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FEDERAL DEPOSIT INSURANCE CORPORATION

TESTIMONY OF

L. WILLIAM SEIDMAN
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

ON

the RESOLUTION OF THE PROBLEMS OF THE SAVINGS AND LOAN INDUSTRY
AND THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION,

BEFORE THE

Senate COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

9:30 a.m.
February 28, 1989.
Room SD-538, Dirksen Senate Office Building

Good morning, Mr. Chairman and members of the Committee. I am pleased to testify today concerning resolution of the problems facing the savings and loan ("S&L") industry and the Federal Savings and Loan Insurance Corporation ("FSLIC").

FDIC SUPPORTS PRESIDENT'S PLAN

The Federal Deposit Insurance Corporation ("FDIC") generally supports President Bush's Reform Plan for the savings and loan industry, announced February 6th, and the recently proposed legislation -- that was introduced last week as S. 413 -- to carry out that plan. We believe it is a sound, constructive and farsighted proposal that should be enacted. S. 413 provides for prompt action to resolve the S&L situation and proposes structural and regulatory reforms designed to make the federal deposit insurance system cost-effective.

Our only reservations concern a few of the provisions relating to the independence of the deposit insurer. As pointed out below, these proposals unfortunately would hamper the FDIC's ability to perform, at the very time it is being asked to undertake major new responsibilities.

We now will address the key issues raised in the Committee's letter of invitation. First, we will describe the FDIC's recommendations for structural and regulatory reforms to the deposit insurance system and our views on the reforms contained in the proposed legislation. Then, we will address the size of the problem and the Administration's financing proposal. Third, will be background information on the interagency oversight effort with respect to insolvent S&Ls. And, finally, we will address the question of the need for a separate thrift industry.

STRUCTURAL AND REGULATORY REFORMS

It has become clear that changes must be made to the federal deposit insurance system to ensure that it is cost-effective and self-financed.

During the past year the FDIC has examined ways to improve the federal deposit insurance system. The product of that review -- our recently released study Deposit Insurance for the Nineties: Meeting the Challenge -- contains numerous recommendations for reform. A copy of the study's Executive Summary is being submitted for the record. A draft of the complete study has been provided to each member of this Committee previously.

The FDIC study sets forth certain principles necessary for a sound deposit insurance system for the future. The first principle is that the deposit insurer should be organizationally and financially independent. Thus, the insurer should be empowered to operate, as nearly as possible, like a private insurer. In accordance with this principle, the insurer needs control over its revenues. Also, the insurer must be given the basic tools necessary to control costs. These requirements will be elaborated upon below.

1. Independence of the Insurer

The FDIC study recommends that the federal deposit insurer be made as organizationally, operationally and financially independent as possible. To guard against conflicts-of-interest, the insurer should not be under the control of a chartering authority. Translated in terms of the issue facing the Congress today, this means the FSLIC should be separated from the Federal Home Loan Bank Board. In fact, in the three alternative plans for agency

structural reforms set out in our study, the one constant was that the FSLIC was to be separated from the Bank Board. The FDIC expressed a preference for an independent FSLIC, but also recognizes the view of others that there are potential benefits in an administrative merger of the FSLIC into the FDIC.

To ensure political independence, the federal deposit insurer should continue to be funded by premium payments from insured financial institutions. Thus, the insurer should be independent from the Congressional appropriations process -- as the FDIC is now. While the insurer will be accountable to the Congress on an annual basis, it should remain free from annual budgetary controls since it receives no general tax revenues.

In this connection, we have recommended that the insurer's trust funds be separately budgeted and not be part of the general operational federal budget. For decades, the insurance funds have been depositing their unspent premium income into the U.S. Treasury. These "deposits" are counted as income to the Government rather than savings reserved for future problems in the industry. When funds are withdrawn from the Treasury to deal with a problem institution, that action is counted as a Government expenditure. Instead, it should be treated as a withdrawal of money on deposit.

In fact, the treatment of trust funds -- like the FDIC fund -- under the current federal budget system is affirmatively misleading. It provides misinformation about operational revenues and expenditures of the federal budget. Thus, we have suggested that the Congress consider setting up a separate budget for the deposit insurance funds. For macroeconomic purposes, however, analysts could combine the new deposit insurance separate budget with the general federal operating budget.

