DEBT LIMIT EXPLANATION

The FDIC strongly favors a limitation on its ability to issue debt to prevent an insurer from obligating general taxpayer funds. However, the current proposal limiting the aggregate amount of FDIC notes and other obligations to less than 50 percent of its net worth is unworkable because it is way too restrictive and would immediately interfere with the operations of the FDIC.

PRACTICAL EFFECT OF THE LIMIT

As of December 31, 1988, the FDIC fund had assets of $22.7 billion (which includes nearly $17 billion in U.S. government securities) and liabilities of $8.6 billion. The liabilities include $3.9 billion in reserves set aside to cover anticipated assistance costs. These reserves, as well as our exposure on any liability including contingent liabilities, immediately are accounted for by a reduction in the FDIC's net worth.

The difference between FDIC's assets ($22.7B) and its liabilities ($8.6B) represent the FDIC's net worth of $14.1 billion. In other words, the FDIC now holds $14.1 billion more in assets than needed to satisfy all existing or expected liabilities.

The provision in H.R. 1278 would limit liabilities to half the FDIC's net worth. This test is way too restrictive since effectively debt would be restricted to less than one-third of the assets held by the FDIC. At this point, the limit would be $7 billion. With $8.6 billion in current liabilities, the test is one the FDIC would fail now. Immediately, the FDIC would be placed under a constraint which would hamper our operational flexibility even though the insurance fund remains very solvent and adequate to handle any foreseeable contingencies.

WHY FDIC MUST ISSUE DEBT AND OVERLY RESTRICTIVE LIMITS SHOULD BE AVOIDED

The FDIC must be able to provide depositors prompt access to their funds in the event of a failure. Ideally, the FDIC will arrange for another institution to acquire the failed bank's accounts. In return, the acquiring bank will accept all the failed bank's assets at a reasonable value along with cash from the FDIC to make up any shortfall. Such transactions minimize the requirements for immediate cash by the FDIC.

Unfortunately, whole institution acquisitions, as described above, often cannot be accomplished. In many situations, the FDIC must either liquidate the assets itself and/or provide guarantees to encourage other institutions to take the assets.

Converting the assets of a failed institution to cash is a difficult and time-consuming process. The FDIC must have sufficient flexibility to issue notes or provide guarantees to acquirers of failed institutions in order to bridge the time gap between liquidating the assets and providing immediate protection to depositors. Moreover, the FDIC must be able to act quickly. Without the necessary flexibility, the FDIC will be faced with the dilemma of either delaying closings or not providing depositors immediate access to funds.