STATEMENT OF
DONNA TANOUE
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
ON
REGULATORY BURDEN RELIEF
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON BANKING AND FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES
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ROOM 2128, RAYBURN HOUSE OFFICE BUILDING

Chairman Roukema, Ranking Member Vento, and members of the Subcommittee, I appreciate the opportunity to present the views of the Federal Deposit Insurance Corporation on the draft bill to reduce unnecessary regulatory burden on banks and streamline the bank regulatory process. The FDIC shares your commitment to eliminating unnecessary regulatory burden while maintaining the protections established for consumers and the safety and soundness of financial institutions. In fact, the FDIC recently reviewed all 120 of its regulations and written statements of policy, with the goal of improving efficiency, reducing unnecessary costs, and eliminating inconsistencies and outmoded and duplicative requirements. As a result, the FDIC has rescinded or revised over 80 of our regulations and policy statements.

Two of the revisions deserve special mention. The FDIC recently consolidated virtually all of its application procedures for deposit insurance, branching and mergers into a single rule that takes effect October 1, 1998. This rule will make it easier for banks to determine the procedures they are required to follow. It will also reduce the amount of information that an institution must provide in applications. Most important, the rule will significantly expedite processing of filings made by well-managed, well-capitalized institutions. Currently, filings by over 90 percent of depository institutions would qualify for expedited processing.

Also, the FDIC has proposed revising regulations governing the investments of insured state banks and savings associations. Currently, a state bank must submit an application and wait for approval before it makes an investment prohibited for a national bank or its subsidiaries. Under the proposal, a qualified bank could file a notice with the FDIC of its intention to invest in real estate or equity securities, if state law permits the investment. An application would no longer be required. Absent FDIC objection within 30 days, the bank could make the investment, provided it did so through a subsidiary, subject to certain firewalls and limits on the amount of investment. I expect the FDIC to act on the final version of the regulation soon.

The FDIC supports many of the provisions in the discussion draft of legislation proposed by Chairman Roukema. However, we do have concerns about a few provisions. In

general, I will focus my comments on those issues that we find especially significant and will discuss an additional initiative that we urge the sponsors to add to the draft bill. More specifically, my first two points address issues that affect the role of the FDIC as deposit insurer. My remaining comments concern issues that affect the FDIC as a bank supervisor and receiver of failed institutions.

DEPOSIT INSURANCE FUNDS ISSUES

The provision in the draft bill requiring the FDIC to make payments from the funds to the Financing Corporation (FICO) and a related provision in the Deposit Insurance Funds Act of 1996 (the Funds Act) that creates a special reserve in the Savings Association Insurance Fund (SAIF) directly affect the deposit insurance funds. Any laws affecting the deposit insurance funds must be carefully considered. The deposit insurance system in the United States, by most measures, has worked very well. As problems have been identified, Congress has moved to correct them. In most cases, changes have been made within the context of a reasoned evaluation of their effect on the overall deposit insurance system. A piecemeal approach to changing the system runs the very real danger of unintentionally unsettling the delicate balance that has been achieved.

Financing Corporation Payments

When the FDIC became responsible for insuring deposits of savings associations, it also became responsible for collecting and forwarding interest payments due on bonds issued during 1987 - 1989 to fund the Federal Savings and Loan Insurance Corporation (FSLIC). The original mechanism for collecting interest for FICO was to give this obligation a first call on assessments collected from members of the SAIF. The Funds Act addressed many of the problems created by this situation - the largest being the undercapitalization of the SAIF due to a diversion of premiums to other sources, including FICO. The Funds Act repealed the FICO claim on deposit insurance assessments and gave FICO its own assessment authority.

The draft bill would change this funding scheme by requiring the FDIC to make payments from the deposit insurance funds to FICO under certain conditions (§103). For several reasons, the FDIC strongly opposes this proposed requirement. While the FICO obligations were incurred to meet depositor claims on the FSLIC, they are not obligations of the deposit insurance funds. FICO has its own assessment authority, separate from the FDIC’s deposit insurance assessment authority, to fund interest payments to FICO bondholders. Tapping the deposit insurance funds to pay an obligation that currently falls on insured banks and thrifts would divert funds intended for deposit insurance to another purpose. While the diversion in this case is relatively small, using the deposit insurance funds’ resources for such purposes makes it much more difficult to argue against using the funds’ resources to pay for other programs unrelated to depositor protection.

