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ORAL STATEMENT
OF
DONNA TANOUE
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON BANKING AND FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
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Thank you, Madam Chairwoman and members of the Committee. I appreciate this opportunity to testify on behalf of the FDIC regarding the merger of the insurance funds and related issues. This morning I will discuss three points: One, why the funds should be merged; two, why there is no magic number for a deposit insurance fund; and, three, why the Congress should exercise great caution in considering rebates to insured financial institutions or a cap on the insurance funds.

First, why merge the funds? As we have stressed in previous testimony, a merger would ensure that the risks to the deposit insurance system are as diversified as possible, thus reducing the concentrations of risks by size and numbers of institutions, by geography and by types of products. With ongoing consolidation in the industry - resulting in the growth of large, complex, diversified banks - the FDIC's risk is increasingly located in a few large institutions. Added benefits resulting from a merger would be greater efficiency, including lower costs and reduced regulatory burden for approximately 850 institutions that hold deposits insured by both funds. The timing for a merger could not be better, given the current health of the bank and thrift industries and the condition of the funds. In short, a merger is unequivocally in the best interest of the American taxpayer.

Two, there is no magic number for a deposit insurance fund. The test of an insurance fund is not how it does in good times, but how it does in bad times. In 1981, the FDIC fund had a reserve ratio of 1.24 percent; that is to say, it had $1.24 for every $100 of insured deposits. In 1991 - ten years later - it had a reserve ratio of minus .36 percent. Today, the Bank Insurance Fund has a reserve ratio of 1.38 percent. Since 1991, the reserve ratio has varied 174 basis points.

How large should a deposit insurance fund be? Big enough to do the job.

History offers a cautionary tale in that regard. In the late 1940s, contemporary wisdom had it that a $1 billion fund was sufficient to cover almost any economic contingency. The FDIC rate assessment was - in effect - cut back. As a result, assessments on the banking industry were reduced $6.7 billion from what they otherwise would have been. It is interesting to note that in 1991 - at the height of the banking crisis - the BIF had a net worth of negative $7 billion, a shortfall almost the amount that had been credited to the industry.

As we learned in the late 80's, the deposit insurance funds stand between bank failures and the American taxpayer. In light of rapid change in the financial world, a strong insurance fund - one up to the job -- is of critical importance to all of us.

That is why we urged the Congress to exercise great caution in considering rebates -- my third point this morning. The Bank Insurance Fund reserve ratio has not grown in the last three years. While the amount of money in the funds has grown, the amount of deposits the insurance fund must cover has grown also. As a result, the reserve ratio I mentioned a moment ago -- $1.38 for every $100 in insured deposits - has remained unchanged since 1997.

Deposit growth can affect the strength of the deposit insurance funds significantly. Deposits fluctuate - sometimes greatly. Fluctuations can occur from economic downturns, or from events -- for example, if an investment bank were to channel billions of dollars into insured accounts. Losses fluctuate greatly, too. Failures last year will cost the BIF around $1 billion, and the fund finished 1999 smaller than it was at the end of 1998 - the first decline since 1991. These losses were, for the most part, unexpected. We live in a volatile world. And while some banks are seeking rebates, it is important to note that more than nine out of ten banks and thrifts currently pay no insurance premiums.

If Congress decides to mandate rebates, despite the concerns, it should be done in the context of reforms that strengthen the banking system and strengthen the deposit insurance system - and that do not distort economic incentives.

Thank you, Madam Chairman and members of the Subcommittee. I look forward to your questions.