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STATEMENT OF

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U.S. GENERAL ACCOUNTING OFFICE

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our views on various sections of S. 1720, the "Financial Institutions Restructuring and Services Act of 1981" and on various sections of S. 1721, which would consolidate the three deposit and share insurance funds.

These bills contain several provisions which are related to work that we have recently completed or now have underway. For example, title III of S. 1720 contains provisions related to our recently begun survey of the separation of commercial banking from investment banking. Title I of S. 1721 is generally related to our ongoing review of the Federal Deposit Insurance Corporation (FDIC), Federal Savings and Loan Insurance Corporation (FSLIC), and National Credit Union Administration (NCUA) insurance funds and their failed institution liquidation operations and to a recently begun survey of the effectiveness of the Federal Financial Institutions Examination Council.

We are limiting our comments today to those areas related to completed evaluations or ones which are reasonably complete. The areas we will address are:

--The improvement of industry and regulatory flexibility (S. 1720, Title I, Parts A, D, and E and Title V).

--The consolidation of the Federal insurance funds (S. 1721, Title I).

--The disposition of unclaimed property recovered from closed national banks [S. 1720, Title II, Section 208(b)].

--The reporting of insider lending by banks (S. 1720, Title II, Section 223 and S. 1721, Title I, Section 120).

THE IMPROVEMENT OF INDUSTRY AND REGULATORY FLEXIBILITY

We would first like to discuss our observations about the provisions in titles I and V of S. 1720 that would give the three Federal deposit and share insurance funds greater flexibility in dealing with troubled institutions. These provisions would

--authorize interstate and interindustry mergers for insured institutions eligible for FSLIC assistance,

--establish FDIC's authority to provide financial assistance to insured banks,

--authorize interstate acquisitions of large ($1.7 billion or more in assets) failed banks,

--facilitate savings and loan and savings bank charter conversions,

--allow the NCUA to arrange credit union mergers with or purchases by other financial institution types, and

--authorize savings and loan and credit union insurance funds to borrow from Federal Home Loan banks and the credit unions' Central Liquidity Facility.

Taken together, these provisions, which in some cases formalize and clarify authority that has been questioned, give the insurance funds greater flexibility in handling the present conditions in the thrift industry. They allow the agencies to spread out their losses and provide time to arrange alternatives to insurance payouts and provide additional sources of liquidity. Although we generally support the additional flexibility being provided in S. 1720, we have some concerns about the implications of some of these provisions.

Titles I and V of S. 1720 have two basic effects: (1) they provide a wider range of purchasers and merger partners than is now available, and (2) they increase the funds' abilities to financially assist institutions instead of paying off the insured accounts. Both effects are responsive to the current situation and are beneficial to the funds, but there are, we believe, limitations to each.

In our 1980 report on foreign banking in the United States, 1/ we observed that current restrictions on interstate banking provided an advantage to newly entering foreign banks in buying large U.S. banks. We also observed that emergency interstate

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1/Despite Positive Effects, Further Foreign Acquisitions Of U.S. Banks Should Be Limited Until Policy Conflicts Are Fully Addressed, GGD-80-66, August 26, 1980, p. 6-13.

acquisition authority proposed in H.R. 7080 (96th Congress) would ameliorate some of the problem. Thus, we support the concept. However, the provisions in S. 1720 could have only a short-lived effect if other basic changes are made to the way the financial industry is regulated.

If broader opportunities for interstate acquisitions are developed in the near future, the emergency thrift acquisition provision of S. 1720 will lose much of its ability to reduce insurance fund losses. Thus, absent a general lowering of the restrictions against interstate acquisitions, the acquisition provisions of S. 1720 would represent the principal, and often only, mechanism for an institution to move into an out-of-State market. This, of course, would ensure the "marketability" of failing institutions--the very objective of S. 1720.

The increased emphasis on financial assistance has some potential problems as well. Deposit insurance, generally acknowledged to be one of the Nation's most successful programs in stabilizing the financial industry, was developed at a time when regulatory policies regarding competition, lines of business, and interest rates could successfully remove much of the risk from banking or thrift institutions. In this environment, FDIC and FSLIC have been able to keep payouts from the fund at low levels while also providing maximum stability to the industry through cash contributions or loans, assisted mergers, and purchase and assumption arrangements.