Second, it should be noted that diverting deposit insurance resources to pay FICO interest is really no more than giving a deposit insurance rebate to the banks. Because of the extraordinary health of the banking industry, the deposit insurance funds are currently above the designated reserve ratio (DRR). Although it may be very tempting to use deposit insurance funds for other purposes, including rebates, at this time, there is no guarantee that either banks or the economy will always be so healthy, particularly given the age of the current economic expansion. Any consideration of rebates should not be made in a piecemeal fashion, but should be part of an overall assessment of deposit insurance premiums and the risks faced by the deposit insurance system. Moreover, given the uncertain effects of the current economic difficulties in many Asian economies and the Year 2000 problem, and the challenges posed to the insurance funds by newly created very large banks, it seems imprudent to direct resources from the deposit insurance funds at this time.

Elimination of the SAIF Special Reserve

Another provision of the Funds Act requires the creation of the SAIF Special Reserve. The FDIC strongly urges the Subcommittee to include language in the draft bill that would repeal this provision. The Special Reserve should be eliminated because it could lead to an assessment rate disparity.

Under the Funds Act, on January 1, 1999, the FDIC must set aside all SAIF funds above the 1.25 DRR in a Special Reserve. The Special Reserve was created as a budget scoring mechanism, not for policy reasons. It can be drawn upon only if the SAIF reserve ratio falls below 50 percent of the DRR and is expected to remain below 50 percent of the DRR for a year. While the creation of the SAIF Special Reserve had a positive budgetary impact in 1996, repealing it today would have no adverse budgetary consequences.

Creating the Special Reserve, however, could lead to an assessment rate disparity between the SAIF and the Bank Insurance Fund (BIF), thus recreating the very same circumstances that the Funds Act was designed to eliminate. Currently, the SAIF reserve ratio is 1.36 percent of insured deposits. FDIC staff estimates that on December 31, 1998, the SAIF reserve ratio will be between 1.37 and 1.45 percent, which would create a Special Reserve of between $884 million and $1.35 billion and reduce the SAIF’s reserve ratio on January 1, 1999, to 1.25 percent. Since the funds in the Special Reserve will remain available to the SAIF, the practical effect of the Special Reserve is to artificially set the SAIF’s reserve ratio below its true level. On the other hand, the BIF reserve ratio will remain at its actual value, which the FDIC expects will be above its current level of 1.37 percent on January 1, 1999.

In the event of unanticipated bank and savings association failures or faster than expected growth in insured deposits after January 1, 1999, the SAIF’s reserve ratio would likely drop below the DRR before the BIF’s, since the SAIF would be starting at the lower level of 1.25. When a fund’s reserve ratio drops below the DRR, the FDIC is required to increase deposit insurance assessments to restore the fund’s reserve ratio

to the DRR. Thus, the FDIC most likely would be required to raise SAIF assessments before instituting a comparable increase in the BIF rates, creating a rate disparity between the two funds. This disparity in assessment rates could arise even though the actual amount of funds available to support the SAIF, which would include the Special Reserve, might exceed that necessary to meet the DRR.

Differences in deposit insurance assessments among institutions should be based upon differences in risk posed to the insurance funds, not upon artificial distinctions. Our recent experience with different assessment rates for BIF and SAIF-insured deposits and the resulting deposit shifting by institutions provides an example of the kind of market distortion that can occur when regulation imposes artificial distinctions on insured depository institutions. The SAIF Special Reserve could recreate the problem of rate disparity that was solved by the Funds Act.

BANK SUPERVISION AND RECEIVERSHIP ISSUES

Codification of a Federal Examination Privilege

Currently, no federal privilege protects confidential information that banks provide banking regulators. Recently, a federal court held that banks waive their attorney-client and work-product privileges when they disclose information to banking regulators. As a result, an increasing number of banks are reluctant to share confidential information with their banking regulators. The FDIC strongly supports the draft bill's provisions providing that banks do not waive existing privileges when they respond to examiners' requests (§501). The draft bill would help preserve the cooperative, non-adversarial exchange of information between supervised institutions and their examiners that is critical to the examination process.

The FDIC also strongly supports the draft bill's provisions codifying the bank examination privilege, extending the privilege to cover information collected by examiners and allowing the federal banking regulators to prescribe regulations to control access to confidential supervisory information. The banking agencies have received thousands of subpoenas from litigants seeking confidential supervisory information. Some federal courts, and a few state statutes, recognize a bank examination privilege that protects bank examiners' analyses under certain circumstances, but recent court decisions have eroded this privilege. The draft bill provides that litigants must seek supervisory information solely from banking regulators and first request the information through regulatory procedures before seeking to compel its production in court. These provisions will relieve the courts of the burden of addressing all such requests and give the federal bank regulatory agencies the opportunity to balance the requester's need for information against the need for confidentiality.

