TESTIMONY OF

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ON

S. 3045

BEFORE THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

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ROOM 538 DIRKSEN SENATE OFFICE BUILDING

Good morning, Chairman Riegle, Senator Garn and members of the Committee. I am John Bovenzi, Deputy to Chairman Seidman. The Chairman extends apologies to the Committee for his absence, but I am pleased to testify this morning on behalf of the Federal Deposit Insurance Corporation concerning S. 3045.

S. 3045 would provide the FDIC with greater flexibility in adjusting the rates paid by banks for federal deposit insurance. The bill would change existing law by eliminating the current ceilings on annual increases in the insurance premiums, or assessments, paid by banks to the FDIC. It would also remove the existing overall cap on the assessment rate, and would permit the FDIC to adjust the rate on a semiannual basis should the need arise. The FDIC supports each of these provisions.

Under existing law, the assessment rates to be applied in any particular year are set by statute, with a narrow grant of authority to the FDIC to impose limited increases above the statutory rate. For the Bank Insurance Fund, or BIF, the statutory rate for calendar year 1991 and thereafter is 15 cents per $100 in deposits. For the Saving Association Insurance Fund, or SAIF, the statutory rate increases from 20.8 cents to 23 cents for 1991 through 1993, then decreases to 18 cents in 1994. The Savings Association Insurance Fund rate decreases again in 1998, to the statutory Bank Insurance Fund rate of 15 cents.

Existing law also establishes a reserve ratio -- or a ratio of insurance Fund balances to insured deposits -- of 1.25 percent, with provision for increase by the FDIC to 1.50 percent. If the FDIC increases the reserve ratio above 1.25 percent, investment income on the assessments attributable to the increase will be redistributed to Fund member institutions. If the FDIC subsequently determines that BIF or SAIF exceeds the appropriate designated reserve ratio, the excess funds are to be credited to the member institutions.

As you are aware, the Board of Directors of the FDIC has recently proposed an increase in the assessment rate for banks. This increase, if adopted by the FDIC, would result in a bank assessment rate of 19.5 cents per $100 in deposits for calendar year 1991. At this time, we believe that this rate should be adequate. We also believe, however, that it would be helpful if the FDIC were granted more flexibility as to the timing and amount of any future rate increases.

Accordingly, we generally support the changes that would result from enactment of S. 3045. Additional flexibility in assessing premiums will allow us to do our job better. Flexibility also may facilitate bank discipline by allowing banks to immediately feel the effects of poor industry performance -- this may provide a strong incentive for more self-policing in the industry.

However, the deposit insurance system cannot be fixed merely by charging higher premiums. We need to address the underlying factors as to why the premiums are to be so high. There are problems in the deposit insurance system that need to be addressed and there are problems in the banking industry itself, which also need to be addressed.

In testimony yesterday before the House Banking Committee, Chairman Seidman identified supervision, capital and risk management as three areas that must be at the forefront of our efforts to restore the deposit insurance system and the banking industry to health. Chairman Riegle, we welcome your just released proposal on deposit insurance reform and intend to review it carefully. Hopefully, we will continue to move forward with legislation reforming the deposit insurance system and the banking system in order to effectively complement the proposed legislation on deposit insurance assessments that is before us today.

We appreciate the foresight of the Chairman and other members of this Committee in introducing S. 3045. If enacted, this legislation will give us a head start in reforming the deposit insurance system. There are, however, several additional considerations the Committee might wish to explore in its deliberations on the bill.

First, S. 3045 is limited to assessments for the Bank Insurance Fund. We recommend that the bill be amended to grant the FDIC similar flexibility with respect to assessments for institutions which are members of the Savings Association Insurance Fund. Under existing law, the FDIC has no authority to alter SAIF rates until 1995. We urge that S. 3045 be amended to retain parity in the FDIC's discretion to adjust BIF and SAIF rates.

Second, we recommend that the legislation remove provisions in existing law that mandate rebates of assessments. We would prefer an approach similar to that contained in the Department of Treasury's proposal which provides the FDIC with the discretion to give rebates, taking into account the need to build up fund reserves to withstand future periods of unusual stress. From 1950 through 1983 FDIC income from assessments exceeded expenses and insurance losses. As a result, the FDIC was required to rebate a portion of that surplus back to the banks in the form of a credit against future assessments. These rebates totalled $6.7 billion over the 24-year period. The accumulated interest foregone equalled $24.9 billion. Thus, had these rebates not taken place, the Bank Insurance Fund today would have an additional $31.6 billion, and would have stood at approximately $45 billion at the end of 1989.

Third, the Committee might wish to consider including minimum assessment rates for the two Funds, at levels similar to those prescribed as minimum annual assessment rates under existing law. One potential benefit of a statutory minimum is that it provides guidance as to the minimum rates Congress considers to be appropriate. Another benefit is that it establishes a base rate that would be applicable in the absence of FDIC action.

In summary, the FDIC believes that the increased flexibility granted by S. 3045 is a positive step. We urge that it be extended to cover SAIF assessments as well as BIF assessments, that it provide greater discretion with regard to rebates, and that a minimum assessment rate be included.

I will be pleased to answer any questions the panel may have.