In handling the current difficult condition of the thrift industry and whatever problems develop in the longer run as a result of increased competition among financial institutions, S. 1720 in essence authorizes FDIC and FSLIC to continue to use the financial assistance approaches that have been developed in the past but on a broader scale.

The ultimate effect of S. 1720 on insurance fund finances depends partly on how its provisions are administered. The insurance funds already have a great deal of discretion in defining when an institution is in financial difficulty and in deciding when to take actions that result in cash payouts from the insurance funds. Of the 135 associations that were removed from the Federal Home Loan Bank Board's problem list from January 1979 through August 1981, 82 percent either recovered or merged without FSLIC assistance. If passage of S. 1720 is interpreted by FSLIC, FDIC, and NCUA as a mandate to provide assistance more liberally than in the past, S. 1720 might not have the beneficial effects on insurance fund finances that might be expected. GAO's work on insurance fund condition has centered on FSLIC. Our analysis to date shows that the solvency of FSLIC is in no immediate danger, but the fund certainly cannot be operated in such a way as to make up a larger share of the losses now being experienced by many institutions.

If the Nation's severely troubled associations were spread out evenly across the country, the insurance agencies might not need the authority put forth in this bill. But many of the largest and most severely troubled thrift institutions are centered in only a few of the Nation's financial markets. Therefore, the capacity of these few markets to absorb the number of failing associations is severely strained and the likelihood of federal intervention is increased. Assuming that the flexibility provisions of S. 1720 will be administered in such a way as to be targeted on the areas of special need, we support them as a prudent action to reduce insurance fund risks.

In recent months, we have been working on two reviews which are related to and affected by S. 1720 and, for that matter, S. 1721. One review is of how the three funds liquidate failed institutions, the other deals with the factors affecting the thrift industry. These two reviews have led us to some observations about the trends facing the industry and the FSLIC.

As we all know, the savings and loan industry, which prospered in an environment of stability, has been greatly disrupted by recent high, unstable interest rates and increased competition for deposits. The margin between return on mortgage investment and cost of funds has been shrinking since late 1979, and net worth for the industry as a whole is now falling as institutions are paying a higher rate of interest for deposits than they are receiving from outstanding mortgage loans. We have already seen some failures or serious problems develop, and if present conditions continue, more institutions will experience difficulties. FSLIC has already experienced record cash outlays. It is hard, of course, to anticipate what will happen in the future, which is why we would support providing the funds with additional flexibility. It is our intention to keep close tabs on how conditions in the industry affect changes in the financial condition of each of the insurance funds.

CONSOLIDATION OF INSURANCE FUNDS

After about 50 years of Federal deposit insurance, our recent experience with high interest rates is showing that restricting savings and loans and other thrifts substantially to long-term mortgage loans was risky from an insurance point of view. The insurance funds may be called upon to make good on a larger share of their potential liabilities than would have been thought possible a few years ago. In the long run, allowing thrifts to diversify reduces the risk that has come from putting all their eggs in one basket. However, the competitive environment that is emerging will be inherently more risky than the heavily regulated one that existed when the present deposit insurance programs were developed. This observation leads me to make several comments on S. 1721, the bill which would consolidate the existing insurance funds.

In principle, we have no objection to consolidation of the funds, but we have not completed enough work to comment knowledgeably about the costs and benefits associated with such a move. Our main concern at this point is that S. 1721 does not address broader questions that can be raised about how share insurance should operate in an era of increased competition among financial institutions. These broader issues do not necessarily have to be dealt with immediately, but we feel that the Congress should at least begin to rethink the role and financing of Federal deposit insurance as it takes additional steps toward deregulating the various financial institutions. S. 1720 proposes to make changes in the deposit insurance program in order to cope with economic forces present in the industry, and we think there may be more involved here over the long run than meets the eye.

Although we accept the need to make interim arrangements to deal with present conditions in the thrift industry, we have doubts as to whether it would be wise to continue for long with the traditional approach to deposit insurance when constraints that have reduced the risk to individual institutions are being removed. Over the long run, increased competition among financial institutions, coupled with expansion into new lines of business and an uncertain future for interest rates must surely result in a considerable degree of risk and lower profit margins for many federally insured financial institutions. This in turn translates into risk to the insurance funds, at least as these funds are currently operated.

Without belaboring the matter further, we believe some areas that need to be explored in adapting deposit insurance to a competitive environment are

--basing insurance fees on risk,

--reducing the risk to deposit insurance now associated with uninsured deposits and uninsured liabilities, and

--assuring that institutions exhaust all ways of remaining solvent before deposit insurance assistance is made available.