Bank Merger Act

The draft bill (§310) would eliminate the requirement that merging banks, owned by the same holding company, file a Bank Merger Act (BMA) application with the responsible agency (the banking agency that regulates the acquiring, assuming or resulting institution). Instead, the responsible agency would receive only a notice of the proposed merger, which could come as late as 10 days before its consummation. As currently drafted, the draft bill could also be interpreted to eliminate a BMA application when two bank holding companies and their respective subsidiary banks merge as part of a related series of transactions.

The FDIC opposes section 310 of the draft bill since it is a move in the wrong direction -- it dilutes the role of the responsible agency in bank mergers and may not reduce regulatory burden. In cases where two bank holding companies and their respective subsidiary banks merge virtually simultaneously, the draft bill could limit the role of the responsible agency -- only the Federal Reserve as the holding company regulator would routinely review the overall plan, unless the responsible agency requests an application in response to the 10-day notice. The BMA, however, gives primary authority over bank mergers to the regulatory agency that is primarily responsible for -- and, thus, most familiar with -- the resulting or assuming institution, including its Community Reinvestment Act (CRA) compliance. This authority should be preserved. The holding company supervisor is less familiar with the resulting bank and, in many cases, would not be responsible for supervising it.

Presently, no agency reviews mergers of already affiliated banks under the Bank Holding Company Act (BHCA), although they are reviewed under the BMA. Therefore, under section 310 of the draft bill, when two affiliated banks propose to merge, unless the responsible agency requests an application, no agency would consider the proposed merger under the BMA or BHCA. In addition, there would be no notice and public comment on the merger or CRA review. If, on the other hand, the responsible agency requires an application, the merging banks would file an application as required by existing law, resulting in no reduction in regulatory burden. And, the merging banks would not know with certainty beforehand whether an application would be required.

Interest on Demand Deposits

The FDIC supports the provisions of the draft bill that will allow banks to pay interest on demand deposits (§102). The prohibition against paying interest on demand deposits is antiquated and no longer serves a useful purpose.

In the 1930s, Congress provided for interest rate ceilings on time and savings deposits and enacted the current prohibition against banks paying interest on demand deposits. At the time, two principal arguments were made for controlling the cost of deposits. The first was that deposit competition had the potential to destabilize the banking system. The second was that money center banks would draw deposits from rural communities and divert funds from productive agrarian uses to stock speculation.

Whatever validity these arguments may have had then, they have little today. Congress has removed all the depression-era bank price controls except the prohibition on paying interest on demand deposits. Removing the last of these controls should not threaten the stability of the banking system. First, banks should be able to manage additional costs that might result from this legislative change. Some banks already provide nonpecuniary compensation to businesses for demand deposits through "free" or discounted services or lower interest rates on loans for which they hold compensating demand deposit balances. Banks that begin paying interest on their commercial demand deposits may charge explicitly for services they now provide free or at a discount. Banks and their customers now spend time and money circumventing the prohibition against the payment of interest on demand deposits by, for instance, setting up interest-bearing sweep accounts. Eliminating the prohibition should reduce or eliminate these expenses.

Second, not all demand deposit accounts will necessarily pay interest. Many consumers, for a variety of reasons, presently choose to hold non-interest-bearing demand deposits rather than interest-bearing NOW accounts. Instead of receiving interest, customers with these accounts may receive other benefits, such as returned canceled checks, lower minimum balance requirements, lower service charges, including lower per check charges, or a package of other banking services.

Finally, banks already pay interest on demand-like deposits without threatening the stability of the banking system. Interest-bearing sweep accounts, for example, function as demand deposits for businesses. Interest-bearing NOW accounts function much like demand deposits for consumers, nonprofit groups, and governmental units.

The FDIC believes that the more limited revisions made in the "alternative" §102 proposals are not required. There is no reason to postpone the effective date of the repeal of the prohibition for six years. In our view, the industry does not need more time to prepare for a change. Also, the draft legislation's proposal to permit depositors to make up to 24 transfers per month among their accounts at an institution is an unnecessary compromise.

Interest on Claims in Receiverships

The FDIC supports the provision in the draft legislation (§308) that will clarify our authority to promulgate a regulation establishing the interest rate that a receiver will pay for interest that accrues after the receiver's appointment and establishing the payment priority of this post-insolvency interest.

