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FDIC Testing Cheaper Ways To Save Banks --- Chairman Taylor Seeks Halt In the Rapid Liquidation Of Loans Not in Default

By Kenneth H. Bacon . Wall Street Journal , Eastern edition; New York, N.Y. [New York, N.Y]. 02 Mar 1992: PAGE A2.

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ABSTRACT (ABSTRACT)

The goal of the new effort is to keep performing loans -- those on which borrowers are making payments -- in banks for as long as possible, rather than quickly terminating many of them as in the past. "Liquidating performing assets runs our costs up unnecessarily and damages the local economy pretty badly," says FDIC Chairman William Taylor.

In particular, the FDIC is structuring takeovers of failed banks so that credit isn't immediately cut off to borrowers who are paying interest monthly, although their ability to repay the loan upon maturity is in doubt. Most of these so-called "performing-nonperforming loans" are real-estate loans that borrowers will find it difficult to replace because the value of the underlying collateral has declined.

So, recently, when the FDIC took over CrossLand Savings after the agency couldn't get acceptable bids for the failed Brooklyn bank, the corporation installed a new chairman and instructed him to collect as much as possible on defaulted commercial real-estate loans, to restructure other loans if necessary, and shrink CrossLand down to a core business of residential real-estate lending. When CrossLand failed it had deposits of $5.5 billion and assets of $7.4 billion.

FULL TEXT

WASHINGTON -- Stung by criticism that it was exacerbating regional economic slumps, the Federal Deposit Insurance Corp. is experimenting with potentially less disruptive and costly ways to handle bank failures.

The new methods are still drawing skepticism from Congress and Wall Street.

The goal of the new effort is to keep performing loans -- those on which borrowers are making payments -- in banks for as long as possible, rather than quickly terminating many of them as in the past. "Liquidating performing assets runs our costs up unnecessarily and damages the local economy pretty badly," says FDIC Chairman William Taylor.

In particular, the FDIC is structuring takeovers of failed banks so that credit isn't immediately cut off to borrowers who are paying interest monthly, although their ability to repay the loan upon maturity is in doubt. Most of these so-called "performing-nonperforming loans" are real-estate loans that borrowers will find it difficult to replace because the value of the underlying collateral has declined.

In Texas and New England and other areas hit by bank failures, businesses and politicians have complained that FDIC policies encouraged buyers of failed banks to call performing-nonperforming loans. In many cases borrowers had to default and go out of business because they couldn't refinance.

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The FDIC hopes to sell CrossLand within a year or two, recovering at least $400 million of the $1.2 billion it put into the bank in January. The agency estimated that it would have lost $1.2 billion or more by selling the bank's deposits and then liquidating the performing assets, rather than keeping them in a functioning bank.

The agency also has moved to slow the sale of assets of the former Bank of New England and required the purchaser of another failed savings bank to work with troubled borrowers before disposing of the loans. In addition, the FDIC is telling banks and investor groups that it is willing to help them finance the takeover of failed banks. It recently purchased some preferred stock from Emigrant Savings Bank to help the bank raise the capital to acquire Dollar Dry Dock Bank, a failed savings bank based in White Plains, N.Y.

But banking committees in the House and the Senate have asked the General Accounting Office to investigate the CrossLand and Bank of New England moves. Chairman Henry Gonzalez (D., Texas) of the House Banking Committee worries that the new methods will increase, rather than decrease, the cost of dealing with failed banks. He says he sees efforts to look for easy ways out of the savings-and-loan crisis "as a continuation of an activity that has been disastrous for the taxpayer."

And some Wall Street analysts criticize the FDIC's decision to take over CrossLand, charging that the nationalization will lead only to greater losses. "Look at the bet they're making," says Gerard Smith, a managing partner at Salomon Brothers. "They're saying, `We'll take over this enormous portfolio of real estate and run it until things get better.'"

Harrison Young, the FDIC official who orchestrates takeovers of failed banks, responds that CrossLand "is basically a pretty good bank with a good deposit franchise that made some very bad commercial loans."

More than 1,000 banks have failed in the past six years, and the FDIC expects 200 more banks to fail this year. The bank deposit insurance fund, which is collected from banks, is so low that Congress has given it a new line of Treasury credit.

"If you can keep the assets in the banking system and have a banker working them, the chances of collecting at a higher rate are greater," Mr. Taylor argues. It doesn't make sense, he adds, to sell at a discount a performing mortgage that yields more than you can otherwise get.

He says that putting loans into liquidation reduces their value by about 25%. "What drives a CrossLand strategy is the cost differential" between a loss of 25% from liquidation and a loss of about 15% through arrangements that keep assets in a bank as long as possible while attempts are made to solve the problems, Mr. Taylor explains.

Last month, the FDIC took several steps to slow the liquidation of $1.7 billion of performing-nonperforming loans that Fleet/Norstar Financial Group Inc. took over from the Bank of New England, and encouraged Fleet and other banks to refinance and even enlarge some of those loans.

The FDIC acted after receiving loud complaints from the New England congressional delegation. The time of the change, which came just before the New Hampshire primary, generated charges that the FDIC bent to political pressure. "Our efforts to get the White House to look at this were frustrated until the president's poll numbers went down," says Rep. Barney Frank (D., Mass.). "That's called democracy."

Mr. Taylor, who has headed the FDIC since November, says that any suggestion that the change was politically motivated is "shameful" and potentially damaging to the agency. He says the new policies represent a growing conviction that "massive liquidations in weak economies doesn't serve the public interest." He stresses that the agency is prepared to consider alternatives to liquidation in other parts of the country as well.

Mr. Young, a former investment banker, spends most of his time looking for ways to structure bank takeovers so that they'll cost the FDIC as little as possible. "We have to experiment," he says. "When somebody says, `Hey, this is inconsistent with what you did before,' to a degree our answer is, `I hope so.'"

Credit: Staff Reporter of The Wall Street Journal

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