UNCLAIMED PROPERTY FROM CLOSED NATIONAL BANKS

The next issue we would like to discuss involves a less complex, narrower issue, but an important one nonetheless--the proper disposal of unclaimed property from closed banks. The property came into the Comptroller of the Currency's possession many years ago when receivers of national banks terminated their receiverships. In 1934, the FDIC assumed receivership responsibility for national banks. The Corporation's current policy is to turn unclaimed items over to State agencies when receiverships are terminated.

On September 25, 1981, we issued a report to the Congress about unclaimed property--ranging from stock certificates to jewelry--held by the Comptroller of the Currency. 1/ A copy of our report is provided for the record. We recommended that the Congress give the Comptroller the authority to dispose of the property. The language in section 208(b) of S. 1720 provides for the proper disposal of the property.

We first became concerned about this property in February 1980 when we identified several problems regarding its storage and control. The unclaimed items include documents such as notes, bonds,

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1/Comptroller Of The Currency Needs Authority To Dispose Of Property Remaining From Failed National Banks, GGD-81-94, September 25, 1981.

stock certificates, insurance policies, deeds, wills, and letters. There are other more tangible items such as gold rings, jewels, and old coins. The unclaimed property has not been appraised by experts and there is no accurate estimate of its value. In our report to the Congress we stated that:

> "Aside from the obviously worthless items, the intrinsic value of much of the property probably would be overshadowed by its appeal to collectors for its antique or historic value. Also, there exists the possibility that some of these items might be priceless because of their condition, history, or uniqueness."

We also discovered that the Comptroller had not attempted to locate the owners of the property and, for many years, no claims had been received. Yet, the Comptroller had no plans to dispose of the items. At our suggestion, the Comptroller and the Smithsonian Institution entered into an agreement allowing the Smithsonian's Museum of American History to take temporary custody of the inventory in order to review the items for possible addition to its collections.

At that point, the Comptroller believed that he had authority to dispose of the property. As we discussed in our report, such authority did not exist and new legislation was needed. Therefore, we recommended that the Comptroller make a final attempt to return property to the rightful owners and dispose of the rest, and we suggested the legislation needed to authorize that approach. Section 208(b) of S. 1720 satisfies our recommendation, and we strongly support its passage.

INSIDER REPORTING

The final observation we have involves the elimination of two required reports. Section 223 of S. 1720 would eliminate paragraph (9) of section 22(g) of the Federal Reserve Act [12 U.S.C. 275a(9)]. This paragraph requires banks to report on extensions of credit to their executive officers. Section 120(p) of S. 1721 would eliminate a similar reporting requirement contained in title IX of the Financial Institutions Regulatory and Interest Rate Control Act (Public Law 95-630). On the basis of cases we have studied, we do not believe that these reports are necessary for the regulators' scrutiny of insider loan abuse. However, the desirability of public disclosure of such lending, as accomplished by the title IX requirement, is an open question.

We have just completed a review of changes made to bank supervision in recent years, and one of those changes involves the reporting of extensions of credit to bank insiders. In 1978, the Congress passed the Financial Institutions Regulatory and Interest Rate Control Act (Public Law 95-630). Titles VIII and IX of that act establish certain requirements for all banks to report information on loans and other extensions of credit to a bank's executive officers and principal shareholders either from the bank or its correspondent institutions. Our own study of the new reports, discussions with Federal bank supervisors, and studies of individual banks lead us to conclude that the information reported under section 22(g) duplicates that which is reported under title IX of the 1978 act. Reports prepared under title IX are required to be available to the public from the reporting banks. The section 22(g) reports are not.

We reviewed several cases involving the discovery of insider loan violations by examiners. We found that neither the section 22(g) nor the title IX reports were instrumental in the examiners' discoveries. Other examination procedures and techniques were utilized to review insider lending. We believe, therefore, that the reports are not needed by the regulators to uncover inappropriate insider transactions. However, that is not the only reason for the title IX report.

Another reason for this report, which is available to the public, is the supposition that banks would be less inclined toward improper insider lending knowing that such lending could be reported publicly. We have no information to prove or disprove this theory. If the Congress believes public disclosure to be a valuable regulatory technique in this instance, then the title IX requirement should be retained.

This concludes my prepared statement, Mr. Chairman. We will be happy to answer any questions you may have.