allowances, and foreign branch profits, dividends, and subsidiaries' earnings retained abroad.

[2] Consists of tax liabilities, trade debt, and direct foreign investment in the U.S.

[3] Plant and equipment, residential structures, inventory investment, and mineral rights from U.S. Government.

Source: Board of Governors of the Federal Reserve System.

CONSUMER INSTALLMENT CREDIT

[Millions of dollars; seasonally adjusted]

Period	Installment credit outstanding (end of period)					Net change in installment credit outstanding [1]				
	Total	Automobile	Revolving	Mobile home	Other	Total	Automobile	Revolving	Mobile home	Other
1980: Dec	298,154	111,991	55,111	18,736	112,317	1,671	−484	1,754	529	−127
1981: Dec	311,259	119,008	61,070	20,058	111,124	13,105	7,017	5,959	1,322	−1,193
1982: Dec	325,805	125,945	66,454	22,064	110,802	14,546	6,937	5,384	2,546	−322
1983: Dec	368,966	143,560	79,088	23,562	122,756	43,161	17,615	12,634	958	11,954
1984: Dec	442,602	173,564	100,280	25,861	142,897	73,636	30,004	21,192	2,299	20,141
1985: Dec	518,252	210,187	121,816	26,850	159,400	75,650	36,623	21,536	989	16,503
1986: Dec	573,017	247,428	135,851	27,096	162,642	54,765	37,241	14,035	246	3,242
1987: Dec	610,468	265,851	153,078	25,920	165,620	37,451	18,423	17,227	−1,176	2,978
1988: Dec	664,701	284,556	174,057	25,201	180,887	54,233	18,705	20,979	−719	15,267
1989: Dec [2]	716,624	290,770	197,110	22,343	206,401	(3)	(3)	(3)	(3)	(3)
1989: Sept [2]	705,703	288,839	190,378	22,661	203,825	2,185	−1,122	1,194	−73	2,187
Oct	710,133	290,210	191,734	22,621	205,568	4,430	1,371	1,356	−40	1,743
Nov	713,903	290,972	194,679	22,197	206,055	3,769	761	2,944	−424	487
Dec	716,624	290,770	197,110	22,343	206,401	2,722	−202	2,431	146	346
1990: Jan	717,829	290,904	199,146	22,604	205,175	1,205	134	2,036	261	−1,226
Feb	717,869	289,629	199,927	22,633	205,680	40	−1,275	781	29	505
Mar	720,445	290,932	202,263	22,708	204,543	2,576	1,303	2,336	74	−1,137
Apr	720,835	288,936	203,965	22,702	205,232	390	−1,996	1,702	−6	689
May	724,485	288,931	207,153	22,815	205,585	3,650	−5	3,188	113	353
June	724,601	287,168	208,362	22,733	206,338	116	−1,764	1,208	−83	753
July	729,329	286,791	212,138	22,795	207,605	4,728	−377	3,776	63	1,267
Aug ^{r}	732,385	285,283	214,492	22,976	209,635	3,056	−1,508	2,354	180	2,030
Sept ^{p}	735,386	285,446	216,397	22,757	210,787	3,001	163	1,905	−219	1,152

[1] For year-end data, change from preceding year-end; for monthly data, change from preceding month.

[2] Data newly available in January 1989 result in breaks in many series between December 1988 and subsequent months.

[3] Because of breaks in series, net change not available.

Source: Board of Governors of the Federal Reserve System.

Economic Linkages and the Causes of the Current Recession

- Collapse of Construction and Real Estate Industries
- Loss in Value of Household Wealth (Demand Side)
- Illiquidity and Systemic Rigidities (Supply Side)

Possible Ways Out

- Monetary Policy: Pushing on a String?
- Regulatory Policy and Price "Fixing"
- Shift in Regulatory Psychology PLUS Market Recovery

Possible Blunders

- Cause a Sudden Withdrawal of Funds from Banking System
  - Loss of confidence in safety
  - Force bank consolidation
- Force Banks to Reduce Loan Capacity
  - Increase reserve requirements
  - Increase capital requirements
  - Reduce bank capital
    - FDIC insurance
    - Write down of assets

The Treasury's Recommendations

Objectives:

Increased safety for depositor

Minimum exposure for taxpayer

Means:

Stronger Role for Capital

Increased Possibilities for Profitability

Modifications to "Safety Net"

Noncontroversial or "Consensus" Options

Key Issues Remaining:

- o Explicit Safety Net
- o Implicit Safety Net
- o Affiliation with commercial enterprises
- o Analysis of seriousness of systemic risk
- o Credit Unions
- o Clearance

Uninsured PAY $100K.
Depositors get paid off

VARIATIONS — Variable Rate
= 70
Big Banks vs little Banks as failures
Need Treas. & Fed Permission

Thrown into Batch
Insurance Funds
Why

<u>Recommendations</u>

1. Vary deposit insurance premiums according to levels of risk based capital.

2. Pilot project to explore a private coinsurance system.

3. Eliminate insurance coverage of "brokered" deposits.(*)

4. Eliminate pass-through insurance.(*)

5. Limit insurance to $100,000 per depositor.(*)

   - Use Random Audit Approach

   - Effectively limit amount insured, rather than payoff

6. Continue no insurance or assessments on deposits in foreign branches of U.S. banks.

7. Assess collateralized borrowing.

8. No protection of creditors

9. Reduce protection of uninsured depositors

   - Limit FDIC to cheapest resolution

   - Develop ABA like mechanism for overnight haircut

   - Prohibit FDIC from invoking systemic risk by requiring FED and Treasury approval.

