# Chapter Three -- 1980

Significant events of 1980 affecting the FDIC and the banks it supervised included unprecedented interest rate levels and fundamental reform of the banking laws. An increase in federal deposit insurance to $100,000 from $40,000 per depositor was one significant feature of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980, signed into law on March 31, 1980, by President Jimmy Carter.

## *Table 3-1*[3-1]

### *1979 - 1980: FDIC at a Glance*
***($ in Millions)***

| | 12/31/79 | 12/31/80 | Percent Change |
|---|---|---|---|
| Number of Bank Failures | 10 | 10 | 0.00% |
| Assistance to Open Banks | 0 | 1 | N/A |
| Total Failed and Assisted Banks | 10 | 11 | 10.00% |
| Total Assets of Failed and Assisted Banks | $133.0 | $8,083.5* | 5977.82% |
| Estimated Losses on Failed and Assisted Banks** | N/A | $30.7 | N/A |
| Estimated Losses as a Percent of Total Assets | N/A | 0.38% | N/A |
| Assets in Liquidation | $1,900.0 | $1,791.8 | -5.69% |
| FDIC Staffing | 3,598 | 3,644 | 1.28% |
| Number of Problem Banks | 287 | 217 | -24.39% |
| Deposit Insurance Fund Balance | $9,792.7 | $11,019.5 | 12.53% |
| Deposit Insurance Fund Balance as a Percent of Insured Deposits | 1.21% | 1.16% | -4.13% |

*Includes open bank assistance for First Pennsylvania Bank, N.A., with assets of $8 billion. Excluding this transaction, the percent change would be -37.22 percent.
**Losses for all resolutions occurring in this calendar year have been updated through 12/31/95. The loss amounts are routinely adjusted with updated information from new appraisals and asset sales, which ultimately affect projected recoveries.

*Source:* FDIC, *1980 Annual Report* and Reports from FDIC Division of Finance and FDIC Division of Research and Statistics.

***Notable Events.*** In addition to the stresses produced by high interest rates, financial institutions had to cope with the changes created by the passage of banking deregulation legislation. DIDMCA was the most sweeping banking reform package enacted since 1933 and began the gradual process of removing the restrictions that had placed a ceiling on the interest rates banks could offer their

[3-1]The tables and charts throughout this book are shown for ease of comparison. They are formatted the same way in every chapter. Refer to the Appendix for a guide that includes definitions of terms used in the tables and charts.

depositors. It sought to deregulate banking and promote more competition to benefit consumers; it also liberalized lending powers of federal thrifts and preempted some state usury laws.

***Economic/Banking Conditions.*** The U.S. economy showed broad-based weakness in 1980. The growth in Gross Domestic Product (GDP) declined, interest rates rose as did inflation, and job growth was meager. Growth in real GDP was sluggish for the second consecutive year, declining almost 0.3 percent after 1979's slow but moderate 2.9 percent growth.[3-2] The nation's unemployment rate jumped to 7.2 percent from 5.8 percent in 1979.[3-3] Real estate markets showed mixed signs. Home sales were down 22 percent and housing starts were also down 26 percent from the previous year.[3-4] On the other hand, office markets remained tight, with the national office vacancy rate at a stable and very low 4.9 percent.[3-5] The deterioration in the residential sector was due in part to steadily rising interest rates. The discount rate rose to 11.8 percent and the 30-year mortgage rate was up to 13.8 percent.[3-6]

Some regions of the country were experiencing better economic times than the rest of the country. California's economic growth was above the national average at 1.7 percent Gross State Product growth,[3-7] in part due to the solid performance of the defense-related industry in southern California. The growth was also a result of the high number of primary government contracts in that part of the state. Low commercial vacancy rates sparked rapid growth in the real estate market.[3-8] Commercial and Industrial (C&I) loans rose slightly from 17.6 percent of bank assets in 1979 to 17.9 percent in 1980 and were well above the national median of 9.6 percent; southern California had the highest levels in the nation at 20.6 percent of bank assets. California was, in fact, the only region to surpass the country median in all loan categories as a percent of bank assets with the region's gross loans and leases at 60.4 percent, total real estate loans at 17.2 percent, commercial real estate loans at about 8 percent, and C&I loans at 17.9 percent.

