FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

September 23, 1993

Honorable Jim Leach
Ranking Minority Member
Committee on Banking, Finance
and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Congressman Leach:

I would like to express my appreciation for your leadership with respect to the RTC/SAIF funding legislation. As the House and Senate begin to resolve their differences in the legislation, I would like to take this opportunity to raise a concern regarding the Savings Association Insurance Fund. Although the current versions of RTC funding legislation are an improvement over the status quo, both bills leave unresolved issues regarding the viability and the future of the thrift industry and the SAIF.

The House adopted a provision providing the Resolution Trust Corporation with an additional 18 months (until April 1, 1995) to resolve failing SAIF-insured institutions. I would support the Conferees in adopting the 18-month extension.

Prior to the SAIF accepting failed institutions for resolution, it is my hope that the Congress will examine what the viability and future is for the thrift industry and the SAIF. The SAIF has three major obligations: to fund insurance losses associated with failures of SAIF members, to recapitalize the insurance fund to an amount equal to 1.25 percent of insured deposits, and to provide approximately $800 million per year of FICO bond interest payments through the year 2019. In 1989, FIRREA authorized the Treasury, under certain conditions, to provide appropriated funds to SAIF. These funds could have been used to meet these obligations through the year 2000. Thus, while Congress envisioned a healthy, growing thrift industry, FIRREA was crafted so that a backstop would be available in the event that unfavorable industry conditions persisted.

The proposed legislation focuses on the obligation to fund insurance losses over the next several years. This is accomplished in the House bill by extending the RTC's responsibility for failed institutions by eighteen months, thus providing an opportunity for the SAIF to capture the net premium income during this time without incurring any insurance losses. In both the House and Senate proposals, Treasury funds are available to SAIF only to cover losses subject to certain certifications.

By focusing on insurance losses, the proposed legislation leaves recapitalization and the FICO obligation as the responsibilities of SAIF members. While Treasury funding for recapitalization was contemplated by FIRREA, Congress subsequently has determined it is more appropriate to hold SAIF members responsible for recapitalizing their insurance fund. This means that, with respect to recapitalization, SAIF members will be held to the same standard as BIF members. However, the FICO obligation creates a troubling disparity between BIF and SAIF members. Given the current assessment base, FICO interest payments add 10 basis points to SAIF premiums. Even if the insurance losses of the two funds are comparable in the future, a differential premium rate will exist for most of the next 25 years as a result of the FICO obligation.

The specter of a continuing premium differential creates a powerful incentive for SAIF-insured institutions to minimize premium costs by shrinking the base against which assessments are levied (currently domestic deposits). This can be accomplished in a variety of ways <u>even if Congress enacts a moratorium on conversions of SAIF- to BIF-insured institutions</u> and if the definition of the assessment base is expanded to include other direct funding sources. Furthermore, shrinkage may be hastened by the thrifts' awareness that their share of the FICO burden will increase as the assessment base dwindles. The net result could be a dramatic shrinkage of the assessment base, and therefore assessment revenue, that outpaces any increase in premium rates. This could ultimately frustrate any attempt to recapitalize the SAIF and could threaten the ability of the industry to fund FICO payments.

If you or your staff wish to discuss this further, please do not hesitate to contact me.

Sincerely,

Andrew C. Hove

Andrew C. Hove, Jr.
Acting Chairman