   - Pay for uninsured payoffs with Treasury line of credit to be repaid by banks through FDIC

10. Capital based supervision

    - More freedom for well capitalized

    - Early Intervention: dividends, lending growth

    - Early closure

11. No current increase in minimum capital requirements

12. Annual on-site examination

13. Improve market value reporting -- but do not for accounting (NOTE)

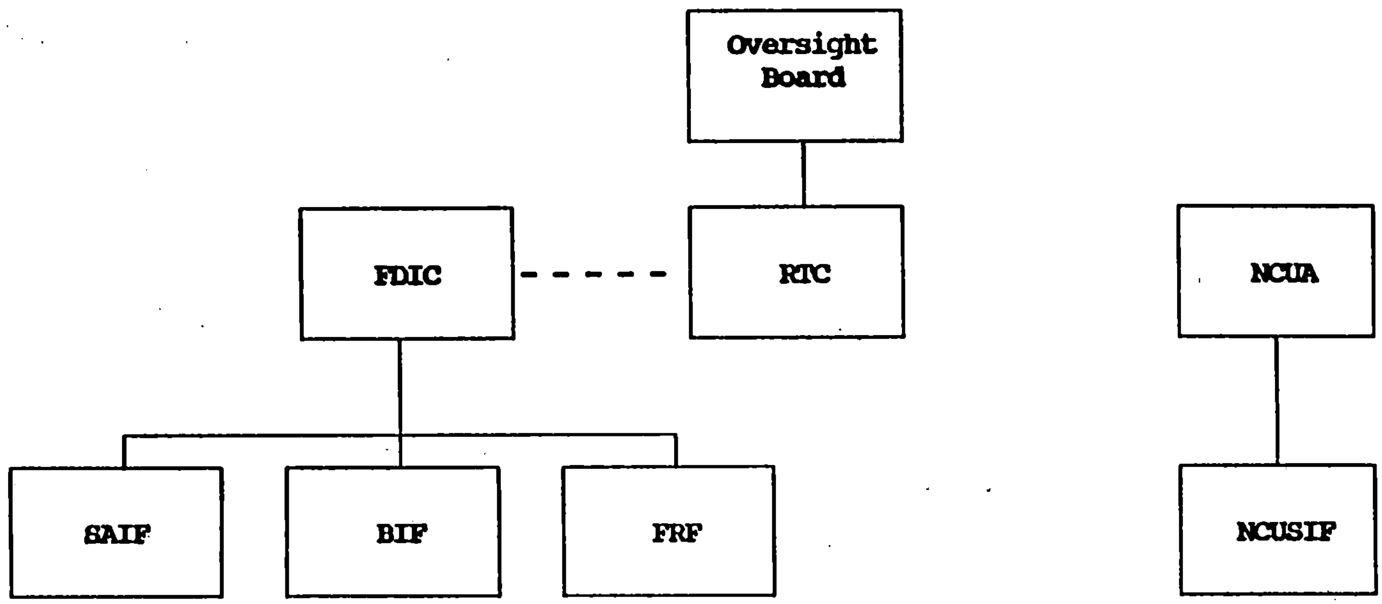
14. Restrict activities of state-chartered banks as in FIRREA