2. Enhanced Control Over Revenues

To ensure that the deposit insurer has adequate resources, it should have additional controls over its revenues. Most importantly, the deposit insurer must have the authority to adjust insurance premiums, within prescribed limits, to reflect experience and costs on a continuing basis. If the FDIC had such authority -- rather than being subject to the 1/12 of 1 percent assessment rate that has been in the law since 1935 -- 1989 premiums would be expected to increase significantly based on our 1988 loss experience.

Year-end results for 1988 indicate a net loss from operations of approximately \$4 billion to the FDIC insurance fund. That means that the fund dropped from \$18.3 billion to about \$14 billion last year. Furthermore, the FDIC's fund dropped from 1.1 percent of insured deposits to a little over .8 percent of insured deposits during that one-year period. This demonstrates the need for a premium structure that can respond to the current environment and that has sufficient flexibility to maintain an acceptable level of reserves.

Other powers are necessary to enhanced revenue control. Borrowings that are secured by assets -- assets which otherwise would be available to the insurer in the event of a bank failure -- should be part of the assessment base. The insurer also should be able to require new institutions obtaining federal insurance to pay an entrance fee in order to maintain an adequate reserve-to-deposits ratio. Finally, the FDIC should be specifically authorized to borrow from both the Department of the Treasury and the Federal Reserve.

3. Improved Ability to Control Costs

The federal deposit insurer also must have additional tools necessary to control costs. In many respects, these mirror those that are available to private insurers. The fundamental tool is the ability to control the granting and revocation of insurance. At a minimum, the insurer should be able to set standards for insurability which must be certified by the primary federal supervisor as having been met. The insurer also must have the ability to promptly terminate insurance privileges when an institution is operating in an unsafe and unsound manner. The current procedures for terminating federal deposit insurance should be streamlined to take no more than six months from the start of a proceeding to removal.

The insurer also needs tools to determine whether an institution is posing an inordinate risk to the fund and to require the cessation of any activities that pose such risk. Thus, the insurer must be able to examine all insured institutions. Furthermore, it must have the express authority to determine that certain activities -- including more speculative activities authorized by states for state-chartered institutions -- pose an undue risk to the insurance fund and to require that institutions cease those activities within the insured institution itself. The insurer should be able to require that any such activity be conducted outside of the insured entity, in an affiliate or subsidiary, subject to "firewalls" designed to minimize the exposure of the insured entity to the activity that is being conducted in the separate, but affiliated, corporate entity. Those firewalls should include: (1) a prohibition against the use of the insured entity's regulatory-required capital to capitalize the subsidiary or affiliate; (2) assurances that transactions between the insured entity and its subsidiary or affiliate are on

an arm's length basis and do not jeopardize the insured institution; and (3) a requirement that the institution divest the subsidiary or affiliate if the insurer determines that those requirements are not being met or that the affiliated entity poses a threat to the safety and soundness of the insured institution.

Additional tools also are necessary to enable the insurer to better control costs when dealing with failed institutions. It must have the power to require that all federally insured institutions owned by a common parent indemnify the insurer against any losses resulting from the failure of an affiliated insured institution. The FDIC believes this is preferable to the proposal circulated last year that would have required the consolidation of affiliated insured institutions within a holding company complex. Indemnification for such losses is a more direct and efficient way of accomplishing the same objective.

In resolving failures, the FDIC also should have the ability to distinguish between depositors and other claimants. Specifically, depositor claims should be able to be transferred to another institution while other claimants share on a pro-rata basis with the FDIC in asset liquidations.

All of the federal regulatory agencies also need enhanced enforcement authorities. The FDIC recommends that any legislative package adopted by this Committee include enforcement authorities and penalties substantially similar to those in the enforcement title from S. 1886, as passed by the Senate last year, and from H.R. 5094 as adopted by the House Banking Committee. These measures initially were submitted to the Congress jointly by all the federal regulatory agencies.

PRESIDENT'S PROPOSED LEGISLATION

President Bush recently proposed legislation entitled The Financial Institutions Reform, Recovery and Enforcement Act of 1989. That legislation was introduced last week, by request, as S. 413. It provides for funding the resolution of insolvent S&Ls and extensive structural and regulatory changes to the deposit insurance and thrift regulatory systems. Our comments on the size of the problem and its proposed funding are contained later in this testimony.

