The FDIC Quarterly Banking Profile

L. William Seidman, Chairman

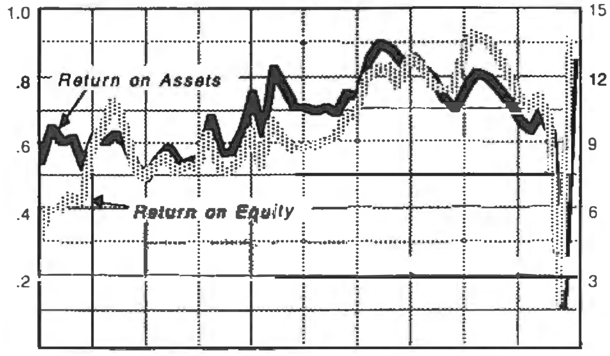
Fourth Quarter 1988

COMMERCIAL BANKING PERFORMANCE —FOURTH QUARTER 1988

- ***U.S. Banks Rebound from 1987 Low with Best Profitability of Decade***
- ***Earnings Records: $25.3 Billion in 1988, $6.7 Billion in Quarter***
- ***Lower Loan Loss Expense Gives Major Boost to Earnings***
- ***Industry Improves Reserve Coverage of Problem Loans***
- ***Number of Unprofitable Banks Drops Sharply***
- ***Banking Industry's Equity Capital Level Reaches New High***
- ***FDIC Handles Record Number of Bank Failures in 1988***

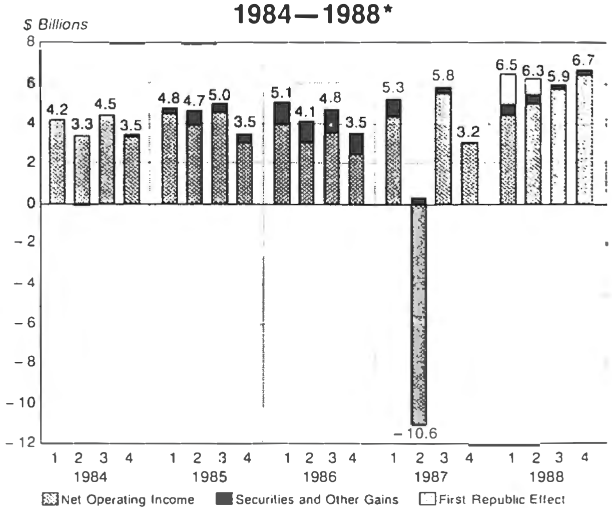
In a sharp rebound from record low results in 1987, commercial banks earned a record $25.3 billion in 1988. The previous record was the $18.1 billion earned in 1985. Improved industry profitability was reflected in a return on assets of 0.84 percent, the highest level since 1973. Aggregate return on equity was 13.61 percent, the highest since 1980, and the third highest ever for FDIC-insured commercial banks. Improvement was seen across the board, as the percentage of banks that were unprofitable fell to 13.9 percent of the industry from 17.7 percent in 1987 and 19.8 percent in 1986.

Chart A
Returns on Assets and Equity of Insured Commercial Banks 1938—1988



Fourth quarter net income of $6.7 billion was also a record, $800 million over third quarter 1988, the previous high. This is the first time that the banking sector has enjoyed consecutive record-setting quarters. The previous high for a fourth quarter was $3.5 billion.

Chart B
Quarterly Net Income of FDIC-Insured Commercial Banks 1984—1988*



*1988 first and second quarter amounts are adjusted for effect of First Republic failures. See Note page 4.

The year's impressive results were attributable to several special factors. After setting aside sizable reserves for troubled loans to developing nations during 1987, large banks reduced their provision for loan losses by 78.5 percent in 1988. The industry's