15. Nationwide banking

16. End 1930s Line of Business Restrictions and Bank Holding Company Act

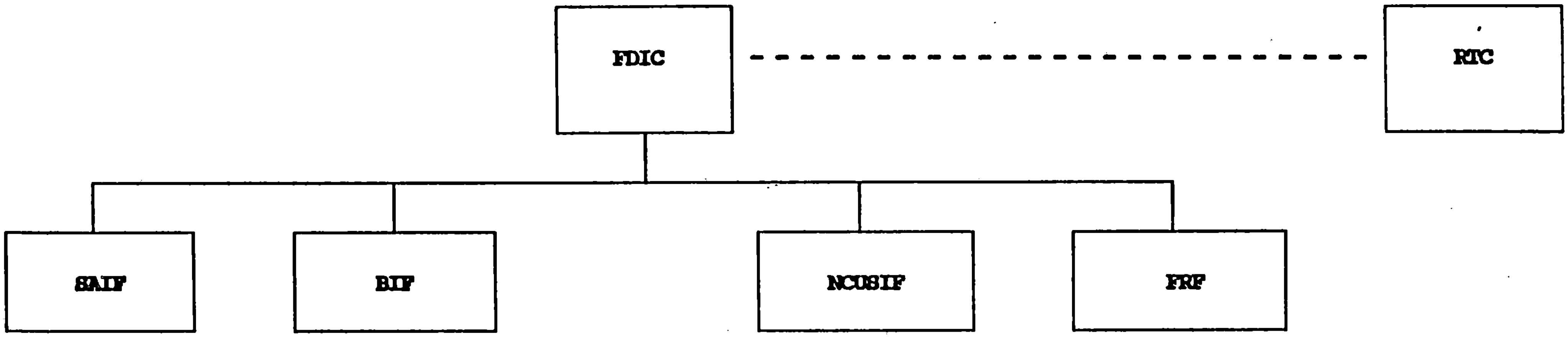
TAB M

CURRENT DEPOSIT INSURANCE AND RESOLUTION SYSTEM



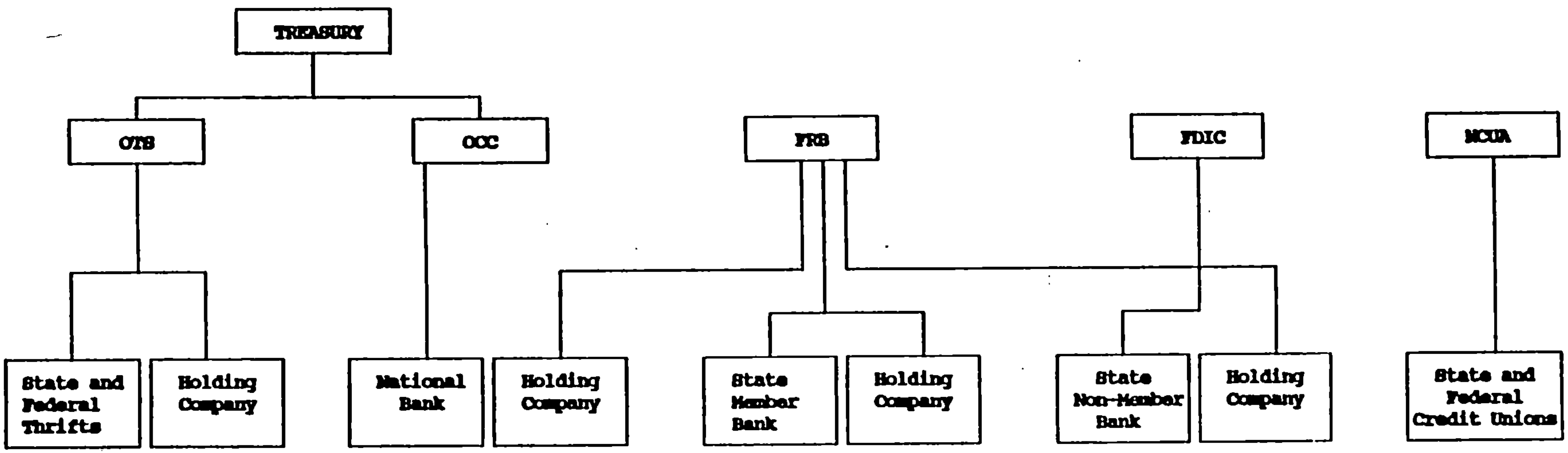
TAB M

OPTIONS A AND B: ONE INSURER/RESOLVER



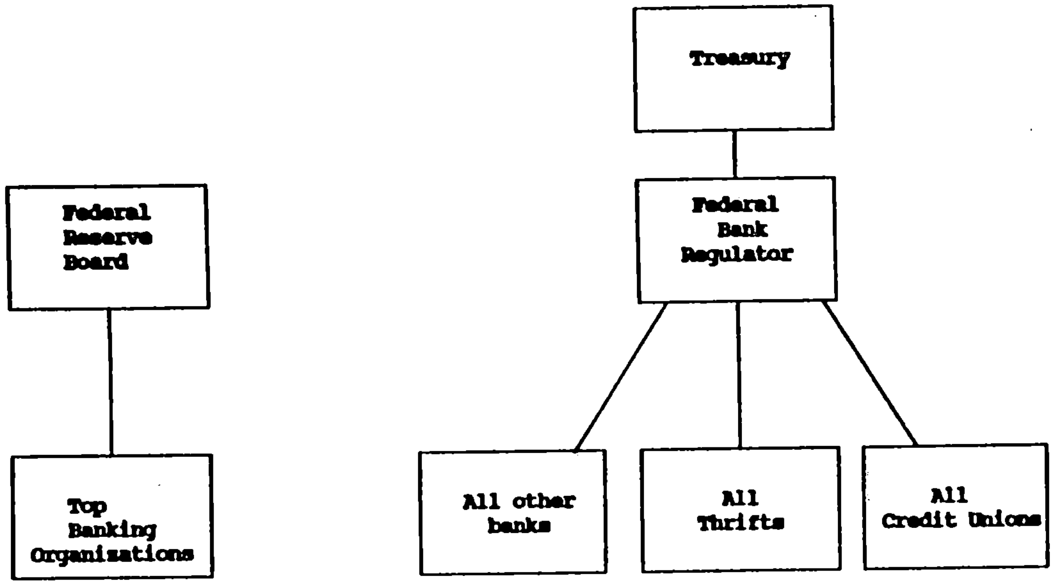
TAB J

CURRENT FEDERAL REGULATION OF INSURED DEPOSITORIES AND THEIR HOLDING COMPANIES

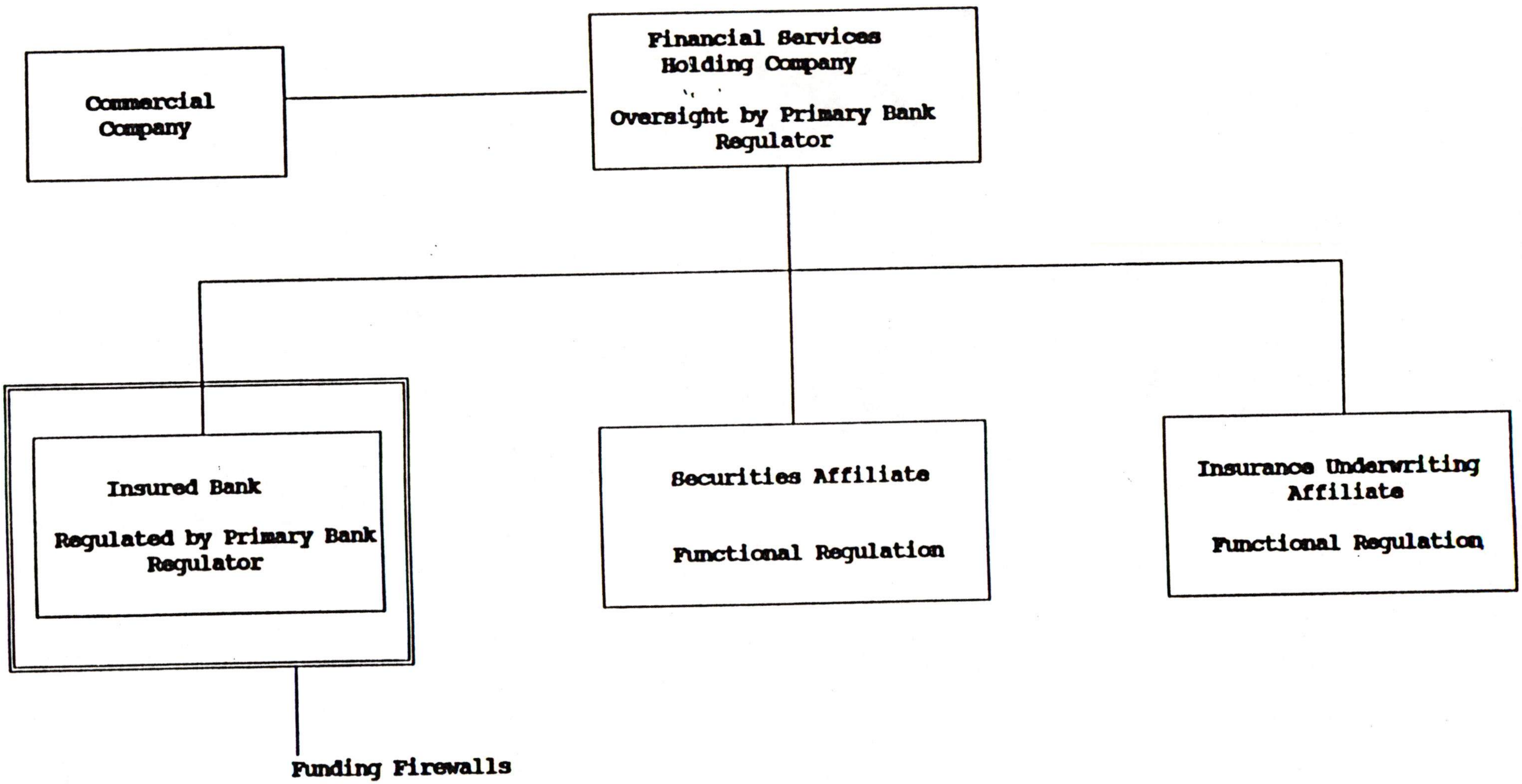


TAB J

OPTION B: LARGE AND SMALLER BANK REGULATORS



Proposed Financial Structure



II. One Insurer and Resolver (TAB M)

A. Move Credit Union Insurance Fund under FDIC

B. Reorganize FDIC Board

a. Replace OTS and OCC directors with FBR director

b. Eliminate one independent director

c. Result is 3-person board as it was before FIRREA

d. [NCUA chairman on board if not under FBR?]