The FDIC supports S. 413 as a sound and viable measure that should be enacted promptly by the Congress. As noted, however, we have some points of disagreement with the legislation, each of which bears upon the independence of the FDIC. While those points will be addressed in detail below, in short, they involve (1) appointment of the FDIC Chairman; (2) restrictive limitations on the issuance of debt; and (3) reporting requirements.

As might be suspected, the President's proposal is not perfect from the FDIC's perspective. Clearly, some compromises had to be made along the way. We recognize that compromise is part of the process and none, in our view, compromises the essential soundness of the proposal.

For example, in the area of increased insurance authorities over the banking industry, the FDIC has been given substantially greater authority with respect to thrifts previously insured by the FSLIC than it has, or will have under the proposal, with respect to banks. Another example -- state-chartered thrift

supervision could have followed the pattern of state-chartered banks and thus be placed under the primary federal supervision of the FDIC. But they are not. We believe the legislation has reached workable solutions in each of these cases.

While we know this Committee is acutely aware of the need for expeditious legislative action to resolve the FSLIC situation, we would be remiss if we did not stress that point. Nothing of major substance can be accomplished until the Congress acts to provide funding and guidance.

Now we would like to turn to more specific comments on the President's legislative proposals for structural and regulatory reform. In its most fundamental components, the package incorporates most of the recommendations made in the FDIC study. It specifically provides for (1) the independence of the thrift insurer subject to the problems noted; (2) enhanced deposit insurance revenues and better control by the insurer over those revenues; and (3) additional tools to better control the insurer's costs.

1. Independence of the Insurer

The President's proposal would separate the FSLIC from the FHLBB and consolidate the FSLIC with the FDIC for insurance and case resolution purposes. While providing a single management and administrative structure, it would maintain the FDIC and FSLIC funds as separate insurance pools that could not be commingled. Each pool would have its own premium income stream and the expenses and expenditures of their respective institutions would be charged against their respective pools.

In separating the FSLIC from the Bank Board, the proposal also establishes a new structure for the chartering of federal thrifts and the supervision of all federal and state-chartered thrifts and their holding companies. The Federal Home Loan Bank Board would be dissolved and replaced by a single Chairman of the Federal Home Loan Bank System ("FHLBS") who would be under the Secretary of the Treasury -- just as is now the case for the Comptroller of the Currency ("OCC").

Making the thrift insurer independent is an essential step in ensuring that a situation like the one we are facing today does not recur. As stated earlier, from an agency point of view, the FDIC would have preferred to see the FSLIC separate from the FDIC. The judgement of the Administration has been that in terms of start-up time and costs, administratively merging the FSLIC into an existing insurance structure at the FDIC is more cost-effective. We will work diligently to ensure that result.

The President's plan does not provide for a separate budget -- as recommended by our study -- for the FDIC insurance funds.

Although the President's proposed legislation would make important progress in ensuring the independence of the former FSLIC, certain provisions of the plan run counter to the principle of establishing an independent deposit insurer. In fact, in each of these instances, the legislation would make changes to the existing independence of the FDIC that would limit its independence.

First, the bill would permit the President to appoint and remove, with or without cause, the Chairman and Vice Chairman of the reconstituted FDIC Board

of Directors. At present, the Board of the FDIC elects its Chairman. We believe such removal authority could compromise significantly the independence of the FDIC, and recommend that it be deleted. In fact, when that removal authority is coupled with the fact that two of the other Board members are under Treasury, the FDIC Board, in effect, could be controlled by the Administration. If a change is needed, we would suggest that a system similar to the Federal Reserve System -- appointment for a term with the consent of the Senate -- be adopted.

Second, another provision of S. 413 would place limits on the FDIC's borrowing authority. We believe it is appropriate to limit the FDIC's ability to issue notes and other debt obligations. However, the proposed limitations are impractical and overly restrictive and could seriously undermine the safe and cost-effective operations of the insurer in the near term.

To put the proposed limit in perspective, it would restrict the FDIC's obligations to \$7 billion. We are almost at the proposed cap already. Currently the FDIC has about \$6 billion in obligations. In each case the liability was properly recorded with the appropriate charge taken against net worth.