FDIC
Office of Research & Statistics

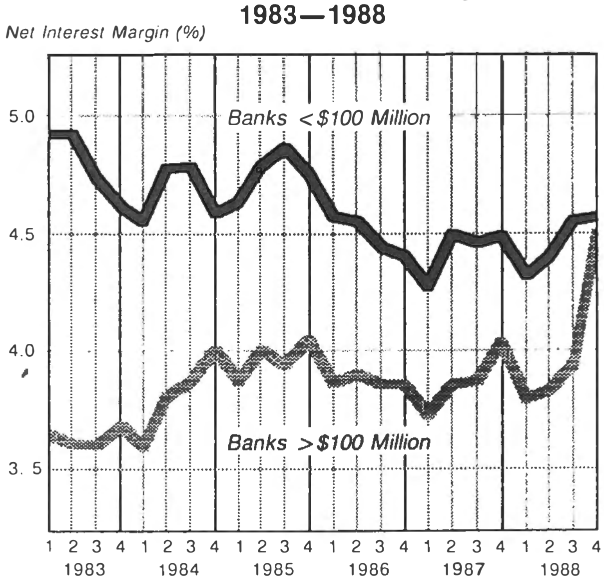
John Quinn
(202) 898-3940

Ross Waldrop
(202) 898-3951

aggregate loan loss expense was $20.9 billion less in 1988 than in 1987, explaining a good deal of the improvement in net income. At the same time, the extent to which banks' loan loss reserves covered noncurrent loans and leases improved from 78.0 percent at the end of 1987 to 82.6 percent at the end of 1988.

Under an agreement reached earlier in the year, banks issued new credits permitting Brazil to resume interest payments on its U.S. bank debt. This enabled banks to book nearly $3 billion of accumulated interest during the fourth quarter. As a result, net interest income of the largest banks was 26.7 percent higher in the fourth quarter than in the same quarter in 1987. Net interest margins widened considerably, approaching small-bank levels.

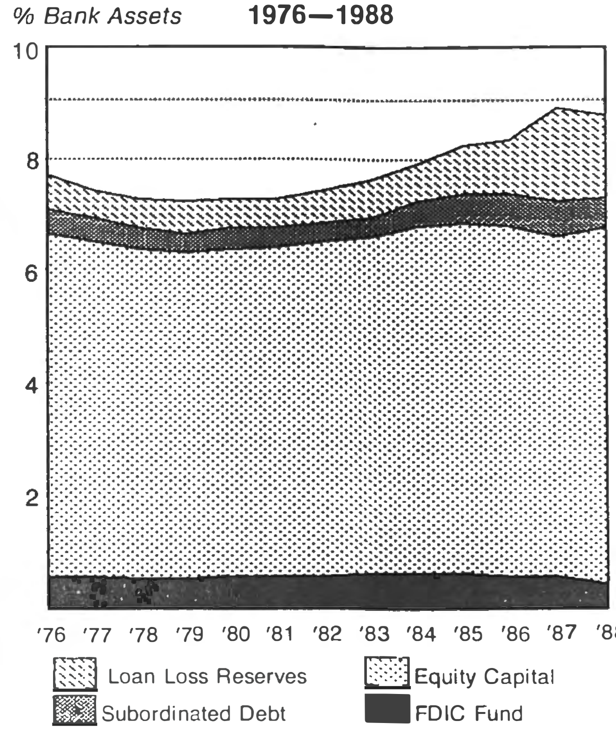
Chart C
Quarterly Net Interest Margins
1983—1988



One other element of the improved picture of commercial banking performance was the FDIC's resolution of a record number of insolvency cases during 1988. The FDIC handled 221 bank failure and assistance transactions, removing some of commercial banking's most unprofitable institutions from industry totals. The closing of the banks of First Republicbank Corporation in July resulted in the removal of $2.3 billion in pre-failure losses from industry aggregates, and a $1.4 billion net addition of equity capital. Also, under the terms of the failure transaction, the FDIC provided guarantees covering approximately $5 billion of that company's bad assets during the fourth quarter. This explains more than half of the industry's $8.9 billion reduction in nonperforming assets from third-quarter levels.

While the large amount of assistance provided to resolve bank insolvencies in 1988 improved the industry's balance sheet, it had the opposite effect on the FDIC's balance sheet. For the first time in its history, the FDIC experienced a full-year operating loss. Costs associated with the resolution of banking problems, especially those in Texas, caused the deposit insurance fund to decline by slightly more than $4 billion.