C. Reorganize RTC Board and Merge with Oversight Board

a. FDIC board would be RTC board with two additions

b. Secretary of Treasury

c. HUD Secretary

d. FDIC Chairman would be RTC Chairman

D. [Alternative -- Split out RTC from FDIC and establish new board with full-time Chairman but Administration participation]

Support and Opposition

- Agencies will strongly support.
- Strong theoretical support from Congress, but Democratic partisans may be politically unwilling to let Administration off hook.
- Bankers will support, but will want RTC split off from FDIC.
- Thrifts would probably support.

ccrunch

THE NEW YORK TIMES, FRIDAY, NOVEMBER 23, 1990 D2

Economic Scene | Leonard Silk

Trying to Soothe Scared Bankers

ADDRESSING the New York chapter of the Arthritis Foundation this week, Treasury Secretary Nicholas F. Brady urged bankers to keep lending to their good customers. He is afraid the bankers may be spooked into creating a credit crunch by their fears of an economic slump and their worries about meeting tougher regulatory standards. To ease the latter worry, Mr. Brady told regulators not to use "unrealistically negative scenarios in evaluating loans."

"There are many ways to strengthen a balance sheet," said the Treasury Secretary, once an investment banker, "without shedding loans" — like cutting costs, reducing dividends and merging with rival banks. Some large banks are determined to make mergers that would give them a chance to cut expenses and increase earnings. They fear that unless a banking crisis is prevented, the current economic slowdown could become the most severe recession of the postwar period. The banks are driving to protect themselves, and cutting loans is one way of trying — but one that poses severe risks to local communities and the economy as a whole.

• • •

Prices of the securities of many leading money-center banks and regional banks have been falling, and their yields have been rising, in some cases to "junk bond" levels. Thus far, public notice has focused on the banks' falling common stocks, rather than on the climbing yields of their subordinated debt and preferred stock. Yield levels on the common stock, debt and preferred shares of most banks have climbed sharply, although Mr. Brady asserted, "Over all, the banking system is healthy, despite some pockets of difficulty."

Morris W. Offit, the president of Offitbank, an investment management bank, sees the situation the other way around, with general weakness and pockets of health. He thinks that "nobody has made the connection between the banks and the risks to the real economy." He also argues that the soaring costs of capital are making it increasingly difficult for banks in every region to raise the money to meet tougher regulatory standards. Mounting pressures on the banks, Mr. Offit says, create risks of a "tremendous contraction" of the economy.

Although not all banks have felt the squeeze, many are seeing their costs of capital climb. Citicorp, the nation's biggest bank, has seen the yield on its subordinated debt climb to 13 percent, from 10.5 percent two months ago. Yields on the debt of many other banks are even higher: Chase Manhattan was at 14.2 percent this week; Baltimore Bancorp at 14 percent; Bank of Boston at 18.5 percent; Dominion at 15.5 percent; First City of Texas at 25 percent; First Fidelity at 15 percent; MNC Financial at 27 percent; Midlantic at 21 percent and Shawmut at 17 percent.

But some banks can still finance debt in the open market at much lower yields, among them are J. P. Morgan, at 9.6 percent; Bankers Trust and Security Pacific, at 10.7 percent each; Mellon, at 11.3 percent, and Wells Fargo at 11 percent.

The anxious bankers contend that if a financial crisis is to be headed off, some big steps will have to be taken by the Government and the Federal Reserve. They insist that the Fed should go further to ease money to counteract recessionary forces and they maintain that the Fed can do so with much lower risks of inflation than in the 1970's. Some even perceive a threat of ruinous deflation, if downward pressures on the economy are not soon checked.

Some bankers want Government officials "to stop bashing the banks in public." Bank-bashing, they say, is making it harder for them to raise the capital they need to meet the standards of the Bank for International Settlements. To date, however, most banks are meeting those standards.

And the bankers are pressing the Administration to speed up a restructuring of the industry that would enable them to reduce their risks and costs, and expand their earnings, by merging with other banks. A revamped system would also allow banks to conduct business nationwide and expand into areas banned by existing law, especially the Glass-Steagall Act, like underwriting securities, selling insurance and operating mutual funds.

• • •

Without specifying exactly what banking legislation the Administration may propose soon after New Year's Day, Secretary Brady said in his Arthritis Foundation speech this week, "It's time to overhaul the system." He called for "fundamental structural reform" of the laws enacted during the Depression that have produced an "outmoded, burdensome and inefficient" financial regulatory system. This was his strongest statement on the subject to date. But the legislation is likely to face a tough fight in Congress, with small and regional banks fighting their larger money-center rivals.

For its part, the Federal Reserve, clinging to its historical secrecy, insists that it is well aware of the dangers of a banking crisis and has plans for dealing with one. The Fed thinks — a Fed, as well as a White House, can think anonymously — that it would only worsen anxieties in the marketplace, and possibly drive up interest rates and hurt the economy, if it talked publicly about its plans to rescue banks, provide liquidity and protect the economy and the financial system. The Fed insists that it knows more about the risks, and how to deal with them, than the nervous bankers do.

It feels that it demonstrated that capability, along with other central banks, after the October 1987 stock market crash.

5

A Better Way to Protect Deposits

The recent collapse of Freedom National Bank in Harlem demolished a proud symbol of black-owned neighborhood enterprise. It also focused attention on Federal deposit insurance, since several charitable organizations stand to lose hundreds of thousands in accounts they mistakenly thought were insured.

The plight of the Harlem charities should temper enthusiasm for proposals circulating within Congress and the Treasury Department to cut back the limits of federally insured deposits. There are better ways to protect taxpayers than by threatening depositors.

•

Federal deposit insurance was enacted during the 1930's in the aftermath of massive bank failures brought on by the Depression. For 50 years, the system worked to protect solvent banks from panicky withdrawals and to give peace of mind to ordinary depositors.

Starting in the 1970's, Congress deregulated the interest rates that banks were allowed to pay depositors, raised insurance limits to $100,000 from $40,000 and loosened restrictions on bank investments. The combination proved deadly for savings and loan institutions, which had to pay much higher interest rates on deposits than they were earning on their long-term residential mortgages.

