The FDIC Quarterly Banking Profile

L. William Seidman, Chairman

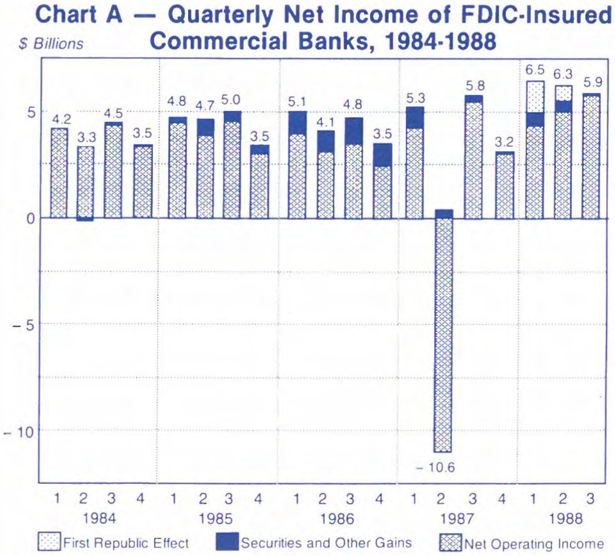
Third Quarter 1988

COMMERCIAL BANKING PERFORMANCE —THIRD QUARTER 1988

- ***Banks Earn Record $5.9 Billion in Third Quarter***
- ***Industry Increases Equity Capital By $4.7 Billion***
- ***Nonperforming Assets Jump $3.2 Billion in Third Quarter***
- ***Southwest Region Accounts for Majority of "Problem", Failed Banks***

The commercial banking sector continued its strong 1988 performance, earning a record $5.9 billion in the third quarter, $100 million more than in the third quarter of 1987, the previous high. Profitability was strengthened by higher noninterest revenues and improved control of overhead expense. For the first nine months of the year, commercial banks reported net income totaling $18.7 billion, surpassing the previous full-year record of $18.1 billion recorded in 1985. Net operating income was $5.8 billion for the quarter and $17.6 billion for the first nine months, both record amounts. The recent improvement in earnings performance should continue through the rest of the year. Many large banks are expected to book interest arrearages on their Brazilian loans during the fourth quarter, which will add more than $1.5 billion to earnings.

Chart A — Quarterly Net Income of FDIC-Insured Commercial Banks, 1984-1988



*1988 amounts are adjusted for effect of First Republic Failures. See Note, page 2.

Real estate loan growth continued to lead asset expansion in the third quarter. Total banking assets grew by $39.7 billion, with almost three-quarters of the growth representing increases in real estate and consumer loans. Home mortgage loans and commercial real estate loans each grew by over $8 billion. Home equity lines of credit accounted for $2.8 billion of real estate loan growth, representing an annualized growth rate of 31 percent. Commercial and industrial loans, while up 2.5 percent from year-earlier levels, declined by $4.3 billion in the quarter. Total assets grew 5.2 percent on both a year-to-year and annualized quarter-to-quarter basis. Year-to-year deposit growth of 4.8 percent failed to keep pace with asset expansion, as banks' reliance on higher-cost, non-deposit liabilities increased.

Average loan yields increased, due in part to the growing proportion of high-yield consumer and real estate loans, but a $3.2 billion increase in nonperforming assets in the third quarter limited interest income growth. At the same time, the shift in funding away from noninterest-bearing deposits to interest-bearing deposits and nondeposit liabilities contributed to higher interest expense. As a result, net interest margins were essentially flat. Noninterest income continued to increase its relative contribution to earnings, accounting for over 14 percent of total gross revenues; as recently as 1984, noninterest income represented less than 10 percent of total revenues. Sources of noninterest income include deposit account and other service charges and fees, foreign exchange and bond trading income, fees from issuance of letters of credit, and loan sales and servicing. Loan sales in particular have become an increasingly popular way for banks to provide loan services while diversifying their risks and affording greater flexibility in balance sheet management. While banks in all size groups have been aggregate net sellers of loans, the dozen largest banks account for over 80 percent of loan sales. The greatest purchasers of loans are banks in the $1-to-30 billion size range, but most loans are sold to non-bank investors. The trend toward increased loan brokering is expected to continue.