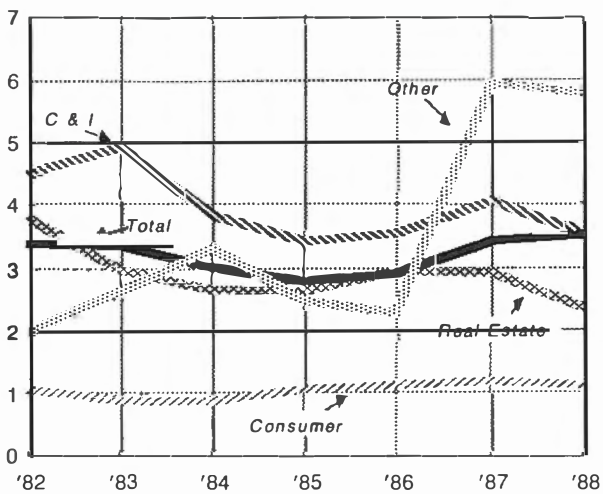
Chart D
U.S. Commercial Banking Industry
"Loss Cushion"
1976—1988



Equity capital increased $16.5 billion during 1988, a rise of 8.9 percent. $3.3 billion of that came in the fourth quarter, as banks ended the year with an aggregate equity capital balance of $196.5 billion. As large banks continued to increase their off-balance sheet activities, total assets in the banking system grew only 4.0 percent over the year, rising to $3.12 trillion from $3.0 trillion at the end of 1987. This placed the industry's aggregate equity-to-assets ratio at 6.30 percent, the highest level since banks began reporting on a fully consolidated basis in 1976. For the first time in thirteen years, net loan charge-offs exceeded the provision for loan losses, resulting in a 6.9 percent reduction in loan-loss reserves. This combination of rising equity capital and declining loss reserves in 1988 is the opposite of what occurred at the largest banks in 1987.

The nation's largest banks enjoyed the greatest improvement in profitability, both in the fourth quarter and for the full year, due especially to reduced loan-loss provisioning and the addition of Brazilian interest income. Large banks also continued to meet with success in efforts to curb overhead expense growth. Higher profits enabled money-center banks to bolster equity capital while sharply increasing dividend payments. Banks in the largest size group were the only ones to register a decline in nonperforming assets; however, lower than usual loss provisioning and increased net charge-offs meant that their reserve coverage of noncurrent loans fell in 1988.

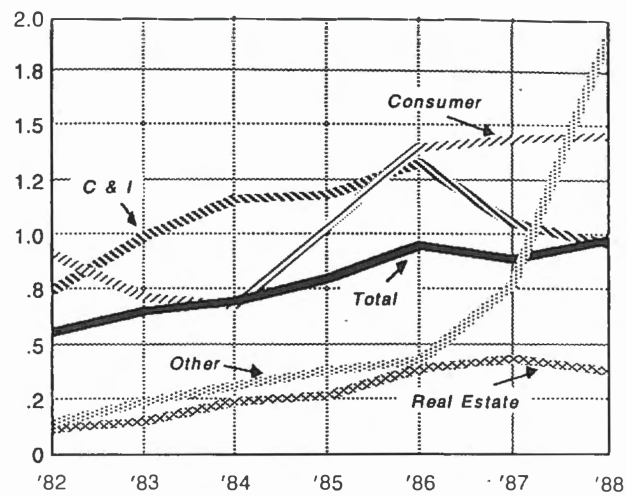
Chart E
Noncurrent Loan Rates
1982—1988



With the FDIC already having handled the major problems in the Southwest, the most significant on-going problem facing the banking sector remains troubled loans to developing nations. Banks have established sizable reserves against these credits, and most have taken steps to reduce their absolute and relative exposure. Still, large banks did not add to their reserves against these credits during 1988, in spite of further slippage in secondary market prices on these loans. Although Brazil brought its debt payments current during 1988, the long-term outlook remains clouded. Many debtor countries continue to confront economic and social problems that limit their ability to maintain interest payments. Higher interest rates or a slowdown in world economic growth would further strain the ability of these countries to meet their payments obligations.

Domestic credits are also vulnerable to economic slowdown or a run-up in interest rates. Home equity lines of credit, only recently introduced, and variable-rate mortgages have not been tested in a high rate environment. A continued rise in the prime lending rate, to which many of these loans are tied, could provide such a test during 1989.

