United States General Accounting Office 142322

GAO

Testimony

142322

For Release on Delivery Expected at 10:00 a.m. Thursday, September 27, 1990

Comments on H.R. 5590: A Bill to Recapitalize the Bank Insurance Fund

Statement of
Richard L. Fogel
Assistant Comptroller General
General Government Programs

Before the
Subcommittee on Financial Institutions Supervision, Regulation and Insurance
House of Representatives

049583 / 142322

GAO/T-GGD-90-64

GAO Form 160 (12/87)

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss H.R. 5590, a bill to recapitalize the Bank Insurance Fund (BIF) with a contribution by the banking industry equal to 1% of its total deposits. The legislation would allow this deposit to be carried as an asset on the books of banking institutions and as equity on BIF's books. The deposit would be expensed if it is needed to resolve failed institutions and would be replenished by the banking industry under procedures to be prescribed by FDIC to maintain its level at 1%. As we understand the proposed legislation, the 1% deposit would recapitalize BIF in the same way that the National Credit Union Share Insurance Fund was recapitalized in 1984.

Due to BIF's undercapitalization, the federal system of deposit insurance for banks faces a period of danger and uncertainty unprecedented since its establishment in the Great Depression. We support the fund's need for additional resources. However, at this point we are not persuaded that the restructuring of the deposit insurance financing that this bill would require is necessary to place the deposit insurance system on sound financial footing.

WHY BIF NEEDS MORE MONEY

In the past 2 years, the FDIC fund (now BIF) lost about $5.1 billion. As a result, the ratio of insurance reserves to insured deposits fell to .7 percent, an all time low, at the end of 1989.

And additional insurance losses can certainly be expected because there are still over 1,000 banks on the problem list and failures are continuing to occur at the rate of about 200 per year. A recession, accompanied by the failure of one or more very large banks, could lead to insurance losses that would exhaust the fund and require taxpayer assistance.

The need to provide additional funding for BIF cannot be overemphasized. One of the most important lessons from the thrift industry debacle is that a weakly capitalized insurance fund encourages regulators to defer action and the owners and managers of problem institutions to gamble on not being closed down. Additional funding, which includes having enough cash on hand to resolve cases in an appropriate and timely manner, is therefore needed to avoid a situation in which bank regulators fail to act on problems because of BIF's lack of money.

COMMENTS ON H.R. 5590

One of the benefits of H.R. 5590 is that it sends a clear signal to the banking industry that it, not the taxpayer, is to the greatest extent possible to be held responsible for the losses in the deposit insurance system. This is the right objective and the main point at issue involves judgements about how to accomplish it. In our view, the goal of industry responsibility can best be met at this time by giving FDIC authority to raise premiums as needed to pay for insurance losses and to achieve an adequate level of reserves. H.R. 5610, which was recently passed by the House, lifts the current constraints on FDIC's ability to increase premiums, and will, if enacted, pave the way for this result. We hope the Congress can agree soon on this measure.

We have three sets of concerns with H.R. 5590: 1) the nature of the accounting treatment accorded the deposit, 2) the size and timing of the deposit in relation to FDIC's needs and the industry's ability to pay, 3) and the implications of the proposed legislation for resolution of several deposit insurance reform issues.

Accounting Issues

The funding arrangement contained in H.R. 5590 differs from raising premiums because the 1% deposit can be treated as an asset rather than an expense on the books of insured banks until the deposit is actually used to pay insurance losses. Although technical accounting arguments can be advanced for and against treating the deposit as an asset, we are very concerned about the effects of the controversy that could surround public discussion of these arguments. Such discussion may confuse many people and deflect attention from policies needed to increase industry capitalization and improve the accuracy of financial reporting.

From a conservative accounting viewpoint, we believe that a deposit such as that contemplated under H.R. 5590 should be viewed as an expense rather than an asset. The basic reason for this is that the deposit is not a resource available to protect creditors in the event of insolvency. We also strongly support efforts to raise industry capital adequacy requirements over the long run, but these requirements must be based on measures of real economic strength. Therefore, if the 1% deposit were to be recorded as an asset by banks, we think it should be excluded from the asset base used to determine capital adequacy. This adjustment would, however, unduly complicate the process of linking capital regulation to GAAP-based financial statements.

Timing Issues

Because there are about $2.8 trillion in deposits in commercial banks and BIF-insured savings banks, the 1% deposit requirement in H.R. 5590 would bring a lot of money into the fund right away and give BIF a margin of safety that is now missing. However, we are concerned about how much money the industry should be asked to pay at any one time. This legislation would require banks to deposit with BIF the equivalent of more than a year's worth of industry earnings, and the question becomes whether BIF's funding needs warrant such drastic action. No one can predict with precision the extent or timing of losses that will occur in the banking industry or the implications of those losses for BIF's finances. But, given the pressure on bank earnings which can be expected in the near future, we think it would be reasonable to spread the increase in funding over several years through higher premiums, provided it gives BIF the money it needs. If H.R. 5610 is enacted, Congress can hold FDIC responsible for raising premiums to match funding needs with the industry's ability to pay.

Deposit Insurance Reform Issues

If a fundamental change is to be made in the way deposit insurance is financed, we believe it should be considered from the broader perspective of deposit insurance reform. In this regard, we have concerns about the implications of H.R. 5590 for two deposit insurance issues.

First, in our recent testimony on deposit insurance reform[1] before the full committee we pointed out that as insurance premiums rise, the unfairness of charging all institutions the same premiums becomes more starkly revealed. Because not all institutions are equally risky we favor the implementation of a system of risk based deposit insurance premiums. H.R. 5590 does not preclude such a system from being developed, but it seems to us that it would make it more difficult to implement one. Under H.R. 5590, BIF's funding needs would be met through a combination of the 1% deposit, interest on the deposit and other reserves, and premiums. The balance among these items could vary considerably from year to year, making it more difficult to

---

[1]Deposit Insurance and Related Reforms (GAO/T-GGD-90-46, September 19, 1990.)

develop a predictable system that penalizes the institutions posing the greatest risk to the fund and that recognizes as well those that are of particularly low risk.

Second, it is not clear whether H.R. 5590, in its references to "total deposits," intends to expand the assessment base to include about $300 billion in foreign deposits. These deposits are not insured but are, in fact, usually protected when a bank fails. If the bill's 1% deposit does not extend to foreign deposits, there would be a strong incentive for banks with offshore operations to turn to those operations for more of their funding. If, on the other hand, the intent of H.R. 5590 is to include foreign deposits we are concerned about how such an increase in the cost of doing business overseas will affect U.S. banks' international competitiveness. There are arguments both for and against assessing foreign deposits in the deposit insurance system. We are currently evaluating these arguments as part of our FIRREA mandated study of deposit insurance reform issues. We are not certain at this time whether the adverse competitive impact of extending the base outweighs the beneficial effects of raising insurance fund revenues through assessments on foreign deposits.

\- - - - -

This completes my prepared statement. My colleagues and I would be pleased to respond to questions.