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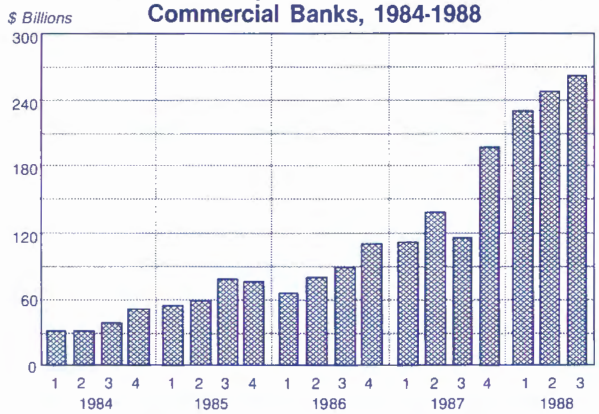
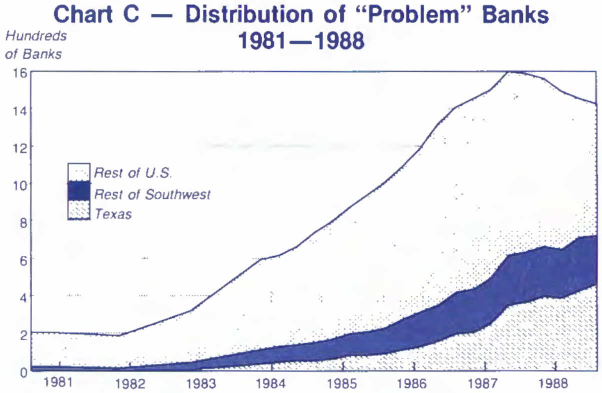
Chart B — Quarterly Loan Sales, of FDIC-Insured Commercial Banks, 1984-1988



The commercial banking industry's equity capital level reached a new high as of September 30, growing $4.7 billion in the third quarter. Strong earnings, as well as the addition of more than $1 billion in new capital stock ($737 million of which was to capitalize NCNB-Texas National Bank, the successor to the First Republic banks) were responsible for the improvement. The industry's equity capital ratio stood at 6.25 percent of total assets at the end of the quarter, its highest level since before the extraordinary transfers from capital to loss reserves five quarters ago. At the same time, many large banks continued to draw down the large loan-loss allowances that they created last year. Loss allowance coverage of noncurrent loans and leases fell in all regions except the Southwest and Midwest.

Nonperforming assets were 0.8 percent higher than a year ago. Compared to a year ago, they were a smaller percentage of assets in all regions except the Southwest; however, nonperforming asset ratios increased from second quarter levels everywhere except the Midwest and West. Third quarter nonperforming asset growth was greatest in the Northeast and Southwest regions. Increases in nonperforming real estate loans and other real estate acquired through foreclosure accounted for more than half of the growth in nonperforming assets.

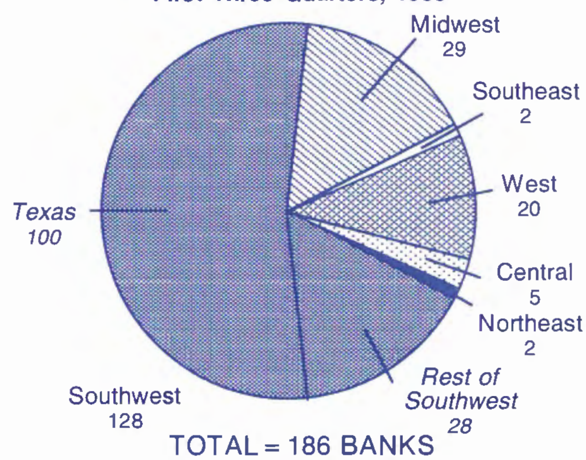
Chart C — Distribution of "Problem" Banks 1981—1988



Midwest banks continued to exhibit signs of credit quality improvement. Their level of nonperforming assets declined, even as their loan charge-off rate fell. The percentage of Midwest banks with earnings losses has remained in the single-digit range this year, in contrast to recent years. Results for the region as a whole offer no evidence of problems from this summer's drought.

