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TESTIMONY OF

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FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

ON

THE CONDITION OF THE SAVINGS ASSOCIATION INSURANCE FUND

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND
URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

10:00 A.M.
JULY 2, 1992
ROOM 2128, RAYBURN HOUSE OFFICE BUILDING

Mr. Chairman and members of the Committee, I appreciate the opportunity to testify today on the condition of the Savings Association Insurance Fund. My presentation will cover the current condition of the Savings Association Insurance Fund, the outlook for the Fund, and the proposed increase in assessment rates for all Savings Association Insurance Fund-member institutions.

BACKGROUND

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) abolished the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Home Loan Bank Board (FHLBB). Their functions were transferred to the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), the Federal Housing Finance Board and the Resolution Trust Corporation (RTC). Under FIRREA, the FDIC became the administrator of two separate and distinct insurance funds: the Bank Insurance Fund (formerly the Deposit Insurance Fund) which insures the deposits of all Bank Insurance Fund-member banks, and the Savings Association Insurance Fund (SAIF) which insures the deposits of all member savings associations (formerly a function of the FSLIC). Both insurance funds are maintained separately to carry out their respective legislative mandates, with no commingling of assets or liabilities. The FSLIC Resolution Fund, a third separate fund under FDIC management, and the RTC replaced the FSLIC in case resolution activities. The FSLIC Resolution Fund is funded through congressional appropriations, asset sales, and assessment income from SAIF-member premiums (through calendar year 1992). The FSLIC Resolution Fund will complete the resolution of all thrifts that failed or were assisted before January 1, 1989; the RTC will resolve all troubled thrift cases that occur from January 1, 1989 through September 30, 1993, after which the Savings Association Insurance Fund will begin resolving cases.

Current Condition of the Savings Association Insurance Fund

Attachment 1 is the 1991 audited financial statement for SAIF. The Fund's income and expenses have been limited during the interim period in which the RTC is responsible for the clean-up of non-viable thrifts. SAIF-member assessment revenue totaled about $1.8 billion in 1991; however, all assessment revenue from SAIF-member institutions is collected by the Federal Home Loan Bank of Des Moines and diverted to the Financing Corporation (FICO) and the FSLIC Resolution Fund. Currently, only assessment income generated from Bank Insurance Fund-member institutions that acquired thrifts under section 5(d)(3) of the Federal Deposit Insurance Act, is deposited in the SAIF. For 1991, this assessment income was approximately $87 million.

As mentioned above, the RTC is expected to cover the caseload of thrifts requiring federal intervention, and therefore cover the losses resulting from such resolutions through September 30, 1993. Additionally, for 1991 and through September 30, 1992, administrative and supervisory expenses incurred by the SAIF are the funding responsibility of the FSLIC Resolution Fund. Consequently, there are limited demands on the SAIF throughout this time period.

The Savings Association Insurance Fund balance will end 1992 in a positive position due to the inflow of assessments from conversion transactions under section 5(d)(3) of the FDI Act. Total assessment revenue will approximate $200 million until year-end 1992. While the FSLIC Resolution Fund's claim on SAIF expires at year-end, the Financing Corporation's draw as a means of funding the interest payments on FICO bonds will continue until the year 2017. This will impede the Fund's growth toward the designated reserve ratio targets.

The Outlook for the Savings Association Insurance Fund

The recently disclosed first quarter 1992 profitability results for the thrift industry are encouraging, particularly given the gloom of the past decade. However, the thrift industry overhang, caused by the lack of funding for the RTC, gives us concern. Lacking adequate funds, the RTC is unable to meet the responsibilities assigned to it under FIRREA. This will make it difficult, if not impossible, for the Office of Thrift Supervision (OTS) to deliver even a relatively clean thrift industry to the FDIC in October 1993. As you know, FIRREA envisioned SAIF as a new fund -- unburdened by the record failures assigned to the RTC for resolution.

