Shadow Financial Regulatory Committee

Statement of

Shadow Financial Regulatory Committee

on

Policies Toward Troubled Depository Institutions

November 17, 1986

While asset valuation problems have received particular attention where institutions have had energy, LDC, and agricultural concentrations, exposure to losses from real estate lending is probably the chief vulnerability at present. When finally recorded, loan write-downs are often a significant percentage of the "book" valuation of such loans. Unrecognized losses now affect -- or soon will -- a broad range of banks and S&Ls having assets totalling hundreds of billions of dollars. These losses pose a substantial threat to the solvency of the FDIC and the FSLIC.

Because of these losses, a substantial amount of additional funding is urgently needed for the FSLIC. Based on reasonable economic estimates, the $15 billion recapitalization recently considered for the FSLIC is significantly less than the amount of funds required by that agency.

The problem of insolvency now facing the FSLIC could also confront the FDIC. In the long run, capital forbearance and open-bank assistance can easily amplify unrealized losses in the banking system. If this occurs, the FDIC may need recapitalization too.

In the current political and economic environment, "open assistance" may be the most appealing way of dealing with the inadequate capitalization of the insurance system. Open assistance should have as its sole objective the reduction of the ultimate total cost of resolving the insolvencies we now face. It may do this by "buying time", if there is a reasonable expectation that the cost of doing so is warranted by specific measures that will alleviate the problem.

When giving such assistance, either through equity or debt infusions, the Committee believes that the FSLIC and the FDIC should have to demonstrate clearly the reasonableness of individual assistance decisions. Criteria governing eligibility for open assistance, and regulatory guidelines covering decisions on such assistance versus closure, should be explicit.
The Committee proposes that, at a minimum, the following criteria for assistance be met:

* The agency should make timely and accurate disclosure of the economic value of the direct and indirect assistance given and the estimated costs of the alternative of liquidating the insolvent institution. The bases for these calculations should also be disclosed.

* An institution's losses should be imposed on its shareholders and uninsured claimants to the maximum extent possible.

* The program should contain a clear schedule for the reprivatization of the institution or its assets.

* The agency should not give the assisted institution sustained and material competitive advantage over stronger entities.