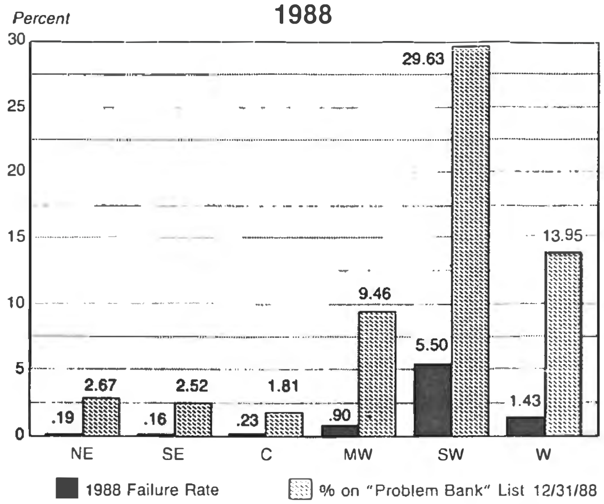
Chart F
Net Loan Charge-Off Rates
1982—1988



Loan growth remained limited to the real estate and consumer sectors in 1988, as these two areas accounted for 104.5 percent of total loan growth. Over $100 billion of the industry's $120 billion total asset growth in the year was attributable to additions to the real estate and consumer loan portfolios. Growth in real estate loans was almost evenly divided between residential and commercial real estate. Persistently strong growth in the Northeast and Southeast regions, in the face of softening market prices, will merit closer attention. Commercial and industrial loans grew by only $6.5 billion during 1988, $770 million during the fourth quarter. Loans in all other categories actually fell $8.8 billion during the year, with $5.4 billion of that reduction seen in the fourth quarter. This last group includes many of the loans to developing countries, some of which have been charged off by banks over the past year and a half.

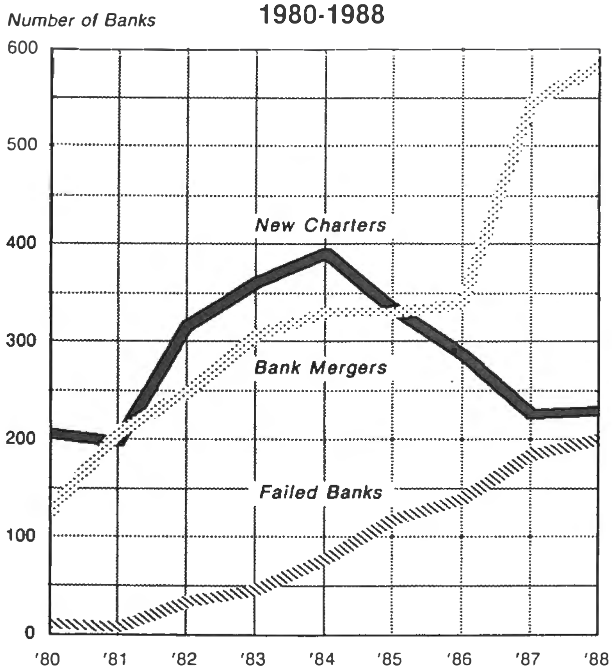
Reversing the historic pattern, larger banks reported higher profitability than smaller banks in 1988. Nevertheless, small banks demonstrated improved profitability, both in the fourth quarter and for the the full year. Improving trends in their relative levels of nonperforming assets and net loan losses, and in the number of unprofitable small banks, suggest that performance gains may carry over into 1989.

Chart G
Regional Failure & Problem Bank Rates
1988



Continuing the trend of recent years, problem and failed banks were predominantly in the western half of the U.S. in 1988, with the greatest concentration in the Southwest. The Southwest was the only region to experience a year-to-year decline in aggregate profitability, and even that decline was understated with so many losses being taken out of the system through bank failure transactions. Improvement is anticipated in 1989, as the region's recovery begins to be reflected in banking results.