Failing S.& L.'s offered fabulously high interest rates to attract deposits, then invested the new money in high-risk ventures. When the investments failed, the Government was stuck paying off depositors. Such gambling with federally insured deposits remains possible under current law.

Many in Congress and the Administration want to prevent a recurrence of the S.& L. bailout by cutting back taxpayer liability. Some proposals would eliminate the right of depositors to keep separately insured accounts at different banks. Other proposals would return the ceiling on insured accounts to $40,000. The idea is to leave wealthy depositors exposed to loss so they will withdraw money from unsafe banks.

There are glaring flaws in this idea. Lower deposit limits would hurt depositors who aren't rich. The Harlem charities are examples of depositors with more than $100,000 at stake. Working-class retirees who receive lump-sum pension payments of $60,000 or more might also find themselves vulnerable if deposit limits were reduced.

In addition, the incentive is sure to backfire. Professional investors and security analysts were unable to predict which savings and loan institutions would fail. How could ordinary depositors be able to tell which banks are sound? More likely, panicky depositors would withdraw money from solvent banks that become the unjustified targets of rumor.

Beyond that, limits on deposit insurance have never been enforced in an evenhanded manner. Regulators do not, and probably cannot, allow depositors at large banks to suffer losses lest hasty withdrawals destabilize the banking system. Stricter limits, if passed, would wind up applying only to small banks, like Freedom National, threatening to drive them out of business.

How then ought the system be reformed? A number of economists have proposed more workable legislation to prevent gambling with insured deposits. Such plans would require banks to keep a large cushion of marketable assets that could be readily claimed by regulatory authorities to pay back depositors. And as losses eroded these assets, regulatory authorities would be *required*, not just permitted, to stop a bank from extending new loans or distributing dividends.

With those kinds of safeguards in place, Congress could confidently lift all limits on the amount depositors could put in insured accounts. Yet the taxpayer would be protected, and millions of pensioners, nonprofit organizations and ordinary depositors could sleep soundly at night, knowing their money was safe.

A18

Regulate Banks: Less, and More

The Bush Administration has put forth a seemingly crazy idea: sweeping deregulation of commercial banks. The last time Washington set out to deregulate financial institutions, it brought on the monumental savings and loan scandal.

But in fact there's nothing crazy about the Administration's bank plan. It is prudent and courageous. Prudent because current regulations make banks financially shaky and unable to survive foreign competition. Courageous because the Administration is sure to be ridiculed by members of Congress quick to stir up distaste for anything that smacks of another S.& L. bailout.

•

Two laws, each more than 50 years old, stifle commercial banks. The McFadden-Douglas Act prevents banks from opening branches across the nation. And the Glass-Steagall Act forbids banks to underwrite and trade securities. Both laws are supposed to keep banks safe. In fact, they do the opposite.

The key to lowering financial risk is diversification: by investing in many different regions, industries and financial instruments, banks could insulate themselves. By forbidding such diversification, the two laws destabilize bank earnings.

A glaring example is the fate of S.& L.'s in the Southwest, dragged down by the collapse of the real estate market. If they had been allowed to operate branches in thriving Northwest states and not been forced to invest so heavily in real estate, they would still be alive.

The banking laws create another mortal problem. U.S. banks are losing customers to foreign banks which are permitted to offer a panoply of services, ranging from insurance to securities trading. Deregulation is necessary for American banks to survive. But it cannot proceed until Congress makes sure that failing banks can't gamble with federally insured deposits. That's what created the S.& L. debacle, and it remains possible under current law.

The Treasury Department is reviewing several promising options. The essential ingredients are clear. First, the Government needs to set high capital standards, above current levels. Next, as bank losses mount — and capital slips below specified targets — regulators would be *required* to intervene. Failing banks would be prevented from extending new loans, paying dividends or otherwise squandering funds needed to reimburse depositors.

Mandatory intervention was missing during the 1980's as bankrupt S.& L.'s were permitted to get deeper and deeper into trouble. What Congress ought to have learned from that searing episode is that the response cannot be left to the discretion of politically sensitive regulators.

Even if Congress agrees to these safeguards, many details must be resolved. The Treasury Department is grappling with proposals to improve accounting standards, introduce risk-adjusted fees for deposit insurance and set up barriers against misuse of federally insured deposits.

Beyond such details, the overriding need is to free U.S. banks to diversify investments and compete against foreign rivals. Economists have shown this can be done without endangering the taxpayer. Now the Administration has wisely turned policy into proposals. Congress would be wise to accept.

6.

THE WASHINGTON POST TUESDAY, DECEMBER 18, 1990

NT20

Failing Banks

BANKS ARE failing faster than the federal deposit insurance system expected, and the insurance fund is already dangerously low. Now L. William Seidman, chairman of the Federal Deposit Insurance Corp., projects losses over the next two years showing the fund dropping still further. It is urgently important to build the fund up again, as Mr. Seidman correctly warns. The question, as usual, is how to do it.

The immediate cause of the bank failures is a weakening economy that results in more loan defaults, especially in real estate. But behind that cyclical pressure there is a deeper and more troubling trend. Banking over the years has become far less reliably profitable than it once was. The evolution of the world's financial system has taken away from the banks many lines of business that were solidly profitable for them. They have responded by getting excessively deeply into kinds of lending that are much riskier—foreign lending in the late 1970s, real estate lending in the late 1980s. Now, with only a mild downturn in the national economy, a lot of them are in serious trouble.

The strain on the deposit insurance system is not an isolated crisis that can be resolved by tinkering with actuarial ratios and increasing the premiums that banks pay. It needs to be seen clearly as a symptom of widespread vulnerability in an industry that is operating under obsolete laws, with barely adequate capital and increasingly severe competition.

The insurance premiums are now being raised, but they can't go up much farther. The premiums come out of banks' profits, and the insurance fund can hardly expect to strengthen itself with strategies that weaken the banks it insures. That point is made forcefully by three economists, James R. Barth, R. Dan Brumbaugh and Robert E. Litan, in a study for the House Subcommittee on Financial Institutions. Their calculations suggest that even a mild recession could easily swamp the banks' deposit insurance fund and force a rescue with taxpayers' money, as in the case of the S&Ls.

All of these recent hearings, analyses and forecasts are providing a kind of overture to the Treasury Department's proposals due next month for deposit insurance reform and the legislation that will certainly follow. It is entirely clear that the Treasury can't limit itself to deposit insurance alone, but will have to address the state of the whole banking industry. Without substantial structural changes, the decline of American banking is not reversible. Without stable and prosperous banks in this debt-ridden economy, a strong expansion of business and a rising standard of living are unlikely.