The southwest region's C&I loans also increased, to 13.2 percent of bank assets, above the national median of 9.6 percent, while the region's total real estate loans at 12 percent of assets fell well below the national median of 18.1 percent. The region's farm sector growth continued from the 1970s. Farm production, farm prices, and agricultural exports were all increasing in the 1970s, and those factors were boosting the local economy.[3-9] As the 1980s began, U.S. farmland exports exceeded $40 billion, farm prices had nearly doubled since 1970, and farmland value per acre had increased

[3-2] Bureau of Economic Analysis, Department of Commerce.
[3-3] CB Commercial Torto/Wheaton Research and Bureau of Labor Statistics, Department of Labor.
[3-4] *Housing Market Statistics,* National Association of Home Builders (June 1996).
[3-5] CB Commercial Torto/Wheaton Research.
[3-6] *Housing Market Statistics,* National Association of Home Builders (June 1996), and Federal Home Loan Mortgage Corporation.
[3-7] Bureau of Economic Analysis, Department of Commerce.
[3-8] CB Commercial Torto/Wheaton Research.
[3-9] *Economic Report of the President*, 1986.

by 220 percent since 1975. Agricultural lending had also increased by 359 percent since 1970, to a total farm debt level of $178.8 billion.[3-10]

Adding to the economic growth was the strong demand for oil around the world with OPEC restrictions causing oil prices to rise. That, in turn, sparked an increase in demand for oil rigs and drilling in the Southwest.[3-11] There was a great deal of lending in those two industries based on the belief that they would continue to be profitable and prices would continue to rise.

Nationally, there were 220 newly chartered banks. The Office of the Comptroller of the Currency (OCC) believed that new charters would increase bank competition. The industry saw a shift to commercial real estate loans, especially in the Southwest and California. That trend is noteworthy, as commercial real estate loans tend to be riskier than C&I loans, due to the boom and bust nature of real estate markets.

Geographic and product limitations on banks and thrifts kept the U.S. depository institution industry diffused and segmented. At the end of 1980, there were 14,434 commercial banks with total assets of $1,855.7 billion; 4,005 savings and loan associations with assets of $620.6 billion; 323 mutual savings banks with assets of $153.6 billion; and 21,467 credit unions with assets of $69 billion. Thus, at the beginning of the turbulent 1980s, the U.S. had more than 40,000 state or federally chartered depository institutions that together controlled approximately 60 percent of total financial assets. The remaining 40 percent were controlled by insurance companies, pension funds, securities brokers and dealers, money market funds, finance companies, and other financial firms.

Deposit insurance continued to provide needed protection for consumers and small depositors. Large depositors and other bank creditors perceived that their funds were only minimally at risk, if at all, because most bank failures resulted in mergers in which all depositors were protected against loss. As rates were deregulated, depositors began to place their money in those banks and thrifts that were paying the highest rates, without regard to the management or financial stability of the institutions.

As part of its monitoring system, the FDIC maintained a list of problem banks. Banks were rated under the Uniform Financial Institutions Rating System, also known as the CAMEL system, which rated the Capital, Assets, Management, Earnings, and Liquidity of banks as they were examined. Each component was assigned a number from “1” to “5,” with “5” being the worst. The bank then received a composite rating from “1” to “5,” with “5” again being the worst. Banks with a composite rating of “4” or “5” were placed on the problem bank list. The number of banks on the list, which had reached 485 in November of 1976, declined steadily and was 217 at the end of 1980, representing about 1.5 percent of all insured banks.

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[3-10] National Agricultural Statistics Service, U.S. Department of Agriculture. Economic Research Service, U.S. Department of Agriculture. Federal Reserve System, Board of Governors, Flow of Funds Accounts, Table L. 102. Gerald H. Anderson, “The Decline in U.S. Agricultural Exports,” Federal Reserve Bank of Cleveland *Economic Commentary* (February 15, 1987), 1.
[3-11] Annual Energy Review, Department of Energy.

Table 3-2 compares the number and total assets of FDIC insured institutions, as well as their profitability as of the end of 1979 and 1980.