Credit-quality problems continued to plague banks in the Southwest, especially in Texas. More than one in four Southwestern banks lost money in the third quarter. Nonperforming asset levels continued to increase despite higher net charge-off rates, indicating that a number of institutions are still losing ground in their efforts to stabilize loss levels. More than half of the 186 banks that failed or required assistance to avert failure in the first nine months of this year were Texas banks. Over half of the 1,429 banks on FDIC's "Problem" list as of September 30 were located in the Southwest region. Southwest banks were the only regional group whose third quarter profitability was lower than in the same period a year ago.

Chart D — Distribution of Failed/Assisted Banks First Three Quarters, 1988



The outlook for the balance of this year remains favorable, even though the return to more traditional profitability levels is bypassing Southwest banks. A significant portion of this year's earnings, however, will be attributable to the drawdown by large banks of the sizable loss reserves established last year, the restoration of interest on troubled foreign debt, and nonrecurring gains from asset sales. Full-year net income should exceed $23 billion, and aggregate profitability will be at its highest level of the last five years.

NOTE: Quarterly earnings for the banking industry are normally derived by subtracting the reported year-to-date results for the prior quarter from those reported for the current quarter. Using this approach, the sum of quarterly earnings will equal the year-to-date total. However, the failure in July of 42 banks of First Republicbank Corporation effectively removed $2.3 billion in losses and $641 million in negative equity capital from year-to-date aggregates. Given the unusual magnitude of these losses, and to avoid overstating third quarter earnings, the First Republic banks were excluded to arrive at a more accurate portrayal of third quarter performance.

Table I. Selected Indicators, FDIC-Insured Commercial Banks

	1988*	1987*	1987	1986	1985	1984	1983
Return on assets	0.82%	0.02%	0.12%	0.63%	0.70%	0.65%	0.66%
Return on equity	13.38	0.34	2.00	9.94	11.31	10.73	10.70
Equity capital to assets	6.25	6.13	6.04	6.20	6.20	6.15	6.00
Primary capital ratio	7.84	7.75	7.70	7.22	6.91	6.91	6.59
Nonperforming assets to assets	2.47	2.58	2.46	1.94	1.87	1.97	1.97
Net charge-offs to loans	0.91	0.80	0.92	0.98	0.84	0.76	0.67
Asset growth rate	5.18	5.03	2.03	7.71	8.86	7.11	6.75
Net operating income growth	N/M	N/M	-85.27	-20.65	6.30	3.40	-3.69
Percentage of unprofitable banks	13.30	16.86	17.66	19.79	17.09	13.06	10.58
Number of problem banks	1,429	1,591	1,559	1,457	1,098	800	603
Number of failed/assisted banks	186	151	201	144	118	78	45

Table II. Aggregate Condition and Income Data, FDIC-Insured Commercial Banks
(dollar figures in millions)