65

THE NEW YORK TIMES, TUESDAY, DECEMBER 18, 1990 A-4

The Bad Bank News: Not That Bad

Every day seems to bring more bad news about banks. Over the weekend William Seidman, chairman of the Federal Deposit Insurance Corporation, admitted that bank failures were far worse than he had previously predicted, and that the fund would reach unacceptably low levels. Yesterday three private economists gave even scarier testimony to a House subcommittee. Even if the imminent recession turns out to be mild, they said, the insurance fund could run short.

Bad as the news is, it's not dire. Bank failures — even if they include a few large money-center banks — will not become contagious and do not threaten the economy. The Federal Reserve Board and the F.D.I.C. have sufficient tools to manage the problem. In the worst of all outcomes, the taxpayers who are bailing out the savings and loan industry will be hit with another bailout. But that one would be small by comparison, its price measured in tens, not hundreds, of billions.

•

As the recession spreads across the country, many more commercial banks are expected to fail. Insured depositors will be paid off by the F.D.I.C., which is why the insurance fund is expected to lose $5 billion next year.

The primary problem is structural: restrictive regulations have made it impossible for U.S. banks to make much profit. And because every bank pays the same insurance premium, prudent banks wind up paying for the errors of imprudent ones. Structural reform is the only long-term answer, and will be the subject of a major report due from the Treasury Department early next year.

But in the meantime, Mr. Seidman's insurance fund is leaking and needs to be fortified. He describes a plan by which banks will fork over about $45 billion in higher insurance fees. They, in turn, will pass these higher costs along to the depositors in the form of lower interest rates. The risk is that the higher fees could throw marginally solvent banks into bankruptcy.

This risk is worth taking for the short term. If necessary, the threat could be mitigated by substituting Treasury funds for part of the higher bank fees. The proposal Mr. Seidman lays out would put enough money into the insurance fund to cover anything but a severe recession; and even in that unlikely case, the fund could be made whole with a modest transfer from taxpayers without undue harm to the economy.

Each release of bad news about banks prompts quick analogies to 1929. Yes, there was a widespread collapse of the banking system then, and yes, that collapse led to general economic collapse. But 1990 bears little resemblance to 1929.

For one thing, there is now deposit insurance, to give depositors ironclad protection and peace of mind. The banking system will be hit with no contagion of depositor panic and withdrawals. For another, the Federal Reserve System would never repeat the mistake made during the Depression by allowing total bank reserves and the money supply to collapse.

Proposals of the kind Mr. Seidman describes won't make U.S. banks healthy; that will take structural reform. But they can relieve the short-run problem of an insurance fund that is running out of money. His message is calming.

64

Banks in the Crunch

The federal government has to take care not to destroy the banking industry for the supposed purpose of saving it.

Although taxpayers are in no mood to bail out shaky commercial banks after having to shell out $200 billion for failed savings and loan institutions, proposals to slap a $25 billion special assessment on banks should be approached with caution. While something must be done to bolster the fast-shrinking fund that insures each deposit up to $100,000, it will do nobody any good to push wobbly banks over the edge and deny stronger banks the capacity to make loans essential to get the nation out of recession.

So if political realities make it imperative for banks rather than taxpayers to take the hit, the government will have to be considerate of weak institutions and take actions that limit damage in the industry as a whole.

One step would be to lift Depression-era restrictions so that commercial banks can get into insurance, trading in securities, direct investment in physical assets and interstate operations. This would help some big money-center banks faced with foreign competition. What it would do for smaller banks is open to debate. Closer regulation would be required to avoid risky ventures that would merely compound current problems.

Another step, which deserves instant approval, is to enforce dividend restraint on banks whose earnings no longer justify usual payouts to stockholders. While this might depress the value of certain bank stocks, it would retain capital needed both for continued lending and for dealing with problem loans already in the portfolio.

Because the nation has entered the recession with so many of its financial institutions in terrible shape, the plight of the banks cannot be divorced from the state of the general economy. The Federal Deposit Insurance Corp. was organized for the express purpose of preventing the kind of banking collapse that deepened and prolonged the Depression. This policy still obtains. The FDIC's Bank Insurance Fund must be preserved at all costs if the public confidence necessary for an early economic recovery is to be preserved.

Next month the Bush administration will be offering a banking reform package that attempts to combine the sour and the sweet. Higher assessments for the FDIC fund, tougher regulation, incentives for sound banking practices and limitations on dividends should be accompanied by the lifting of obsolete restrictions on the fields banks can enter. This could be the biggest overhaul of the banking system in more than half a century; it had better be a good one.

THE WASHINGTON POST . WEDNESDAY, DECEMBER 19, 1990

W 2

DAVID WARSH

Bank Reregulation Will Be Painful, But It May Make U.S. System Safer

Forget Iraq, at least for the moment. The real blood is about to begin flowing in this country. The banking industry is about to take more casualties (in the form of pink slips) than anyone fears in the Saudi desert, if and when the siege of Kuwait turns into a shooting war. But like the situation in the Persian Gulf, the skirmish here just may be worth the cost.

Starting in January, the Treasury Department is going to begin taking down the barriers that cramp and crib big American banks. As Treasury Secretary Nicholas F. Brady said in his Arthritis Foundation speech in November, "It is time to overhaul our financial system." He is right—and there are very few people who will remain unaffected by the reforms.

The news last week was dominated by talk about how bank regulators do their jobs—too easy on the thrifts, too hard on the banks, too fragmented on the insurance companies. But it is this balkanized system of regulation itself that is the real villain, not the regulators.

Some comparative perspective on the American banking industry helps. In context of battles over the recently discontinued talks on the General Agreement on Tariffs and Trade, it was often observed that nations have very different tastes in subsidies. The Italians, for example, have more farmers in their small country than there are in the entire United States. A complex pattern of agricultural subsidies and prohibitions reflect the fact that Italians like their wheat fields to come up to the city walls and prefer that suburban malls be relatively few and far between.

These crotchets are not peculiar to the Old World. Thanks to sets of regulations dating back to the New Deal, the Civil War and the Constitutional Convention itself, the United States has more bankers today than farmers. Chief among these statutes are the McFadden-Douglas Act, which prohibits banks from nationwide branching, and the Glass-Steagall Act, which keeps banks out of the investment business and vice versa.