## *Table 3-2*

### *Open Financial Institutions Insured by FDIC*
***($ in Billions)***

| | *1979* | *1980* | *PERCENT CHANGE* |
|---|---|---|---|
| ***COMMERCIAL BANKS – FDIC REGULATED*** | | | |
| Number | 14,364 | 14,434 | 0.49% |
| Total Assets | $1,691.8 | $1,855.7 | 9.69% |
| Return on Assets | 0.80% | 0.79% | -1.25% |
| Return on Equity | 13.91% | 13.68% | -1.65% |
| ***SAVINGS BANKS – FDIC REGULATED*** | | | |
| Number | 324 | 323 | -0.31% |
| Total Assets | $147.1 | $152.6 | 3.74% |
| Return on Assets | 0.45% | -0.17% | -137.78% |
| Return on Equity | 6.69% | -2.59% | -138.71% |
| ***SAVINGS ASSOCIATIONS – FHLBB REGULATED*** | | | |
| Number | 4,039 | 4,005 | -0.84% |
| Total Assets | $568.1 | $620.6 | 9.24% |
| Return on Assets | 0.67% | 0.13% | -80.60% |
| Return on Equity | 12.12% | 2.45% | -79.79% |
| *Source:* Reports from FDIC Division of Research and Statistics. | | | |

***Bank Failures and Assistance to Open Banks.*** In the early 1980s, the FDIC relied on two basic methods to resolve failing banks: the purchase and assumption (P&A) transaction and the deposit payoff. When determining the appropriate method for resolving bank failures, the FDIC considered a variety of policy issues and objectives. Four primary issues were (1) to maintain public confidence and stability in the U.S. banking system, (2) to encourage market discipline to prevent excessive risk-taking, (3) to resolve failed banks in a cost-effective manner, and (4) to be equitable and consistent in employing resolution methods.[3-12]

Another resolution method that was beginning to be used more and more was open bank assistance (OBA). The Federal Deposit Insurance Act of 1950 included an OBA provision, granting the FDIC the authority to provide assistance, through loans or the purchase of assets, to prevent the failure of an insured bank. The FDIC's authority to provide OBA was expanded by the Garn-St Germain Depository Institutions Act of 1982, which eliminated certain prohibitive features of the former Act. Figure 3-1 provides specific information on each type of resolution method.

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[3-12] John F. Bovenzi and Maureen E. Muldoon, "Failure-Resolution Methods and Policy Considerations," *FDIC Banking Review* 3, no. 1 (fall 1990), 1.

## *Figure 3-1*

### *Common Resolution Methods*

A **Purchase and Assumption Agreement (P&A)** was an agreement in which the acquirer purchased some or all of the assets of a failed bank and assumed some or all of the liabilities, including all insured deposits. As part of the P&A transaction, the acquiring institution usually paid a premium for the assumed deposits, decreasing the total resolution cost. Traditionally, the FDIC preferred a P&A transaction to a deposit payoff, as it was less disruptive to the community.

In a **Deposit Payoff (also known as Payoff)**, as soon as the bank was closed by the chartering authority, FDIC was appointed the receiver and all insured depositors were paid the full amount of their claims. Uninsured depositors and other general creditors of the bank usually did not receive either immediate or full reimbursement on their claims; instead, they obtained receivership certificates which entitled their holders to a proportionate share of the collections on the failed bank's assets.

With **Open Bank Assistance (OBA)**, the FDIC was allowed to directly assist an operating insured bank if the bank was in danger of closing and its continued operation was essential to maintain adequate banking services in the community. The FDIC could make loans to, purchase the assets of, or place deposits in the troubled bank. Under normal circumstances, banks were expected to repay the assistance loans.

In 1980, ten commercial banks failed; three of those were in Kansas. One bank received open bank assistance. The ten insured banks that failed had deposits of $210.7 million. In seven cases involving banks holding deposits of $195.7 million, the FDIC arranged a P&A transaction where a healthy bank, either new or existing, purchased selected assets of the failed bank and assumed its deposits. In three bank failures with aggregate deposits of $15 million, the FDIC paid off depositors up to the statutory limit ($40,000 prior to March 31, 1980, and $100,000 after that date).