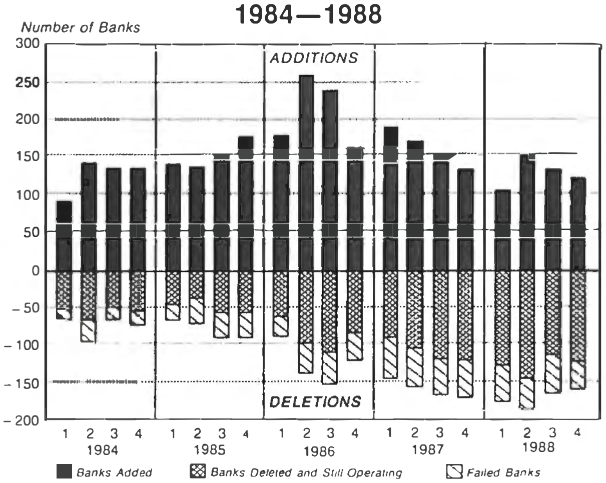
Chart H
Structural Changes Among
FDIC-Insured Commercial Banks
1980-1988



The liberalization of state branching laws in Texas and the Midwest has accelerated consolidation of the banking industry. Since new bank chartering peaked in 1984, the industry has seen a reduction in the number of operating banks. Due in large part to fewer branching restrictions, this process is also a natural response to competitive pressures facing the industry, and the need for improved efficiency.

This trend has also been reflected in a shrinkage of the "Problem Bank" list. Most of the weakest banks have left the system. In addition, some "problem banks" have been converted to branches of other banks. But most significantly, many banks that found their way onto the "Problem Bank" list due to local economic problems and difficulty with the more competitive, deregulated environment of the 1980s, have succeeded in adapting, and have been able to shed "problem" status.

Chart I
Quarterly Changes
in FDIC "Problem Bank" List
1984—1988



Without last year's one-time contributions, 1989 earnings are not likely to equal 1988's results, although several positive trends are expected to continue. The two-year decline in the numbers of unprofitable and "problem" banks should persist; and there should be a decline in the number of failures for the first time in eight years. Large banks' 1988 earnings may not prove sustainable, but small bank performance is likely to show further improvement.

NOTES: The data of one $10 billion national bank in the Northeast region was received too late to include in this report and is missing from the aggregates. It reported net losses of $125 million for the year and $205 million for the fourth quarter, but this will not materially affect the performance indicators or conclusions of this report. Also, as explained in the previous issue, the closing of the banks of First Republicbank Corporation in July resulted in the effective removal of $2.3 billion in first-half losses from full-year industry earnings. Industry earnings for the first and second quarters of 1988 have been restated to reflect this change.

Table I. Selected Indicators, FDIC-Insured Commercial Banks

	1988	1987	1986	1985	1984	1983	1982
Return on assets	0.84%	0.12%	0.63%	0.70%	0.65%	0.66%	0.71%
Return on equity	13.61	2.00	9.94	11.31	10.73	10.70	12.11
Equity capital to assets	6.30	6.04	6.20	6.20	6.15	6.00	5.87
Primary capital ratio	7.86	7.70	7.22	6.91	6.91	6.59	6.47
Nonperforming assets to assets	2.14	2.46	1.94	1.87	1.97	1.97	1.85
Net charge-offs to loans	0.98	0.92	0.98	0.84	0.76	0.67	0.56
Asset growth rate	4.00	2.03	7.71	8.86	7.11	6.75	8.12
Net operating income growth	2008.37	-85.27	-20.65	6.30	3.40	-3.69	-0.62
Percentage of unprofitable banks	13.86	17.66	19.79	17.09	13.06	10.58	8.27
Number of problem banks	1,394	1,559	1,457	1,098	800	603	326
Number of failed/assisted banks	221	201	144	118	78	45	34

Table II. Aggregate Condition and Income Data, FDIC-Insured Commercial Banks

(dollar figures in millions)