The FDIC's \$14 billion of net worth represents the unencumbered assets available in excess of that needed to satisfy all actual and contingent liabilities. In other words, the FDIC has not used debt because it does not have the necessary resources, but because of other valid business reasons. Examples of such reasons include providing failed bank acquirors additional

flexibility in markets with weak loan demand, avoiding untimely portfolio sales and even maintaining some additional leverage to ensure buyers hold up their end of the bargain. We would hate to lose this flexibility.

Thus, instead, we recommend a very simple borrowing limit: No notes can be issued which will put the agency into a deficit net worth position. Thus, the FDIC would be able to obligate neither itself nor the general government revenues in an amount beyond the limits of the FDIC's resources as determined by GAO audit. By imposing the limit that we recommend, the insurer could not issue debt if it does not have its own resources to repay that debt and, thus, could not obligate taxpayer funds.

Third, S. 413 would require the FDIC to submit quarterly reports to both the Secretary of the Treasury and the Director of the Office of Management and Budget on the FDIC's "financial operating plans and forecasts . . . taking into account the Corporation's financial commitments, guarantees and other contingent liabilities." We believe it should be sufficient to file such reports with the Administration through the Treasury and, to save costs and paperwork, the documents should be the financial reports prepared by the FDIC in the ordinary course of its business.

2. Enhanced Revenue Provisions

The President's legislative package establishes a new insurance premium structure that appears viable for both the FDIC and FSLIC insurance fund pools to be designated for the present, respectively, as the Bank Insurance Fund ("BIF") and the Savings Association Insurance Fund ("SAIF"). The insurance

premium paid by banks into BIF would increase to 12 basis points in 1990 and to 15 basis points in 1991. Premiums on institutions in SAIF would remain at 20.8 basis points through 1990, increasing to 23 basis points for 1991 through 1993 and then dropping to 18 in 1994.

Furthermore, the FDIC would be provided with flexibility to raise the premiums above these levels if extraordinary circumstances raised the specter of serious future losses to the fund. On the other hand, once the funds of either BIF or SAIF exceed the target reserve level of 1.25 percent, then assessments could be rebated to the institutions insured by that particular fund.

The FDIC study recommended that premium rates be increased to more accurately reflect loss experience. S. 413 calls for such an increase and we support it. As discussed in more detail later in our testimony, raising bank premiums from eight basis points to 12, and then 15, seems reasonable and prudent and very close to the result under the recommendations contained in our study. Furthermore, as the FDIC requested, S. 413 would provide the insurer with flexibility to increase rates under specified circumstances.

The FDIC also believes the premiums charged to FSLIC insured institutions -- which rise to 23 basis points for a three-year period and then decline to a point lower than current premiums -- are both reasonable and apparently within the capacity of those institutions to pay. However, those increased premiums cannot be evaluated in a vacuum. There should be careful consideration of the effect on the industry's viability of these premiums coupled with the significantly increased capital requirements and loss of income from the FHLB System.

As we have consistently stated, the cost of resolving the savings and loan situation should be borne to the greatest extent possible by that industry. Just as importantly, the banks should not be called upon to bear the cost of that resolution. Appropriately, under the President's proposal, the revenues generated from bank premiums will go to build BIF and not to pay for the thrift problem.

Finally, the FDIC would be permitted, within its discretion, to charge a fee for institutions moving from one fund to the other. In its study, the FDIC recommended that fees be permitted in order to maintain a specified reserves-to-deposits level in the insurance fund.

3. Improved Provisions to Control Costs

The President's proposal provides for improved provisions to control insurance costs. As discussed above, the FDIC's study suggests numerous changes that should be made to the deposit insurance system to enable the insurer to better control costs. A primary cost control mechanism is to permit the insurer to operate more like a private insurer -- with control over the granting and revocation of insurance. The insurer also must be able to examine insured institutions to assess risk to the fund. The insured institution itself must be subject to adequate standards -- such as capital, accounting and disclosure -- and the insurer must have sufficient authority to enforce those standards.

An additional dimension to controlling insurance costs is requiring increased capital. In addition, when the insurer's resources have to be used to resolve

a troubled institution, there are measures that can be taken to minimize the cost to the fund. Finally, stronger enforcement provisions assist the insurer in controlling costs.

The proposed legislation contains important new cost control tools in each of these areas. In fact, S. 413 goes a long way in providing the FDIC with the necessary tools to allow it to better control costs.