On April 28, 1980, the FDIC, the Federal Reserve, and the OCC jointly announced a $500 million open bank assistance package to assure the viability and continued operation of First Pennsylvania Bank, N.A., (First Penn), a subsidiary of First Pennsylvania Corporation, Philadelphia, Pennsylvania. First Penn, with assets of $8 billion, was Philadelphia's largest bank and the twenty-third largest in the nation. The assistance to First Penn was in the form of $500 million in five-year subordinated notes supplemented by a $1 billion bank line of credit through access to the Federal Reserve discount window.

## *Table 3-3*

### *1980 Estimated Losses by Transaction Type*
***($ in Millions)***

| *Transaction Type* | *Number of Transactions* | *Total Assets* | *Estimated Loss* as of 12/31/95* | *Estimated Losses as a Percent of Assets* |
|---|---|---|---|---|
| OBA | 1 | $7,953.0 | $0 | 0.00% |
| P&As | 7 | 114.4 | 28.4 | 24.80 |
| Payoffs | 3 | 16.1 | 2.3 | 14.30 |
| Totals | 11 | $8,083.5 | $30.7 | 0.38% |

*Losses for all resolutions occurring in this calendar year have been updated through 12/31/95. The loss amounts are routinely adjusted with updated information from new appraisals and asset sales, which ultimately affect projected recoveries.

*Source:* Reports from FDIC Division of Research and Statistics.

***Payments to Depositors and Other Creditors.*** The ten banks that failed in 1980 had total deposits of $210.7 million in 78,398 deposit accounts. Of those ten banks, the three payoffs represented 5,510 deposit accounts and $15 million in deposits. The assisted bank, First Penn, had deposits of $5.3 billion.

Since the inception of the FDIC in January 1, 1934, until December 31, 1980, 568 insured banks[3-13] were closed, with 3.9 million deposit accounts and total deposits of $6.2 billion. In meeting its responsibilities, the FDIC as insurer disbursed $5.7 billion, and as liquidator recovered $5.4 billion. The result was a net loss to the FDIC of $300 million since it began operations.

Of the 568 insured bank failures, 310 were deposit payoffs. While recoveries of uninsured portions of deposits varied, in the aggregate, 97.3 percent of total deposits in payoffs had been paid or made available at the end of 1980.

***Asset Disposition.*** At the beginning of 1980, the FDIC had $1.9 billion in assets from failed banks. The FDIC liquidated a little more than it acquired, ending the year with total failed bank assets with a book value of $1.8 billion. Those assets had an estimated recovery value of about $710 million.

At the end of 1980, there were 70,968 assets to be liquidated. The FDIC had liquidation offices in 25 states, the U.S. Virgin Islands, and Puerto Rico and handled a total of 88 active bank receiverships. Of those, five receiverships were handled from the Washington office, and 83 were handled from the 50 field liquidation offices.

[3-13] This figure does not include open bank assistance transactions. The FDIC did not begin including assistance agreements with the failures for reporting purposes until 1981. Five assistance agreements, with total deposits of $6.8 billion, including First Penn, should be included in the overall totals.

In disposing of assets retained from failed banks, the FDIC converted the assets to cash as quickly as practical and strived to realize maximum recovery. With the recoveries, the FDIC first repaid the insurance fund the cash that had been advanced for the administrative costs. Remaining recoveries were distributed to the claimants of the receivership based on the priorities contemplated under the National Bank Act of 1864. Although the National Bank Act did not explicitly state the claims priorities, the FDIC interpreted the payment order to be as follows: 1) administrative expenses of the receiver, 2) deposit liabilities and general creditor claims, 3) subordinated debt claims, 4) federal income taxes, and 5) stockholder claims. Some states developed their own priorities which were different from the national law and the FDIC followed the state laws for state chartered institutions. In 1993, the National Depositor Preference Amendment was enacted which set the priorities for all state and federally chartered institutions. The National Depositor Preference Amendment is discussed later in Chapter 16 – 1993.

The FDIC adopted a workout strategy for dealing with acquired nonperforming loans. That strategy usually involved assigning delinquent loans to specific account officers, who would be responsible for negotiating repayment or settlement of the debts with borrowers. Frequently, litigation, foreclosure, and the sale of available collateral were necessary to achieve final debt resolution. That strategy was typical of the approach used by private and public entities in handling delinquent paper. Performing loans were warehoused and routinely serviced until final payoff by the borrower.

Table 3-4 shows the FDIC's assets in liquidation and chart 3-1 shows the asset mix.