Even if all thrift institutions identified as non-viable by the OTS are placed into conservatorship with the RTC by the time the SAIF assumes resolution authority on October 1, 1993, future developments cannot always be foreseen. Tremendous uncertainty exists concerning expected thrift failure rates. The only certainty regarding future thrift failures is that there will be insurance losses to the SAIF. As a consequence, near term insurance losses resulting from resolutions of failed institutions may place an immediate demand on the SAIF beginning October 1993. Therefore, by not providing funding for the RTC now, the inevitable is just delayed to a later date.

Going forward, assessment revenue will be the primary source of funding for the SAIF. Although average annual total assessment revenue is projected to be approximately $2.6 billion for 1993 through 1997, the obligation to the Financing Corporation will continue to draw approximately $800 million annually, leaving the fund with an annual net of approximately

$1.8 billion. Given the outlook for demands on the Fund, assessment revenue alone will be insufficient to meet these needs.

In addition to assessment revenue, there are, however, other prescribed funding sources for the SAIF. To ensure sufficient capital for the Fund, two types of Treasury supplements were mandated by FIRREA: revenue supplements, intended to ensure annual revenue of $2 billion from assessments for fiscal years 1993 through 2000, and net worth supplements, to ensure that the fund maintains a minimum net worth balance. FIRREA, as amended, requires that the minimum net worth begins at at least a zero balance for the year beginning October 1, 1991, and increases to $8.8 billion for the fiscal year beginning October 1, 1999. Neither of these two sources of funding from the Treasury has been utilized yet. Both supplements are scheduled to require action as a budget item for fiscal year 1993, but were not requested in the Administration's budget for 1992 or 1993.

FIRREA also authorizes the SAIF to obtain working capital by borrowing funds from the Federal Financing Bank, the Treasury, and the Federal Home Loan Bank. Finally, FIRREA allows for discretionary payments to be made to the SAIF by the Resolution Trust Corporation, but this seems highly improbable given the lack of funding currently available to the RTC.

Section 211 of FIRREA established a designated reserve ratio for the SAIF of 1.25 percent of insured deposits. The Omnibus Budget Reconciliation Act of 1990 specified that the reserve ratio be achieved within a reasonable amount of time. As noted above, the SAIF is currently well below the designated reserve ratio. Based on the level of year-end 1991 insured deposits, the Fund would need approximately $9.5 billion to meet the designated reserve ratio. To illustrate what it will take to meet the ratio, given that the Financing Corporation will continue to draw roughly $800 million annually from SAIF-member assessment income, it would take eight years for the Fund to recapitalize if the only source of revenue were assessments at the current assessment rate of 23 basis points, and if there were no insurance losses to the fund.

Unfortunately, even under the most optimistic circumstances, SAIF-insured institutions will continue to fail, after the FDIC assumes resolution responsibility for failed thrifts on October 1, 1993. It is uncertain what the demands on the Fund will be at that time, and as a result, it is unclear when the designated reserve ratio will be reached.

Proposed Premium Increase

In May 1992, the FDIC's Board of Directors voted to propose an increase in the SAIF assessment from the current 23 cents to 28 cents per $100 of assessable deposits, effective January 1, 1993. Our proposed regulation is found in Attachment 2. The increase in the premium is proposed for two reasons. First, as explained earlier in my testimony, while FIRREA established the mandated 1.25 percent reserve ratio, the Omnibus Budget Reconciliation Act of 1990 specified that this recapitalization be achieved within a reasonable amount of time. Since the FDIC is ultimately responsible for insuring an $800 billion thrift industry, we need at least $10 billion in income to eventually reach the 1.25 percent target reserve ratio. While the exact time permitted for recapitalization is not stated, the FDIC intends to set assessment rates in order to reach that goal as soon as feasible without unduly burdening the thrift industry or causing credit crunch problems.

The reduction of assessment revenue available to the SAIF as a result of the Financing Corporation's continuing draw on the Fund increases the length of time required to recapitalize the SAIF. Although the statute requires the Treasury to provide sufficient funding for the SAIF, the FDIC views that statutory obligation as contingent upon the thrift industry's inability to recapitalize its insurance fund.