Enhanced Ability to Control the Granting and Revocation of Insurance. The President's proposal provides enhanced ability to control fund membership. Under S. 413, the FDIC would be able to deny insurance coverage to any S&L, both state and federal. As is the case currently with state-chartered banks, state-chartered thrifts would be required to apply directly to the FDIC for insurance. However, the FDIC also would be authorized to review and to deny any application for a federal savings and loan charter that would result in eligibility for insurance if the FDIC determines that specified statutory standards have not been met.

While under S. 413 insurance for national and state Fed member banks will continue to be automatic, the OCC and the Federal Reserve Board ("FRB") would be required to consider a new and additional standard -- risk to the deposit insurance fund -- before granting a national bank charter or Federal Reserve membership.

The FDIC would be provided with the authority to immediately suspend deposit insurance if an insured institution has no tangible shareholders' equity. Also, the FDIC would be able to promptly remove insurance from any insured

institution that is engaging in unsafe or unsound practices, operating in an unsafe or unsound condition or otherwise causing undue risk to the insurance fund. Under current statutory procedures, termination proceedings can take anywhere from two-to-three years to complete. An expedited hearing procedure would be established under the proposed legislation that would permit revocation within approximately six months of the filing of a notice of intent to terminate.

Improved Ability to Assess Risk. Under the President's proposed legislation, the FDIC would be provided with the necessary tools to examine and assess risk in thrifts. The FDIC would be entitled to copies of all examination reports filed with the FHLBS and would have the right, upon notification to the FHLBS, to examine all insured thrifts for insurance purposes.

This examination authority is the same as the FDIC's current authority with regard to national banks and state member banks. However, since in the past there have been some questions about the FDIC's authority to examine independently such banks to protect the insurance fund, the FDIC would like to have legislative history making this clear.

In addition to its new examination authority over thrifts, the FDIC would be authorized to request that the FHLBS or a state supervisory authority take any enforcement action applicable to any insured institution or its officers and directors. If the appropriate authority declines to take such enforcement action, the FDIC would be permitted to initiate that action independently. We believe this additional authority will be very helpful.

Improved Regulatory Standards Applicable to Thrift Institutions. The Bush legislative proposal appropriately applies bank-like regulatory standards to thrift institutions. It also provides additional powers to ensure safe and sound operations.

Under the proposal, the FHLBS would be required to establish capital standards for thrift institutions that are no less stringent than those for national banks. The standards would be required to be fully implemented by June 1, 1991 -- although thrifts would have ten years within which to amortize their goodwill. Thrifts also would be required to conform to accounting and disclosure standards now applicable to banks and the FHLBS would have to adopt supervisory policies equal to those now applied to banks.

We support high and consistent capital standards for S&Ls and banks. We must be sure, however, that the S&L industry can satisfy the bill's requirements within the time permitted without unduly damaging the viability of the weaker segment of the industry. Since this is a complex determination, appropriate flexibility should be provided the insurer so that the proper time-frame and balance can be assured.

The FDIC would have additional risk-reduction authorities under S. 413 relative to thrifts that it does not now have explicitly -- and would not be given under S. 413 -- with respect to banks. Specifically, the FDIC would be able to prohibit or restrict the growth of assets by a thrift institution that does not meet minimum capital standards established by the FDIC. We believe that the authority provided in S. 413 for the FDIC to establish such minimum capital standards is particularly important.

Furthermore, the FDIC would have the explicit authority to determine that state-authorized activities that are not permissible for federally chartered S&Ls pose an undue risk to the insurance fund and to require that the thrift cease conducting those activities within the insured entity itself. The FDIC believes that this last authority also is very important. We suggest that such activities be allowed in subsidiaries or affiliates of holding companies with appropriate safeguards through tough firewalls.

Improved Ability to Buy Thrifts. S. 413 takes steps toward expanding the pool of private capital that would be available to rescue the thrift industry. First, additional nonbank holding companies may be interested in acquiring thrifts once the cross-marketing and tandem operation restrictions of the Competitive Equality Banking Act ("CEBA") are lifted. Second, two years after enactment, bank holding companies would be permitted to acquire healthy thrift institutions, without the imposition of the tandem operation restrictions now imposed by the FRB.