### *Table 3-4*

### *1980 FDIC End of the Year Assets in Liquidation*

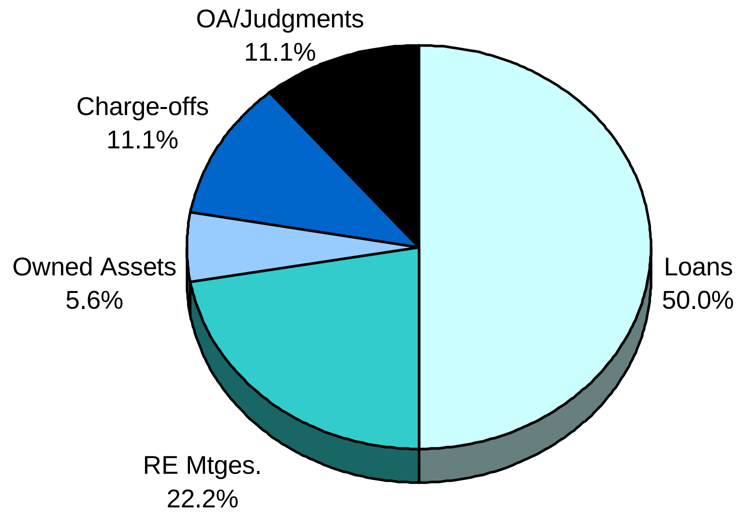
***($ in Billions)***

| ASSET TYPE | 12/31/80 BOOK VALUE | 12/31/80 ESTIMATED RECOVERY VALUE |
|---|---|---|
| Loans | $0.9 | $0.3 |
| Real Estate Mortgages | 0.4 | 0.3 |
| Investments | 0.0 | 0.0 |
| Owned Assets | 0.1 | 0.1 |
| Charge-Offs | 0.2 | 0.0 |
| Securities | 0.0 | 0.0 |
| Other Assets/Judgments | 0.2 | 0.0 |
| **Total** | **$1.8** | **$0.7** |

*Source:* Reports from FDIC Division of Finance.

## Chart 3-1

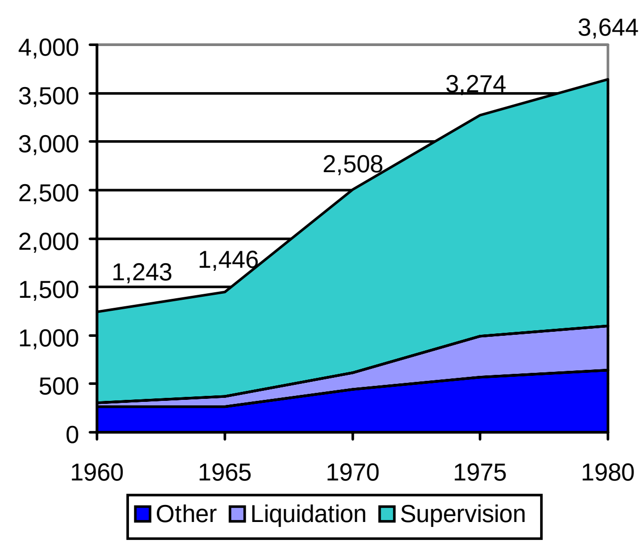
## 1980 FDIC End of Year Asset Mix




*Source:* Reports from FDIC Division of Finance.

## Chart 3-2

## FDIC Staffing




Source: FDIC, *1980 Annual Report*

***Insurance Fund and Staffing.*** The deposit insurance fund grew in 1980 by $1.2 billion to $11 billion, the largest in an uninterrupted series of annual increases since 1935. The fund's strength was derived from a high degree of liquidity in its assets, 92 percent of which were U.S. Treasury securities. At the end of 1980, the FDIC had 3,644 total staff, compared to 3,598 at the end of 1979, an increase of 46. The Division of Liquidation staff [3-14] increased from 432 at the end of 1979 to 460, and the Division of Bank Supervision staff increased slightly from 2,540 at the end of 1979 to 2,544.

[3-14] Liquidation staff does not include support personnel from other FDIC divisions, such as the Legal Division and the Division of Accounting and Corporate Services (later the Division of Finance), who also were working on liquidation matters.