The laws that created and protected the thrift industry as a kind of captive money machine for the real estate industry are a virtual sideshow to the main business of banking—and even so, congressional tampering and interference with the oversight of the savings and loan industry cost the Treasury the equivalent of a small war.

The point is that the result of these and other laws is that any small town in America has more local banks, and more competition, than ever would have evolved had the industry not been hedged about and protected by extensive government supervision. But as well organized as the bankers are, all that is about to change—chiefly as a result of international competition.

Between 1973 and 1988, the hierarchy of world banking underwent a dramatic geographic shift. According to Herve de Carmoy, a French banker with extensive American experience who has written a lucid and compelling guide to the situation, the Japanese banks grew at an annual average rate of 13.5 percent during those years, while American banks grew at 3 percent annually. The result, naturally, was that Japanese banks displaced American banks at the top of the assets pyramid, with a brief interlude at the beginning of the 1980s during which European banks were in the lead.

Interestingly enough, however, for all the shift in leadership among nations, there has been no increase in concentration in the global banking industry, de Carmoy says in "Global Banking Strategy: Tactics for Managing in Turbulent International Markets," which is to be published in this country next month by Basil Blackwell.

The 10 leading banks in the world accounted for around one-quarter of the lending activity of the 100 biggest banks in 1973, and about one-sixth of the biggest 300 banks; 15 years later, they still accounted for about the same market shares, according to de Carmoy. In other words, the world banking sector has undergone no fundamental structural change in the last 15 years.

The next 15 years will be different. Partly because of technology, partly because of increasing competition, partly because of regulation and partly because of the changing nature of what is humanly possible, world banking is about to enter a period of ferocious shakeout, according to de Carmoy. The economics of banking—and the competition among nations—now favors decisively the biggest banks.

Thus, he says, the industrial nations today are at "the beginning of a long period which will see the gradual formation of a world banking oligopoly. The strategic questions faced by all the players in this new game are twofold: to be or not to be a part of this world oligopoly in the more or less faraway future; and, as a part of it, how to survive and in what form."

It is the prospect of playing catch-up in this game with the Europeans and the Japanese that is motivating the Bush administration. It has to act—and quickly—if American banks are to have the freedom to combine and reach out to meet their foreign rivals. Bank of America, Chase Manhattan Corp. and Citicorp were last ranked one, two and three among world banks in 1974; today, they are dwarfed by their Japanese and European competition. Only Citicorp remains among the world's Top 10.

Other American banks can rise, through combinations and new lending, to take their places among the world's leaders, but only if the country's old-fashioned banking laws are extensively rewritten. Money markets of all

12 cont

BANK CONT

sorts will change dramatically, of course, if insurance companies, banks, investment banking firms, payment systems and giant non-bank suppliers of credit—such as the auto companies, General Electric Co. and Sears, Roebuck & Co.—are all allowed to form gigantic integrated combinations to finance themselves and other corporations. But a streamlined system could be more satisfying to the customer, and cheaper.

One other good effect may come of American banking reregulation. It could become safer. The patchwork palimpsest of money supply control and bank supervision that has grown up over the years may have to be rationalized along with the banks. It was the failure of the political supervision of this apparatus that led to the thrift crisis in the first place; it is uneven and uncoordinated regulation that has imposed additional and unnecessary pain in the current credit crunch.

No fair-minded person should blame the regulators for doing their jobs; it's completely unreasonable to berate them for being too easy with the thrifts and then to demand that they go easier on the banks. But one can only wish the Treasury well as it goes about the high-stakes job of building an internationally competitive banking system—and a regulatory apparatus to oversee it.

David Warsh is a columnist for the Boston Globe.

 A/G

No Wonder Banks Fail

By WALTER WRISTON

The first rule of sound banking is never to put all your eggs in one basket. Since no one is smart enough to know where trouble will strike next, or in what form, diversification of assets is the only sound course. One would think that legislation governing banking would foster this time-tested concept. The reverse is true. A system designed in the heady first 100 days of the Roosevelt administration is no more appropriate to conditions in the financial markets of 1990 than the air quality standards that were accepted then are appropriate today. Worse, the network of laws and regulations that exists today actually fosters bank failures.

True diversification takes many forms, but an obvious one is geographic diversity. If a bank is limited to making loans in its own neighborhood and that neighborhood goes downhill, so will the bank. A small bank (or a big one) in an agricultural area with 100% of its loans to farmers in its area will be in trouble if the crop should fail. All this is, or should be, self-evident, but American banking laws are currently designed to cause bank failures by prohibiting American (but not foreign) banks to branch across the common market called the U.S. and in some states until recently not to branch at all!

One Geographic Basket

It is interesting to note that our neighbor to the north, Canada, suffered no big bank failure during the Great Depression—a period when the U.S. lost 5,000 banks. Canada permitted nation-wide banking, and when the crops were scarce in Manitoba, the fish were biting in Nova Scotia. No chain bank had all its loans in one geographic basket.

The U.S. could learn from that example. Since the present American banking system violates the first rule of banking, preserving the present legal structure serves only to produce bank failures. While those banks that are established in a certain location and thus enjoy an area monopoly dislike "outside" bankers invading "their market," present law facilitates the concentration of assets. Indeed, by its Community Redevelopment Act, which orders banks to lend locally, the law actually *mandates* concentration.

Part two of the lesson on concentration of assets concerns the kinds of assets that make up the omnibus figure on a balance sheet—loans to businesses, to governments and to individuals. Does a bank's income come only from interest on loans and securities, or does it flow from diversified financial products, like life or casualty insurance premiums, underwriting fees and commissions or other financial services? Once again we find a system designed to defeat sound management. Just as the 1927 McFadden Act frustrated the geographic dispersal of deposits and assets by forbidding banking across state lines, so the 1933 Glass-Steagall Act has, over the years, fostered product monopolies by forbidding banking across product lines.

Taking only the smallest literary license, the great Deutsche Bank in Germany could be described as a closed-end mutual fund, as it owns the capital stock of dozens of great industrial firms. Finance and commerce are not separated, but merged. By blocking American banks—but not General Electric Capital, Ford Credit or General Motors Acceptance Corp.—from diversifying their product line, the system once again forces banks not only to put all their eggs into one basket, but to fill the basket with the same kind of eggs. If banks did this as a result of a management decision, instead of by law, any alert regulator would severely and justifiably criticize the practice as unsafe and unsound. Perhaps this distinction too has outlived its usefulness, as some in the Bush administration seem to think.