While these two steps are helpful, the FDIC believes that bank holding companies should be permitted to acquire failed or failing S&Ls immediately, without the cross-marketing, activity and branching restrictions or any other restrictions that have been routinely imposed by the FRB. To date, when bank holding companies are permitted to acquire failed or failing thrifts, the Federal Reserve prohibits them from changing the thrifts name in any way that would lead thrift customers to believe that the institution is a commercial bank. However, the FRB then also requires the thrift to operate as if it is a bank, subject to bank branching and activity limitations. The FDIC thinks that the imposition of cross-marketing, activity and branching limitations on

the acquisition of failing and failed thrifts by bank holding companies unwisely curtails the ability of banks to buy thrifts and, thus, raises the insurers' costs.

Sound Protection for the Insurance Fund in Handling Failed Banks. S. 413 contains the fund indemnification provision that the FDIC believes is vitally important in dealing with failed insured depository institutions that are commonly controlled. The legislation would require that all such institutions that are under common control guarantee the insurer against loss in the event of a failure of any of the other insured institutions so commonly controlled.

The proposed legislation also includes another very important measure that would help the FDIC to minimize the funds' exposure in failed bank resolution cases. That provision would allow the FDIC to distinguish between depositors and other claimants in resolving failures. Specifically, depositors claims could be transferred to another institution while other claimants would share on a pro-rata basis with the FDIC upon liquidation of the failed institution's assets. It is important to point out that this is not the "depositor preference" measure that the FDIC recommended during the 99th Congress. Under depositor preference statutes, other claimants are subordinated to the FDIC. Under this proposal, other claimants would share pro-rata with the FDIC.

Enhanced Enforcement. S. 413 also would include enhanced enforcement provisions very similar to those included in the bill that was adopted by the Senate and the House Banking Committee in the last Congress. These measures originally were proposed jointly to the Congress by all of the federal financial regulatory agencies. We believe that those measures, as well as the

enhanced civil and criminal penalties contained in the President's bill, are important to the agencies' ability to deal with mismanagement, waste, fraud and insider abuse. We question, however, whether the amount of some of the new civil penalties are not too Draconian.

BUDGETARY IMPACT OF PROBLEM

We now will turn to two of the other issues raised in the Committee's letter of invitation -- the size of the S&L problem and the proposal for financing that problem.

Size of the problem. In order to estimate fully the budgetary implications of the thrift problem, ascertaining the size of the insurance loss is critical. At the beginning of 1988, there were approximately 500 insolvent thrifts under generally accepted accounting principles ("GAAP") with assets over \$200 billion. During 1988, the Federal Home Loan Bank Board ("FHLBB") took action on more than 200 S&Ls at a reported cost of over \$39 billion on a present value basis. We understand that the General Accounting Office ("GAO") soon will release a cost analysis of S&L transactions during 1988.

As of the end of the third quarter of 1988, there were about 220 thrifts that were insolvent under regulatory accounting principles ("RAP"), not including those thrifts handled by the FHLBB in 1988, and another 119 GAAP insolvent thrifts. In addition, there would be approximately another 100 insolvent S&Ls under banking standards -- namely, if goodwill were eliminated. Our latest estimates suggest that current operating losses at RAP and GAAP insolvent S&Ls

are about \$200 million per month. That figure will be higher as interest rates rise or as S&Ls experience unusual deposit outflows, as they have recently, and must fund with higher cost deposits.

We have stated in the past that reliable cost estimates of resolving the insolvent S&Ls should be made by on-site examinations. We are in the process of making such estimates pursuant to the joint oversight effort discussed below. Our best estimates at this time are in the same range as the Treasury Department's estimated cost. See the attached Charts A and B.

When discussing cost figures, it is important not to confuse present value with actual dollars spent over the life of the workout. Charts A and B provide information on those cost figures. The present value is the appropriate figure to focus on -- it represents the cost in today's dollars. The actual dollar figure mixes apples and oranges because a dollar spent in the future is worth less than a dollar today.

For example, consider buying a house that sells for \$100,000. One could either pay cash or finance it. If the purchase is financed with, say, a 30-year fixed rate mortgage at 10 percent annual rate, the monthly payment will be approximately \$875. Over the thirty years, the payments add up to \$316,000. Even though the person who finances the house outlays, over the life of the mortgage, more than three times the number of dollars than the person who pays cash, we do not say that the house costs three times as much for people who finance.