	Preliminary 3rd Qtr 1988	2nd Qtr 1988	3rd Qtr 1987	%Change 87:3-88:3
Number of banks reporting	13,239	13,411	13,851	-4.4
Total employees (full-time equivalent)	1,528,627	1,536,440	1,554,143	-1.6
CONDITION DATA				
Total assets	$3,094,988	$3,055,286	$2,942,641	5.2
Real estate loans	657,338	637,795	579,034	13.5
Commercial & industrial loans	595,150	599,452	580,394	2.5
Loans to individuals	367,374	358,217	341,834	7.5
Farm loans	31,130	30,686	31,045	0.3
Other loans and leases	251,190	256,598	265,805	-5.5
Total loans and leases	1,902,182	1,882,749	1,798,112	5.8
LESS: Reserve for losses	49,171	49,247	47,411	3.7
Net loans and leases	1,853,011	1,833,503	1,750,701	5.8
Temporary investments	472,400	467,678	446,338	5.8
Securities over 1 year	393,662	387,662	387,395	1.6
All other assets	375,915	366,444	358,207	4.9
Total liabilities and capital	$3,094,988	$3,055,286	$2,942,641	5.2
Noninterest-bearing deposits	451,199	462,958	450,382	0.2
Interest-bearing deposits	1,924,198	1,892,791	1,816,232	5.9
Other borrowed funds	403,819	391,070	367,419	9.9
Subordinated debt	17,197	17,207	17,433	-1.4
All other liabilities	105,229	103,298	110,775	-5.0
Equity capital	193,346	188,012	180,399	7.2
Primary capital	246,136	241,079	231,478	6.3
Nonperforming assets	76,530	73,367	75,901	0.8
Loan commitments and letters of credit	819,002	812,740	773,627	5.9
Domestic office assets	2,678,870	2,637,865	2,519,000	6.3
Foreign office assets	416,119	417,421	423,642	-1.8
Domestic office deposits	2,047,035	2,026,577	1,922,216	6.5
Foreign office deposits	328,362	329,122	344,398	-4.7
Earning assets	2,719,056	2,688,843	2,584,434	5.2
Volatile liabilities	1,101,438	1,070,628	1,039,873	5.9

INCOME DATA	Preliminary First Three Quarters 1988	First Three Quarters 1987	%Change	Preliminary 3rd Qtr 1988**	3rd Qtr 1987	% Change
Total interest income	$197,479	$180,423	9.5	$69,313	$61,761	12.2
Total interest expense	119,697	106,418	12.5	42,641	36,508	16.8
Net interest income	77,782	74,005	5.1	26,672	25,252	5.6
Provisions for loan losses	11,579	29,249	-60.4	4,395	3,874	13.4
Total noninterest income	33,338	29,422	13.3	11,383	10,366	9.8
Total noninterest expense	74,537	71,245	4.6	25,281	24,194	4.5
Applicable income taxes	7,411	4,044	83.3	2,593	2,035	27.4
Net operating income	17,593	-1,112	N/M	5,786	5,516	21.5
Securities gains, net	517	1,395	-62.9	-18	264	N/M
Extraordinary gains, net	611	181	237.6	175	69	153.6
Net income	18,721	464	3,934.7	5,943	5,849	1.6
Net charge-offs	12,727	10,647	19.5	4,225	3,698	14.3
Net additions to capital stock	1,388	1,114	24.6	1,071	371	188.7
Cash dividends on capital stock	9,117	6,969	30.8	2,866	2,279	25.8