	Preliminary 4th Qtr 1988	3rd Qtr 1988	4th Qtr 1987	%Change 87:4-88:4
Number of banks reporting	13,114	13,238	13,701	-4.3
Total employees (full-time equivalent)	1,532,319	1,527,335	1,545,281	-0.8
CONDITION DATA				
Total assets	$3,119,868	$3,094,361	$2,999,757	4.0
Real estate loans	674,738	657,285	600,097	12.4
Commercial & industrial loans	595,781	595,010	589,309	1.1
Loans to individuals	377,024	367,359	351,157	7.7
Farm loans	30,198	31,117	29,425	2.8
Other loans and leases	247,744	252,269	257,357	-4.4
Total loans and leases	1,925,280	1,901,932	1,829,058	5.3
LESS: Reserve for losses	46,405	49,184	49,855	-6.9
Net loans and leases	1,878,876	1,852,748	1,779,203	5.6
Temporary investments	464,730	482,956	451,176	3.0
Securities over 1 year	380,919	382,781	396,549	-3.9
All other assets	395,343	375,876	372,828	6.0
Total liabilities and capital	$3,119,868	$3,094,361	$2,999,757	4.0
Noninterest-bearing deposits	478,013	450,964	477,561	0.1
Interest-bearing deposits	1,946,208	1,923,945	1,857,603	4.8
Other borrowed funds	377,844	403,833	361,764	4.4
Subordinated debt	17,255	17,197	17,614	-2.0
All other liabilities	103,976	105,100	104,617	-0.6
Equity capital	196,490	193,230	180,503	8.9
Primary capital	246,388	246,062	234,143	5.2
Nonperforming assets	66,803	75,774	73,843	-9.5
Loan commitments and letters of credit	835,755	818,227	794,186	5.2
Domestic office assets	2,716,603	2,678,088	2,574,703	5.5
Foreign office assets	403,265	416,272	425,054	-5.1
Domestic office deposits	2,110,222	2,046,546	1,993,554	5.8
Foreign office deposits	313,999	328,362	341,610	-8.1
Earning assets	2,724,525	2,718,484	2,626,929	3.7
Volatile liabilities	1,069,142	1,101,761	1,049,485	1.9

INCOME DATA	Preliminary Full Year 1988	Full Year 1987	%Change	Preliminary 4th Qtr 1988	4th Qtr 1987	% Change
Total interest income	$271,345	$244,826	10.8	$76,377	$66,143	15.5
Total interest expense	164,432	144,942	13.4	46,147	39,565	16.6
Net interest income	106,913	99,884	7.0	30,230	26,577	13.7
Provisions for loan losses	16,577	37,504	-55.8	5,307	8,575	-38.1
Total noninterest income	44,603	41,466	7.6	11,554	12,308	-6.1
Total noninterest expense	100,929	97,293	3.7	27,373	26,770	2.3
Applicable income taxes	10,035	5,417	85.3	2,681	1,393	92.5
Net operating income	23,975	1,137	2008.4	6,423	2,146	199.3
Securities gains, net	285	1,427	-80.0	-230	30	N/M
Extraordinary gains, net	1,088	203	435.8	494	20	2317.4
Net income	25,348	2,767	816.0	6,687	2,197	204.4
Net charge-offs	18,238	16,430	11.0	5,437	6,001	-9.4
Net additions to capital stock	3,218	2,602	23.7	590	235	150.5
Cash dividends on capital stock	13,219	10,671	23.9	5,279	4,668	13.1