Mr. Chairman, the FDIC is prepared to begin resolving failed SAIF-insured thrifts beginning on October 1, 1993. It is our hope, that by virtue of continued RTC funding, we will inherit responsibility for insuring the deposits of a healthy thrift industry. This will ease the transition from RTC to FDIC and greatly reduce the need for taxpayer funds to operate and recapitalize the SAIF.

FEDERAL DEPOSIT INSURANCE CORPORATION
SAVINGS ASSOCIATION INSURANCE FUND
STATEMENTS OF FINANCIAL POSITION
(dollars in thousands)

	December 31	
	1991	**1990**
Assets		
Cash and cash equivalents, including restricted amounts of $56,119 for 1991 and $12,964 for 1990 (Note 3)	$ 56,681	$ 16,535
Entrance and exit fees receivable, net (Note 4)	91,015	49,384
Due from the FSLIC Resolution Fund (Note 11)	109,561	17,010
Other assets	745	626
	258,002	**83,555**
Liabilities and the Fund Balance		
Accounts payable, accrued and other liabilities	3,428	4,100
Due to the Bank Insurance Fund (Note 5)	20,723	-0-
Total Liabilities	24,151	4,100
SAIF-member exit fees and investment proceeds held in reserve (Note 4)	146,693	62,454
Fund Balance	87,158	17,001
	$ 258,002	**$ 83,555**

The accompanying notes are an integral part of these financial statements.

FEDERAL DEPOSIT INSURANCE CORPORATION
SAVINGS ASSOCIATION INSURANCE FUND
STATEMENTS OF INCOME AND THE FUND BALANCE
(dollars in thousands)

	For the Year Ended December 31	
	1991	1990
Revenue		
Assessments earned (Note 11)	$ 87,964	$ 16,999
Entrance fee revenue (Note 4)	8	-0-
Interest income	2,908	-0-
	90,880	16,999
Expenses and Losses		
Administrative expenses	42,362	56,088
Provision for losses (Note 5)	20,114	-0-
Interest expense (Note 5)	609	-0-
	63,085	56,088
Net Income (Loss) before Funding Transfer	27,795	(39,089)
Funding Transfer from the FSLIC Resolution Fund (Note 1)	42,362	56,088
Net Income	70,157	16,999
Fund Balance - Beginning	17,001	2
Fund Balance - Ending	$ 87,158	$ 17,001

The accompanying notes are an integral part of these financial statements.

FEDERAL DEPOSIT INSURANCE CORPORATION
SAVINGS ASSOCIATION INSURANCE FUND
STATEMENTS OF CASH FLOWS
(dollars in thousands)

	For the Year Ended December 31	
	1991	**1990**
Cash Flows From Operating Activities		
Cash inflows from:		
Administrative expenses funded by the FSLIC Resolution Fund (Note 1)	$ 40,650	$ 56,088
Entrance and exit fee collections (Note 4)	40,868	12,961
Interest on U.S. Treasury obligations	2,207	5
Cash outflows for:		
Transition assessment payment transferred to the FSLIC Resolution Fund (Note 6)	-0-	120
Administrative expenses (Note 1)	43,579	52,399
Net Cash Provided By Operating Activities (Note 10)	**40,146**	**16,535**
Cash and Cash Equivalents - Beginning	**16,535**	**-0-**
Cash and Cash Equivalents - Ending	**$ 56,681**	**$ 16,535**

The accompanying notes are an integral part of these financial statements.

NOTES TO THE SAVINGS ASSOCIATION INSURANCE FUND FINANCIAL STATEMENTS

DECEMBER 31, 1991 and 1990

1. Legislative History and Reform

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to reform, recapitalize and consolidate the federal deposit insurance system. FIRREA designated the Federal Deposit Insurance Corporation (FDIC) as administrator of the Bank Insurance Fund (BIF), which insures the deposits of all BIF-member institutions (normally commercial banks), and the Savings Association Insurance Fund (SAIF), which insures the deposits of all SAIF-member institutions (normally thrifts). Both insurance funds are maintained separately to carry out their respective mandates. The FDIC also administers the FSLIC Resolution Fund (FRF) which is responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC).