* through September 30; ratios annualized where appropriate

** Adjusted for effect of First Republic failures — See Note, Page 2.

N/M—Not meaningful

Table III. Third Quarter Bank Data* *(Dollar figures in billions, ratios in %)*

		Asset Size Distribution				Geographic Distribution					
						EAST			WEST		
	All Banks	Less than $100 Million	$100 Million to $1 Billion	$1-10 Billion	Greater than $10 Billion	Northeast Region	Southeast Region	Central Region	Midwest Region	Southwest Region	West Region
CURRENT QUARTER *Preliminary* *(The way it is . . .)*											
Number of banks reporting	13,239	10,464	2,410	328	37	1,085	1,931	2,945	3,130	2,630	1,518
Total assets	$3,095.0	$380.3	$576.5	$998.0	$1,140.2	$1,243.6	$424.1	$494.3	$207.0	$262.4	$463.6
Total deposits	2,375.3	337.7	492.0	745.0	800.6	888.6	338.3	397.7	160.8	218.8	371.1
Net income *(in millions)*	$5,943	629	1,009	1,674	2,631	3,001	1,040	1,295	530	−1,035	1,112
Percentage of banks losing money	12.8%	14.1%	8.5%	6.4%	2.7%	6.6%	9.9%	4.9%	8.0%	28.5%	19.0%
Performance ratios *(annualized)*											
Yield on earning assets	10.25%	10.04%	10.30%	10.27%	10.80%	10.82%	10.21%	9.83%	10.36%	10.10%	10.51%
Cost of funding earning assets	6.31	5.48	5.68	5.95	7.56	7.31	5.80	5.90	5.93	6.16	5.47
Net interest margin	3.94	4.56	4.61	4.33	3.25	3.51	4.41	3.93	4.43	3.93	5.03
Net noninterest expense to earning assets	2.06	2.82	2.68	2.26	1.36	1.57	2.46	2.06	2.15	3.12	2.61
Net operating cash flow to assets	1.66	1.58	1.74	1.82	1.60	1.69	1.72	1.67	2.04	0.71	2.05
Net operating income to assets	0.75	0.73	0.73	0.68	0.91	0.95	1.03	1.05	1.02	−1.66	0.91
Return on assets	0.77	0.74	0.72	0.68	0.97	0.97	1.04	1.06	1.04	−1.66	0.97
Return on equity	12.47	8.33	9.72	10.96	20.08	17.18	14.77	15.62	13.72	−26.35	16.74
Net charge-offs to loans and leases	0.89	1.09	0.82	0.90	0.96	0.86	0.69	0.57	1.11	2.63	0.86
Loan loss provision to net charge-offs	104.0	93.85	133.48	134.90	58.61	70.38	91.52	93.33	101.86	161.29	108.30
Condition Ratios											
Loss allowance to:											
Loans and leases	2.58%	1.67%	1.59%	1.78%	4.05%	2.88%	1.32%	2.04%	1.96%	4.40%	2.82%
Noncurrent loans and leases	76.98	66.55	110.36	86.15	75.63	77.14	97.90	112.35	86.12	51.86	79.23
Nonperforming assets to assets	2.47	2.05	1.83	1.60	3.63	2.39	1.07	1.23	1.67	7.04	2.91
Equity capital ratio	6.25	8.94	7.34	6.22	4.81	5.74	7.09	6.83	7.63	5.73	5.87
Primary capital ratio	7.84	9.80	8.24	7.30	7.75	7.65	7.81	8.00	8.70	7.84	7.80
Net loans and leases to deposits	78.02	58.97	70.54	85.22	83.90	83.32	77.77	73.10	72.54	63.47	81.67
Growth Rates *(year-to-year)*											
Assets	5.2%	6.8%	12.5%	15.3%	2.6%	6.9%	9.0%	6.1%	2.5%	−6.1%	4.7%
Equity capital	7.2	4.4	9.0	11.7	14.3	13.4	9.8	6.7	2.6	−16.7	9.2
Net interest income	5.6	9.8	14.2	16.0	1.2	2.5	7.3	6.6	4.8	−19.1	7.3
Net income	1.6	16.4	−8.7	−9.0	15.2	9.0	2.8	21.1	4.9	N/M	29.3
Nonperforming assets	0.8	0.5	13.7	7.4	−4.9	1.5	3.6	−5.9	−15.7	20.7	−13.9
Net charge-offs	14.3	22.1	31.0	32.6	29.9	55.9	40.0	0.9	−17.8	−95.0	−5.9
Loan loss provision	13.4	4.6	43.6	55.4	−5.2	−4.4	13.2	−6.5	−5.3	N/M	22.6
PRIOR THIRD QUARTERS *(The way it was . . .)*											
Return on assets . . . 1987	0.79	0.63%	0.75%	0.82%	0.85%	0.94%	1.05%	0.92%	0.99%	−0.47%	0.76%
. . . 1985	0.77	0.86	0.90	0.90	0.58	0.80	1.13	0.86	0.83	0.55	0.54
. . . 1983	0.65	1.03	0.84	0.68	0.37	0.67	0.99	0.72	0.99	0.29	0.47
Equity capital ratio . . . 1987	6.13	8.77	7.48	6.26	4.34	5.42	7.05	6.79	7.62	6.45	5.63
. . . 1985	6.32	8.76	7.30	6.04	4.90	5.66	6.91	6.96	7.68	7.17	5.61
. . . 1983	6.11	8.77	7.20	5.76	4.41	5.33	6.94	6.73	7.75	6.99	5.27
Nonperforming assets to assets . . . 1987	2.58	2.27	2.00	1.87	3.53	2.52	1.14	1.39	2.04	5.49	3.55
. . . 1985	2.07	2.19	1.77	1.66	2.55	1.83	1.10	1.62	2.45	2.83	3.07
. . . 1983	2.17	1.65	1.67	2.05	2.79	1.72	1.24	2.23	1.68	2.34	3.72
Net charge-offs to loans and leases . 1987	0.83	1.06	0.88	0.83	0.76	0.58	0.57	0.61	1.44	2.18	0.96
. . . 1985	0.82	1.19	0.83	0.71	0.80	0.49	0.53	0.63	1.59	1.37	1.29
. . . 1983	0.66	0.60	0.61	0.68	0.71	0.36	0.48	0.59	0.57	1.85	0.77