The cost estimate which is projected by the President's proposal is based on today's dollars. If the rescue plan is financed, the actual dollars outlaid will be substantially higher than that amount, but the cost will not be.

Bush Reform Plan financing proposal. Regarding the financing package, the Treasury Department and the OMB are in the best position to comment. From our viewpoint, the President's proposal, while complex, appears viable and sound. The proposal provides for what appears to be an equitable sharing of the financial burden between the S&L industry and the Treasury. However, the plan should assure that ultimately the SAIF be an independent, self-funded insurance fund. The attached Chart C provides a pictorial of the sources and uses of funds under the proposed financing plan.

Ability of banks and S&Ls to pay increased premiums. The legislative proposal calls for increased insurance premiums for both banks and S&Ls. The increased premiums for the S&Ls will be used to partially offset the cost of that industry's problems. The banks' increased premiums will be used to strengthen the FDIC insurance fund. Both premium increases will add to general federal revenues for budgetary purposes.

In our recently released study on deposit insurance, we concluded that FDIC deposit insurance premiums should be adjusted for the risk and costs incurred by the insurance fund. The FDIC spent \$7 billion dollars last year, and our fund declined by about \$4 billion, or over 20 percent. Our fund's reserves at year-end will be reduced to 83 cents per \$100 of insured deposits, well below desired levels. Without regard to the S&L industry problems, the FDIC study recommended that bank premium rates be increased to reflect more accurately recent loss experience of the FDIC fund.

S. 413 calls for such an increase -- and we support this proposal. Raising bank premiums from their current level of 8.33 basis points to 12 basis points next year, and then 15 basis points the year after, is reasonable. We estimate going to 12 basis points will increase premiums about \$700 million, and that 15 basis point will bring in almost \$600 million more.

The increase in premium expenses translates to about 2.1 percent and 3.8 percent of pre-tax earnings at 12 and 15 basis points, respectively. To some extent, this increase probably could be offset by repricing of services, but the ability to do this is constrained by today's competitive market place. Assuming that all the increase resulted in earnings reductions, we estimate that fewer than 100 institutions out of over 13,000 that are now profitable would be made unprofitable.

The majority of the banks that would suffer the most significant decline in profitability from higher assessments are located in the Southwest and Midwest regions, the two regions that have experienced the greatest difficulties during this decade.

Given recent FDIC loss experience, the increases are consistent with our study's conclusions and should not pose an unreasonable burden to the banking system. Importantly, the revenues generated from these premiums will go solely to build the new BIF -- the fund that insures banks.

Under the proposed legislation, once BIF moves up from .8 to 1.25 percent of insured deposits, banks can expect premium rebates. Our preliminary estimate is that rebates could begin as early as the mid-1990s under the President's plan.

We recently completed an evaluation of the rebates the FDIC paid from 1950 through the early eighties. We added all rebates from that period back into our fund and applied the yield we would have earned on those funds. We discovered that, if no rebates had been paid during that time, the FDIC today would have another \$26 billion in its insurance fund.

This indicates that the current rate of eight basis points was more than sufficient to meet costs if no rebates had been paid. Thus, a return to lower premiums may be indicated at some future date.

As to the increase in premiums on S&Ls, in and of itself, it will not unduly damage the industry. As previously stated, flexibility should be provided the insurer so that it can act if industry viability is threatened.

INTERAGENCY OVERSIGHT EFFORT

I would now like to turn to the interagency oversight effort underway to deal with the currently RAP insolvent S&Ls.

As part of the Bush Reform Plan, the President recently requested that the FDIC lead a joint effort to evaluate and oversee most of the RAP insolvent thrifts. In addition to the FDIC and the FSLIC, the Federal Home Loan Bank Board, the Federal Reserve, and the Office of the Comptroller of the Currency are participating in this interagency initiative.

The purpose of this interagency effort is to limit the growth of problems in our nation's insolvent thrifts until a comprehensive reform of the deposit

insurance system and the necessary funding are authorized by the Congress. Insured deposits will remain fully protected throughout this process.

Since the program was announced by President Bush on February 6th, a joint task force of regulators, led by the FDIC, has taken control of 36 of the RAP insolvent thrifts. We plan to go into another 38 this week and expect to assume oversight of the rest of the over 200 RAP insolvent thrifts in the next four-to-six weeks.