FIRREA created the Resolution Trust Corporation (RTC), which manages and resolves all thrifts previously insured by the FSLIC for which a conservator or receiver is appointed during the period January 1, 1989 through August 8, 1992. The Resolution Trust Corporation Refinancing, Restructuring and Improvement Act of 1991 (1991 RTC Act) extended the RTC's general resolution authority through September 30, 1993, and beyond that date for those institutions previously placed under RTC control.

The Resolution Funding Corporation (REFCORP) was established by FIRREA to provide funds to the RTC for use in the thrift industry bailout. The Financing Corporation (FICO), established under the Competitive Equality Banking Act of 1987, is a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the FSLIC. However, effective December 12, 1991, as provided by the Resolution Trust Corporation Thrift Depositor Protection Reform Act of 1991, the FICO's authority to issue obligations as a means of financing for the FRF was terminated.

The Omnibus Budget Reconciliation Act of 1990 removed caps on assessment rate increases and allowed for semiannual rate increases. In addition, this Act permitted the FDIC, on behalf of the BIF and SAIF, to borrow from the Federal Financing Bank (FFB) on terms and conditions determined by the FFB.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (1991 Act) was enacted to further strengthen the FDIC. The FDIC's authority to borrow from the U.S. Treasury was increased from $5 billion to $30 billion. However, the FDIC cannot incur any additional obligation for the BIF or the SAIF if the amount of obligations in the respective Fund would exceed the sum of: 1) its cash and cash equivalents; 2) the amount equal to 90 percent of the fair-market value of its other assets; and 3) its portion of the total amount authorized to be borrowed from the U.S. Treasury (excluding FFB borrowings).

As required by the 1991 Act, U.S. Treasury borrowings are to be repaid from assessment revenues. The FDIC must provide the U.S. Treasury a repayment schedule demonstrating that future assessment revenues are adequate to repay principal borrowed and pay interest due. In addition, the FDIC now has authority to increase assessment rates more frequently than semiannually and impose emergency special assessments as necessary to ensure that funds are available for these payments.

Operations of the SAIF. The primary purpose of the SAIF is to insure the deposits and to protect the depositors of insured savings associations. In this capacity, the SAIF currently has financial responsibility for: 1) all federally insured depository institutions that became members of the SAIF after August 8, 1989, for which RTC does not have resolution authority; and 2) all deposits insured by the SAIF which are held by BIF-member banks (so called "Oakar" banks, created pursuant to the "Oakar amendment" provisions found in Section 5(d)(3) of the FDI Act). After September 30, 1993, SAIF will assume financial responsibility for all SAIF-member depository institutions which had not previously been placed under the RTC's control.

The "Oakar amendment" provisions referred to above allow, with approval of the appropriate federal regulatory authority, any insured depository institution to merge, consolidate, or transfer the assets and liabilities of an acquired institution(s) without changing insurance coverage for the acquired deposits. Such acquired deposits continue to be either SAIF-insured deposits and assessed at the SAIF assessment rate or BIF-insured deposits and assessed at the BIF assessment rate. In addition, any losses resulting from the failure of these institutions are to be allocated between the BIF and SAIF based on the respective dollar amounts of the institution's BIF-insured and SAIF-insured deposits.

The SAIF is funded from the following sources: 1) Reimbursement by the FRF of administrative and supervisory expenses incurred between August 9, 1989 and September 30, 1992. These expenses have priority over other obligations of the FRF and funding is provided as expenses are recognized by the SAIF; 2) SAIF member assessments from "Oakar" banks; 3) SAIF assessments that are not required for the FICO, the REFCORP, or the FRF; 4) U.S. Treasury payments for the amount, if any, needed to supplement assessment revenue to reach a $2 billion level for each of the fiscal years 1993 through 2000; 5) U.S. Treasury payments for any additional amounts that may be necessary to ensure that the SAIF has a statutory specified minimum net worth for each of the fiscal years 1992 through 2000; 6) discretionary payments by the RTC; 7) Federal Home Loan Bank borrowings; and 8) U.S. Treasury and FFB borrowings.