* All income adjusted for effect of First Republic failures; See Note, Page 2.

REGIONS: Northeast — Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Puerto Rico, Rhode Island, Vermont

Southeast — Alabama, Florida, Georgia, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia

Central — Illinois, Indiana, Kentucky, Michigan, Ohio, Wisconsin

Midwest — Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota

Southwest — Arkansas, Louisiana, New Mexico, Oklahoma, Texas

West — Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, Oregon, Pacific Islands, Utah, Washington, Wyoming

Table IV. First Three Quarters 1988 Bank Data *(Dollar figures in billions, ratios in %)*

		Asset Size Distribution				Geographic Distribution					
						EAST			WEST		
FIRST THREE QUARTERS *PRELIMINARY* *(The way it is . . .)*	All Banks	Less than $100 Million	$100 Million to $1 Billion	$1-10 Billion	Greater than $10 Billion	Northeast Region	Southeast Region	Central Region	Midwest Region	Southwest Region	West Region
Number of banks reporting	13,239	10,464	2,410	328	37	1,085	1,931	2,945	3,130	2,630	1,518
Net Income *(in millions)*	$18,721	$2,124	$3,289	$5,565	$7,743	$8,762	$3,116	$3,891	$1,607	-$1,499	$2,844
Percentage of banks losing money	13.3%	14.7%	7.6%	7.0%	5.4%	9.5%	11.8%	4.1%	6.9%	29.0%	20.0%
Performance ratios *(annualized)*											
Yield on earning assets	9.84%	9.78%	9.90%	9.87%	10.32%	10.32%	9.87%	9.54%	10.11%	9.56%	10.11%
Cost of funding earning assets	5.96	5.34	5.46	5.63	7.05	6.81	5.57	5.66	5.73	5.84	5.27
Net interest margin	3.88	4.43	4.44	4.24	3.27	3.52	4.30	3.89	4.37	3.72	4.84
Net noninterest expense to earning assets	2.05	2.77	2.63	2.25	1.41	1.61	2.43	2.02	2.07	2.88	2.71
Net operating cash flow to assets	1.60	1.51	1.63	1.75	1.58	1.65	1.66	1.67	2.06	0.74	1.81
Net operating income to assets	0.77	0.74	0.78	0.75	0.87	0.90	0.99	1.05	1.03	-0.83	0.78
Return on assets	0.82	0.77	0.80	0.78	0.95	0.97	1.03	1.08	1.06	-0.79	0.85
Return on equity	13.38	8.79	10.85	12.45	20.45	17.32	14.80	16.08	14.06	-12.33	14.65
Net charge-offs to loans and leases	0.91	0.83	0.75	1.03	0.92	0.73	0.65	0.69	1.30	2.66	0.97
Loan loss provision to net charge-offs	90.18	107.11	119.32	101.09	63.98	85.07	94.94	81.29	90.25	101.81	90.87
Growth Rates *(year to year)*											
Net interest income	5.1%	5.9%	11.0%	14.5%	3.2%	7.7%	6.3%	6.6%	4.7%	-10.5%	5.1%
Net income	3,934.7	11.1	4.3	40.2	N/M	N/M	11.2	157.1	61.2	N/M	N/M
Net charge-offs	19.5	-5.3	19.7	62.7	21.3	36.0	38.8	38.6	-5.4	15.1	-1.9
Loan loss provision	-60.4	-13.6	8.6	-8.9	-83.9	-76.4	-13.4	-61.3	-38.8	-12.2	-62.4
PRIOR FIRST THREE QUARTERS *(The way it was . . .)*											
Return on assets . . . 1987	0.02	0.67%	0.73%	0.59%	-1.04%	-0.39%	0.99%	0.44%	0.66%	-0.47%	-0.16%
. . . 1985	0.76	0.89	0.92	0.89	0.52	0.80	1.12	0.85	0.85	0.63	0.40
. . . 1983	0.72	1.14	0.92	0.63	0.49	0.69	1.04	0.75	1.07	0.73	0.43
Net charge-offs to loans and leases . 1987	0.80	1.02	0.82	0.76	0.79	0.58	0.53	0.54	1.43	1.93	1.00
. . . 1985	0.71	1.03	0.68	0.61	0.71	0.43	0.48	0.58	1.38	1.15	1.07
. . . 1983	0.60	0.62	0.56	0.70	0.56	0.37	0.49	0.63	0.54	1.26	0.71