The FSLIC has contracted with the FDIC to take control of these institutions that are being placed in conservatorship or receivership. That means the FDIC, with the help of other regulators, will oversee operations of the insolvent thrifts. Managements of the various institutions are subject to the regulators' authority. From the customer's perspective, however, the only visible difference will be a few more people in each institution. Day-to-day operations will continue to preserve basic services to deposit and loan customers.

One of the first priorities of these oversight efforts will be to evaluate the losses at each S&L. Such on-site examinations are necessary to produce accurate estimates of the cost of the thrift problem. Once our estimates are completed and GAO has issued its report on the cost of FSLIC's 1988 deals, the total cost of this problem can be determined.

Another top priority is to identify and stop any abuse, waste, or fraud that may be present. A further priority will be to prepare a business plan for the institution and seek cost reduction through consolidations and more efficient operations.

While in control of these institutions, we and the other regulators will seek to stop any unsafe or unsound practices. We will limit their growth, and downsize them through asset liquidations where possible. However, we will avoid firesales of assets and emphasize the need to sell at values that reflect current appraised values.

Finally, we will develop longer-term solutions to these problems. Our staff will recommend different approaches -- from liquidating the institutions to selling them to qualified purchasers. But our current job is a holding action only. We will not issue notes or enter into income maintenance agreements.

The FDIC has established four task groups to address these responsibilities. These task groups are designed to ensure stable operations in the insolvent thrifts and to evaluate options for permanently resolving their insolvency once funding is approved by Congress.

One of our most important task groups is our new Fraud Squad. As President Bush has said, "unconscionable risk-taking, fraud and outright criminality have also been factors [in the thrift problem]." Investigators assigned to this Fraud Squad will constitute a mobile unit. Whenever our on-site teams discover evidence that fraud or insider abuse may have occurred, the Squad will be sent to conduct a full-scale investigation. This includes looking for ways to get back misappropriated assets when possible, and helping send some to jail when appropriate.

Our three other task groups have separate but complementary assignments.

Our Oversight and Evaluation task group will take control of these institutions, assess their condition and take steps to reduce operating costs where possible.

Our Planning and Restructuring task group will recommend steps to restructure and consolidate institutions where appropriate.

And our Transaction and Acquisition task group will begin the process of seeking out buyers for institutions, real estate and other assets. We will seek to reach agreements with purchasers subject to resources being made available to provide assistance.

The FDIC and the FHLBB have agreed that, until the agencies review the status of the insolvent thrift institutions placed under joint regulatory oversight, only cash assistance transactions will be undertaken by the FSLIC.

We also must note that these additional responsibilities in addressing the S&L situation will place some strain on FDIC resources. We believe that this will not substantially interfere with our responsibilities as a bank regulator. We are dedicated to this new task and will strive for success, but we do expect to experience growing pains and recognize our need to climb a learning curve in the process.

NEED FOR A SEPARATE THRIFT INDUSTRY

The Committee's letter of invitation also asked us to comment on the need for, and viability of, a separate regulated thrift industry. If we did not have a

separate thrift industry today, our reaction is that there would be a question as to whether we need a separate industry dedicated to financing housing. Today, there are many sources vying for that business.

However, we are not starting from scratch. We do have a separate thrift industry now that provides approximately 40 percent of this nation's housing funding. Although that percentage is declining, so long as the public is being provided with that volume of home financing, the industry fulfills an important public purpose.

We believe, however, that it is extremely important that, to the extent we maintain this specialized industry, those institutions must be required to dedicate themselves to that role. Unfortunately, the trend has been in the opposite direction. Thrift institutions now have much broader authorities than commercial banks in many respects and, thus, have forsaken the purpose for which they were chartered. Thus, if a separate thrift industry is to be maintained, it should be devoted primarily to the financing of housing and should not be permitted to engage in incompatible ventures. To assure viability in this era of volatile interest rates, the industry must be supervised to limit interest rate risk through appropriate flexible rate mortgages and securitization.

Ultimately the market will determine the long-range future of the industry.

CONCLUSION

With the exceptions noted, we believe the Bush Reform Plan is a sound, constructive and farsighted proposal, and hope Congress acts on it promptly.

We would be happy to work with the Committee on any aspect of the S&L situation where we may be helpful. I would be pleased, at this time, to answer any questions the Committee may have.