N/M—Not meaningful

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

	All Banks	Asset Size Distribution: Less than $100 Million	$100 Million to $1 Billion	$1-10 Billion	Greater than $10 Billion	Geographic Distribution — EAST: Northeast Region	Southeast Region	Central Region	WEST: Midwest Region	Southwest Region	West Region
CURRENT QUARTER *Preliminary* *(The way it is . . .)*											
Number of banks reporting	13,114	10,286	2,465	324	39	1,080	1,943	2,922	3,109	2,555	1,505
Total assets	$3,119.87	$378.54	$591.41	$997.73	$1,152.20	$1,233.41	$439.89	$505.53	$210.12	$261.51	$469.42
Total deposits	2,424.22	337.22	507.65	752.93	826.42	896.40	351.93	407.89	166.34	222.22	379.44
Net income *(in millions)*	6,687	390*	870	2,044	3,384	3,408	1,009	1,336	234	-330	1,031
Percentage of banks losing money	20.1%	22.4%	12.1%	10.2%	7.7%	12.3%	19.6%	10.1%	17.0%	36.9%	23.8%
Performance ratios *(annualized)*											
Yield on earning assets	11.30%	10.18%	10.40%	10.93%	12.48%	12.25%	10.45%	10.18%	10.68%	10.74%	11.36%
Cost of funding earning assets	6.82	5.61	5.81	6.42	8.15	7.91	6.07	6.12	6.19	6.75	5.72
Net interest margin	4.47	4.57	4.59	4.52	4.33	4.34	4.38	4.06	4.49	3.98	5.64
Net noninterest expense to earning assets	2.34	3.07	2.78	2.33	1.86	1.96	2.48	2.10	2.25	3.35	2.98
Net operating cash flow to assets	1.86	1.36	1.63	1.93	2.08	2.07	1.68	1.75	2.00	0.55	2.25
Net operating income to assets	0.83	0.43	0.62	0.83	1.07	1.03	0.94	1.09	0.88	-0.87	0.85
Return on assets	0.87	0.42	0.60	0.84	1.17	1.11	0.94	1.07	0.45	-0.51	0.89
Return on equity	13.79	4.70	8.15	13.49	23.56	18.91	13.28	15.76	5.97	-8.94	15.21
Net charge-offs to loans and leases	1.14	1.26	0.98	1.13	1.21	1.02	0.74	0.82	1.42	2.37	1.46
Loan loss provision to net charge-offs	97.60	105.31	120.47	107.12	78.22	100.17	107.65	83.71	97.26	109.53	87.73
Condition Ratios											
Loss allowance to:											
Loans and leases	2.41%	1.65%	1.58%	1.75%	3.64%	2.84%	1.29%	1.97%	1.92%	2.99%	2.70%
Noncurrent loans and leases	82.59	70.99	77.42	91.69	81.94	78.68	103.46	117.64	95.74	54.76	86.11
Nonperforming assets to assets	2.14	1.92	1.73	1.52	2.97	2.35	1.01	1.14	1.51	4.56	2.66
Equity capital ratio	6.30	8.76	7.25	6.16	5.12	5.95	6.95	6.76	7.45	5.71	5.91
Primary capital ratio	7.86	9.66	8.21	7.37	7.52	7.81	7.81	8.03	8.56	7.18	7.92
Net loans and leases to deposits	77.50	57.90	70.03	84.68	83.56	83.35	77.24	72.68	71.89	59.73	82.01
Growth Rates *(year-to-year)*											
Assets	4.0%	6.8%	11.2%	13.8%	2.1%	4.5%	8.2%	5.3%	0.8%	-6.5%	5.5%
Equity capital	8.9	4.8	8.8	13.6	17.1	14.6	10.5	9.0	0.9	-8.4	8.3
Net interest income	13.7	8.0	14.3	16.3	26.7	25.5	5.5	8.4	-0.3	-0.0	14.9
Net income	204.4	211.9	29.4	164.9	151.1	92.9	24.7	171.7	-39.7	N/M	242.2
Nonperforming assets	-9.5	1.9	11.2	9.2	-6.4	0.7	4.9	-6.0	-18.2	-26.4	-14.5
Net charge-offs	-9.4	-14.1	-3.5	0.1	7.5	11.8	-30.8	-23.1	-29.1	-27.0	11.3
Loan loss provision	-38.1	-21.1	-2.4	-25.1	-48.7	-28.1	-26.6	-58.9	-26.7	-48.9	-36.4
PRIOR FOURTH QUARTERS *(The way it was . . .)*											
Return on assets . . . 1987	0.42%	0.21%	0.58%	0.39%	0.40%	0.61%	0.79%	0.43%	0.74%	-1.13%	0.42%
1985	0.51	-0.00	0.59	0.84	0.47	0.74	0.78	0.73	0.27	-0.12	0.13
1983	0.77	0.34	0.63	0.63	0.44	0.64	0.82	0.53	0.57	0.41	0.10
Equity capital ratio . . . 1987	6.04	8.55	7.29	6.14	4.41	5.43	6.81	6.52	7.46	6.06	5.77
1985	6.20	8.50	7.20	5.84	4.91	5.67	6.60	6.81	7.34	6.86	5.53
1983	6.00	8.50	7.00	5.70	4.43	5.36	6.76	6.51	7.48	6.72	5.22
Nonperforming assets to assets . . . 1987	2.46	2.10	1.80	1.81	3.47	2.44	1.04	1.27	1.87	5.82	3.28
1985	1.87	2.13	1.70	1.49	2.19	1.55	1.07	1.49	2.22	2.75	2.83
1983	1.97	1.58	1.53	1.70	2.59	1.55	1.11	2.07	1.61	2.04	3.38
Net charge-offs to loans and leases . . . 1987	1.25	1.57	1.18	1.40	1.23	0.16	1.14	1.11	2.01	2.46	1.29
1985	1.22	2.45	1.37	0.90	1.02	0.66	0.91	0.97	2.70	2.40	1.55
1983	1.38	1.63	1.08	0.96	0.64	0.46	0.77	1.01	1.40	1.81	1.05