NOTES TO USERS

COMPUTATION METHODOLOGY FOR PERFORMANCE AND CONDITION RATIOS

All income figures used in calculating performance ratios represent amounts for that period, annualized (multiplied by the number of periods in a year).

All asset and liability figures used in calculating performance ratios represent **average** amounts for the period (beginning-of-period amount plus end-of-period amount plus any periods in between, divided by the total number of periods).

All asset and liability figures used in calculating the condition ratios represent amounts as of the end of the quarter.

DEFINITIONS

"Problem" Banks—Federal regulators assign to each financial institution a uniform composite rating, based upon an evaluation of financial and operational criteria. The rating is based on a scale of 1 to 5 in ascending order of supervisory concern. "Problem" banks are those institutions with financial, operational or managerial weaknesses that threaten their continued financial viability. Depending upon the degree of risk and supervisory concern, they are rated either "4" or "5".

Earning Assets—all loans and other investments that earn interest, dividend or fee income.

Yield on Earning Assets—total interest, dividend and fee income earned on loans and investments as a percentage of average earning assets.

Cost of Funding Earning Assets—total interest expense paid on deposits and other borrowed money as a percentage of average earning assets.

Net Interest Margin—the difference between the yield on earning assets and the cost of funding them, i.e., the profit margin a bank earns on its loans and investments.

Net Noninterest Expense—total noninterest expense, excluding the expense of providing for loan losses, less total noninterest income. A measure of banks' overhead costs.

Net Operating Income—income after taxes and before gains (or losses) from securities transactions and from nonrecurring items. The profit earned on banks' regular banking business.

Net Operating Cash Flow—pre-tax net operating income before the provision for loan and lease losses; a measurement of banks' cash flow, net of interest and overhead expenses, from regular operations. Previously referred to as "adjusted net operating income".

Return on Assets—net income (including securities transactions and nonrecurring items) as a percentage of average total assets. The basic yardstick of bank profitability.

Return on Equity—net income as a percentage of average total equity capital.

Net Charge-offs—total loans and leases charged off (removed from balance sheet because of uncollectibility) during the quarter, less amounts recovered on loans and leases previously charged off.

Nonperforming Assets—the sum of loans past-due 90 days or more, loans in nonaccrual status, and noninvestment real estate owned other than bank premises.

Noncurrent Loans & Leases—the sum of loans past-due 90 days or more and loans in nonaccrual status.

Primary Capital—total equity capital plus the allowance for loan and lease losses plus minority interests in consolidated subsidiaries plus qualifying mandatory convertible debt (cannot exceed 20 percent of total primary capital), less intangible assets except purchased mortgage servicing rights.

Net Loans and Leases—total loans and leases less unearned income and the allowance for loan and lease losses.

Temporary Investments—the sum of interest-bearing balances due from depository institutions, federal funds sold and resold, trading-account assets and investment securities with remaining maturities of one year or less.

Volatile Liabilities—the sum of large denomination time deposits, foreign office deposits, federal funds purchased, and other borrowed money.

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