FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF THE CHAIRMAN

October 9, 1981

Honorable Jake Garn
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
5121 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

This responds to your request that we comment on S. 1508 which would exempt deposits in International Banking Facilities (IBFs) from FDIC assessments and insurance coverage. The Corporation favors passage of the bill with two qualifying comments.

First, certain technical amendments are necessary to make clear that this Corporation, as the insuring agency, is the proper party to determine which obligations should be insured obligations. The amendments would also authorize the Corportion to issue regulations requiring insured banks to identify to the public any of its uninsured obligations, including IBF obligations, that may cause confusion to the public with respect to their insured status. The proposed amendments are attached.

Secondly, we believe that the current statutory framework for assessing deposits of insured commercial banks deserves a comprehensive review by the Congress at an early date, and thus, S. 1508 should be adopted with a sunset provision. The evolution of activities undertaken by U. S. banks, particularly overseas activities, and the procedures used by the Corporation in resolving the difficulties of failing banks make it imperative that our deposit assessment structure be reevaluated. The current mandate to deregulate depository institutions makes this review even more important and timely.

In reviewing the Corporation's legislative history, we note that Congress in 1935 addressed the issue of assessing deposits held in foreign offices of U. S. banks (Hearings before the Committee on Banking and Currency, House of Representatives, 74th Congress, 1st Sess., on H. R. 5357, pp. 71-72). Congress deliberately omitted such a provision on the grounds that the additional operating cost of insurance would place U. S. banks at a competitive disadvantage vis-a-vis their foreign bank counterparts. Although not explicitly stated in the legislative history, we can surmise that foreign office activities of U. S. banks were minimal and this omission did not represent a large loss of assessment revenue.

Over the last two decades, the international activities of U. S. banks have grown dramatically. At year-end 1980, assets in foreign offices represented a significant 17.4 percent of consolidated assets of the banking system. When considering the overall risk of an individual bank, all activities, domestic and foreign, must be included in evaluating the potential exposure of the Corporation in the event of bank failure. Under the current statutory framework, the Corporation is precluded from basing its premium on all the activities of an institution because assessments are limited solely to domestic deposits.

When we consider the customary remedies used by the Corporation in resolving financial difficulties of failing banks, the current assessment mechanism becomes more difficult to rationalize. As you know, when a bank encounters financial difficulty or fails, the Corporation has several options for resolving the situation. One option is to pay off insured depositors up to the statutory maximum. Under this procedure, depositors with balances in excess of $100,000, other general creditors of the bank and, if applicable, foreign office depositors would share pro rata with the Corporation the proceeds of the failed bank receivership estate.

In lieu of a deposit payoff, the Corporation has increasingly utilized remedies available under Section 13(c) "direct assistance" and 13(e) purchase and assumption" of the FDI Act, particularly in the case of large banks which are likely to have foreign offices. In these instances, the Corporation must by statute determine that the transaction "will reduce the risk or avert a threatened loss" to the FDIC (Section 13(e)) or render a finding that the institution is "essential" to its community (Section 13(c)). Under either procedure, uninsured creditors, including foreign office depositors and other general creditors, directly benefit. While we cannot state definitely because of the statutory tests that all large bank failures would be handled under Sections 13(c) or 13(e), there is a high probability of using either of these methods. Given this hypothesis, it seems incongruous that an assessment premium is not exacted for the implied coverage afforded by the Corporation.

Our position of favoring enactment of the pending bill is largely predicated on the argument that under current law U. S. banks may face competitive obstacles due to the fact that many foreign banks would operate IBFs without deposit insurance coverage. As such, these institutions do not face assessment costs which could make serious inroads to the profitability of business conducted by IBFs. We believe this competitive imbalance should be addressed promptly while more permanent solutions are sought.

Our staff has already begun analysis of the issues raised herein, and we hope to bring these matters to the attention of Congress at an early date. Among other things, we are studying the concept of relating deposit insurance assessments to the risk posed by an individual bank, and we are giving

careful consideration to the feasibility of coinsurance of large depositors whereby these persons would not enjoy full coverage of their balances even if a purchase and assumption transaction were consummated. Both concepts would restore a degree of marketplace discipline in lieu of government regulations currently being phased out. We are confident that your Committee will give these subjects careful and thorough consideration.

In conclusion, while the Corporation favors enactment of S. 1508 with the suggested technical amendments, a sunset provision not to exceed two years from the date of enactment should be written into the bill. This provision would insure that the broader issues involving the assessment and insurance of deposits, discussed heretofore in this letter, will be timely considered by the Congress. We believe that the sunset provision would allow the Congress ample time to consider these matters.

We appreciate the opportunity that you have afforded the Corporation to comment on this bill.

Sincerely,

William M. Isaac
Chairman

Attachment