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. Preliminary Full Year 1988 Bank Data *(Dollar figures in billions, ratios in %)*

		Asset Size Distribution				Geographic Distribution					
						EAST			WEST		
1988 *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	13,114	10,286	2,465	324	39	1,080	1,943	2,922	3,109	2,555	1,505
Net Income *(in millions)*	$25,348	$2,457	$4,257	$7,467	$11,166	$12,031	$4,154	$5,215	$1,833	$-1,701	$3,814
Percentage of banks losing money	13.9%	15.4%	8.4%	7.4%	2.6%	9.6%	13.5%	4.3%	8.0%	30.0%	20.7%
Performance ratios											
Yield on earning assets	10.31%	9.84%	10.01%	10.15%	10.75%	10.83%	10.00%	9.70%	10.25%	9.31%	10.43%
Cost of funding earning assets	6.24	5.39	5.54	5.85	7.23	7.11	5.69	5.77	5.85	5.76	5.40
Net interest margin	4.06	4.45	4.46	4.31	3.51	3.72	4.31	3.93	4.40	3.55	5.03
Net noninterest expense to earning assets	2.14	2.85	2.66	2.26	1.53	1.70	2.44	2.04	2.12	2.83	2.77
Net operating cash flow to assets	1.68	1.46	1.62	1.80	1.68	1.76	1.65	1.69	2.05	0.62	1.92
Net operating income to assets	0.82	0.66	0.76	0.80	0.91	0.99	1.02	1.07	0.82	−0.78	0.80
Return on assets	0.84	0.68	0.76	0.80	0.97	1.00	1.00	1.08	0.91	−0.68	0.86
Return on equity	13.61	7.54	10.29	12.88	20.58	17.61	14.20	16.00	12.03	−11.32	14.82
Net charge-offs to loans and leases	0.98	0.86	0.78	1.05	1.05	0.80	0.62	0.72	1.33	2.38	1.23
Loan loss provision to net charge-offs	90.89	115.48	118.74	102.13	65.98	89.65	106.48	82.04	91.85	101.46	81.32
Growth Rates *(year to year)*											
Net interest income	7.0%	6.8%	12.2%	15.3%	9.5%	11.6%	6.8%	7.1%	4.7%	−8.5%	6.5%
Net income	816.0	23.5	11.7	60.1	N/M	N/M	16.4	161.8	35.9	N/M	N/M
Net charge-offs	11.0	−14.7	10.6	39.3	24.3	27.1	−0.0	12.7	−12.6	0.9	15.0
Loan loss provision	−55.8	−15.5	2.9	−13.5	−78.5	−69.0	−19.1	−60.7	−35.2	−27.4	−56.0
PRIOR YEARS *(The way it was . . .)*											
Return on assets . . . 1987	0.12%	0.57%	0.74%	0.53%	−0.65%	−0.13%	0.93%	0.44%	0.67%	−0.62%	−0.01%
. . . 1985	0.70	0.66	0.84	0.87	0.51	0.78	1.01	0.82	0.69	0.43	0.34
. . . 1983	0.66	1.23	1.12	0.86	0.63	0.67	0.96	0.69	0.94	0.64	0.34
Net charge-offs to loans and leases . 1987	0.92	1.15	0.88	0.94	0.89	0.67	0.69	0.68	1.57	1.99	1.07
. . . 1985	0.84	1.41	0.84	0.70	0.79	0.49	0.59	0.68	1.70	1.46	1.19
. . . 1983	0.67	1.16	0.90	0.97	0.77	0.39	0.55	0.73	0.77	1.40	0.79

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.

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

porary Investments—the sum of interest-bearing balances due from depository institutions, federal funds sold and resold, trading-account assets and investment securities 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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