> *If banks did what they do as a result of a management decision, instead of by law, an alert regulator would justifiably criticize their practices as unsafe and unsound.*

The third way in which the present system of laws and regulations works toward producing bank failures is its depressing effect on bank earnings. It is no arcane secret that businesses that earn money survive and that those that don't fail. Banking laws should not prohibit banks from earning money on their assets. But the current system requires that American banks take a sizable chunk of their deposits, currently around 10% for demand deposits, and place them either in their own vaults in cash or at zero interest in an account with the Federal Reserve.

These required reserves amount in the aggregate to about $63 billion on which no interest is paid. No other business in the world labors under such a handicap. The opportunity cost to the industry approximates $5 billion. The Federal Reserve, having thus gotten some of its inventory for nothing, invests these funds in government bonds and collects the interest. Rather than return these earnings to the banks' shareholders, the Fed sends the money to the Treasury. Depending on the interest rate of the moment, the sum lost to shareholders every year comes to about $2.6 billion. All the insured American banks together earned just $15.7 billion last year, and that $2.6 billion is money that could and should be used to build bank earnings and capital.

Toward the end of his term, Federal Reserve Chairman Paul Volcker recommended that this $2.6 billion a year be returned to the banks. So far nothing has come of his suggestion, for this diversion of earnings is really a hidden tax, invisible to all but its victims. If this interest went to the owners of the deposits, a significant step would be taken toward rebuilding bank capital. In addition to these lost earnings, banks will pay the Federal Deposit Insurance Corp. $5 billion next year, or almost a third of their net earnings in 1989.

Capital Strength

Although every bank that has failed since the Great Depression has exceeded the capital ratios set by the bank regulators, capital strength is nevertheless an important element in the banking picture.

The payment of interest on reserve balances to the bank would in and of itself improve capital adequacy; the earnings so generated would flow into the banks' capital accounts, and also would improve bank earnings thus making it easier to sell bank stock in the marketplace. Obviously securities of those companies that earn a good return are more attractive to an investor than those that do not. By improving bank earnings, the market for bank capital will be enhanced. As an added twist, some portion of this refunded interest might be directed to the FDIC, on some agreed schedule, to shore up that fund, once again without taxpayer assistance.

No one in public office would consciously design a system to produce bank failures, but by not changing a system that is almost 60 years old, the U.S. is faced with a structure bound to produce that unhappy result.

Mr. Wriston was chairman of Citicorp from 1967 until 1984.

82

Withdrawal/Redaction Sheet
(George Bush Library)

Document No. and Type	Subject/Title of Document	Date	Restriction	Class.
03. Memo	From Larry Lindsey to John Sununu Re: Rhode Island Credit Union Situation (1 pp.)	12/21/90	~~P~~-5	

Collection:

Record Group: Bush Presidential Records
Office: Chief of Staff, White House Office of
Series: Sununu, John, Files
Subseries: Issues Files
WHORM Cat.:
File Location: Credit Crunch 1991 [3]

Open on Expiration of PRA
(Document Follows)
By JH (NLGB) on 10/28/05

Date Closed:	1/3/2005	**OA/ID Number:**	29151-006
FOIA/SYS Case #:	1998-0004-F[2]	**Appeal Case #:**	
Re-review Case #:	2005-0426-S	**Appeal Disposition:**	
P-2/P-5 Review Case #:		**Disposition Date:**	
AR Case #:		**MR Case #:**	
AR Disposition:		**MR Disposition:**	
AR Disposition Date:		**MR Disposition Date:**	

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P-1 National Security Classified Information [(a)(1) of the PRA]
P-2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P-3 Release would violate a Federal statute [(a)(3) of the PRA]
P-4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P-5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P-6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

PRM. Removed as a personal record misfile.

Freedom of Information Act - [5 U.S.C. 552(b)]

(b)(1) National security classified information [(b)(1) of the FOIA]
(b)(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
(b)(3) Release would violate a Federal statute [(b)(3) of the FOIA]
(b)(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
(b)(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
(b)(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
(b)(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
(b)(9) Release would disclose geological or geophysical information

AC/ER

THE WHITE HOUSE

WASHINGTON

THE CHIEF of STAFF
has seen

December 21, 1990

CCrunch

MEMORANDUM FOR GOVERNOR SUNUNU

FROM: LARRY LINDSEY L

SUBJECT: Rhode Island Credit Union Situation

I thought that you should be aware of the developing situation in Rhode Island. At present it poses no risk, and is legally the state's problem. However, problems like this can always spread. I will keep you appraised of developments.

Attachment

NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

TO: Lawrence Lindsey, Special Assistant to the President

FROM: Roger W. Jepsen, Chairman

SUBJECT: Rhode Island Privately Insured Credit Unions

DATE: December 21, 1990

As NCUA Executive Director Don Johnson and I discussed with you by telephone this afternoon, we wish to make you aware of a developing situation with privately insured financial instituitons in the State of Rhode Island.

There are 35 credit unions in Rhode Island that have share insurance coverage with the Rhode Island Share and Deposit Insurance Corporation (RISDIC), a state-chartered, private corporation. These credit unions hold a total of about 1.5 billion dollars in member shares (savings). RISDIC also insures five loan and investment corporations holding about 500 million dollars in deposits. On November 18,1990, the State closed Heritage Bank, a 25 million dollar RISDIC-insured loan and investment company, because of massive fraud losses.

Following the Heritage failure and the attendant publicity, NCUA has both provided advice to State officials and worked with the State to consider whether the state-chartered credit unions qualify for Federal insurance coverage with the National Credit Union Share Insurance Fund. Officials of the FDIC and Federal Reserve have also been involved in various meetings and discussions.

As of today, we have completed our examinations of the 33 credit unions that have applied for Federal coverage. Our approach will be to insure only those that are fully qualified, and only after they have obtained a release from any further liability to RISDIC. While we have not yet announced any final decisions, it seems clear that eight to ten of the larger credit unions, holding some 1.1 billion dollars in shares, will not meet our standards due to nonperforming commercial loans and other problems.

It is quite possible, because of illiquidity in one or two of the RISDIC institutions, that some or all of them will have to be closed by the State withtin the next several days. It is our plan to continue to move as quickly as possible to complete our review and be in a position to insure those credit unions that qualify, thereby mititgating the adverse effects of this crisis.

In addition to the RISDIC-insured instituions, there are 36 federally insured credit unions in Rhode Island holding a little over one billion dollars in member shares. These institutions are as of now unaffected by the developing problems with RISDIC, and we are taking steps to insulate them from any foreseeable problems.