After paying the principal amount of all claims against the receivership estate of a failed insured depository institution, other than the claims of equity holders, a receiver may have funds remaining to pay accrued interest on the non-equity claims. Neither the Federal Deposit Insurance Act (FDIA), the National Bank Act, nor the statutes of most states address the interest rate that accrues after a receiver's appointment. Also, these statutes generally do not address the priority in which the receiver should pay this

interest. State statutes that do address post-insolvency interest vary greatly, resulting in disparate treatment of receivership creditors from state to state.

In the past few years, an increasing number of FDIC-administered receiverships have had sufficient assets to make some post-insolvency interest distributions. This trend may continue because the prompt corrective action requirements of the FDIA can result in institutions being placed in receivership before their capital is depleted. Institutions closed because of a liquidity crisis -- rather than because they are balance-sheet insolvent -- may also have sufficient assets to pay post-insolvency interest.

A uniform interest rate and distribution priority for all receiverships would benefit the receiver, receivership creditors, and equity holders. A federal regulation would treat similarly situated creditors in bank failures equally by eliminating existing discrepancies in distributions on the basis of an institution's location.

Judicial Review of Conservatorship and Receivership Appointments

The FDIC supports the provision in the draft legislation (§304) that would shorten the time period during which the appointment of the FDIC as conservator or receiver of a failed insured depository institution can be challenged. Current law permits judicial review of the FDIC's appointment for as long as six years in certain cases. While we support a reasonable period of time for judicial review, the process of resolving failed institutions should not be compromised by the possibility of a challenge, several years after the fact, to the FDIC's appointment as conservator or receiver.

Call Report Simplification

The FDIC supports the draft legislation's intent to achieve call report simplification (§302). In fact, the banking agencies have already made significant progress along the lines included in the draft bill. For example, all insured depository institutions now file call reports electronically. The FDIC has made all major categories of call report information available to the public electronically via its website. Also, under the auspices of the Federal Financial Institutions Examination Council (FFIEC), the banking agencies are developing a simplified, less burdensome "core report" that would be filed by banks, bank holding companies and savings associations in place of the existing call report. However, the FFIEC may postpone the implementation of the core report to allow depository institutions to focus more resources on the Year 2000 problem.

It is worth noting that changes in the industry have affected the availability of information that bank regulators need. For example, banks and thrifts, including those with multi-state operations, report financial results based on their main-office location, regardless of the location of their branches and customers. With more and larger institutions operating on an interstate basis, bank call reports and thrift financial reports fail to give regulators an accurate picture of where loans are actually being made. Thus, regulators are finding it much more difficult to identify regional lending patterns, diminishing their ability to assess geographic concentrations in interstate bank portfolios. Although

changes to the call report can be burdensome for banks, some adjustments may be necessary to allow bank regulators to gather the information that we need to do our jobs effectively. The banking agencies will continue to work together through the FFIEC to assure that any necessary changes are minimized.

Deposit Brokers

Section 29A of the FDIA prohibits a deposit broker from soliciting or placing any deposits with insured depository institutions unless the deposit broker has notified the FDIC in writing that it is a deposit broker. The FDIC supports the draft bill's repeal (§309) of the notification requirement contained in FDIA section 29A. The notification requirement serves little useful supervisory purpose and may actually confuse consumers.

The FDIC can and does obtain sufficient information on brokered deposits through onsite examinations and offsite surveillance. During safety and soundness examinations, the FDIC thoroughly reviews liquidity and funding sources, including brokered deposits, for every institution it supervises. In addition, banks must report brokered deposits on call reports submitted to the regulatory agencies. The FDIC also closely monitors deposit growth. The FDIC and the other bank regulatory agencies can curtail the use of brokered deposits effectively when necessary, through formal and informal enforcement actions, including informal agreements, prompt corrective action and cease-and-desist orders.

Although a deposit broker must notify the FDIC that it is in the business of deposit brokerage, the FDIC cannot reject a notice and has no explicit enforcement powers over deposit brokers generally. Nevertheless, deposit brokers frequently state that they are "registered" with the FDIC. These statements can easily deceive consumers, who tend to associate the FDIC with the safety of their funds.

CONCLUSION

The FDIC supports the Subcommittee's continued efforts to reduce unnecessary burden on insured depository institutions without compromising safety and soundness or consumer protection. We continually strive for more efficiency in the regulatory process and are pleased to work with the Subcommittee in accomplishing this goal.

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