2. Summary of Significant Accounting Policies

Assessment Revenue Recognition. FIRREA directed that the FICO, the REFCORP and the FRF have priority over the SAIF for receiving and utilizing SAIF-member assessments to ensure availability of funds for specific operational activities. Accordingly, the SAIF recognizes as assessment revenue only that portion of SAIF-member assessments not required by the FICO, the REFCORP or the FRF. Assessments on SAIF-insured deposits by "Oakar" banks are retained in the SAIF and, thus, are not subject to draws by the FICO, the REFCORP or the FRF (see Note 11).

Litigation Losses. The SAIF includes in current period expenses the change in the estimated loss from litigation against the SAIF. The FDIC Legal Division recommends these estimated losses on a case-by-case basis. As of December 31, 1991 and 1990, no litigation was pending against the SAIF.

Cost Allocations Among Funds. Operating expenses (including personnel, administrative and other indirect expenses) not directly charged to each Fund under the FDIC's management are allocated on the basis of the relative degree to which the expenses were incurred by the Funds.

The cost of furniture, fixtures and equipment purchased by the FDIC on behalf of the three Funds under its administration is allocated among these Funds on a pro rata basis. The SAIF expenses its share of these allocated costs at the time of acquisition because capitalizing these expenditures would not be cost-beneficial to the SAIF.

Related Parties. The nature of related parties and descriptions of related party transactions are disclosed throughout the financial statements and footnotes.

Restatement. A restatement was made to the 1990 financial statements regarding assessments paid on SAIF deposits by "Oakar" banks (see Note 11).

Reclassifications. Reclassifications have been made in the 1990 Financial Statements to conform to the presentation used in 1991.

3. Cash and Cash Equivalents

The SAIF considers cash equivalents to be short-term, highly liquid investments with original maturities of three months or less. Cash and cash equivalents as of December 31 consisted of the following (in thousands of dollars):

	1991	1990
Cash	$ 491	$ 6,241
Cash equivalents	56,190	10,294
	$ 56,681	$ 16,535

SAIF exit fees collected plus interest (See Note 4) comprise substantially all of the cash and cash equivalent balances and may only be used to meet SAIF's potential obligation to the FICO.

4. Entrance and Exit Fees

The SAIF will receive entrance and exit fees for conversion transactions in which an insured depository institution converts from the BIF to the SAIF (resulting in an entrance fee) or from the SAIF to the BIF (resulting in an exit fee). Interim regulations approved by the FDIC Board of Directors and published in the Federal Register on March 21, 1990, directed that exit fees paid to SAIF be held in a reserve account until the FDIC and the Secretary of the Treasury determine that it is no longer necessary to reserve such funds for the payment of interest on obligations previously issued by the FICO. It is the FDIC's policy to invest exit fee collections in overnight Treasury securities and hold the proceeds in reserve pending determination of ownership.

The SAIF records entrance fees as revenue after the BIF-to-SAIF conversion transaction is consummated. However, due to the requirement that SAIF exit fees be held in a reserve account, thereby restricting the SAIF's use of such proceeds, the SAIF does not recognize exit fees, nor any interest earned, as revenue. Instead, the SAIF recognizes the consummation of a SAIF-to-BIF conversion transaction by establishing a receivable from the institution and an identical reserve account to recognize the potential payment to the FICO. As exit fee proceeds are received, the receivable is reduced while the reserve remains pending the determination of funding requirements for interest payments on the FICO's obligations.

Within specified parameters, the interim regulations allow an acquiring institution to pay its entrance/exit fees due, interest free, in equal annual installments over a period of not more than five years. When an institution elects such a payment plan, the SAIF records the entrance or exit fee receivable at its present value. The discount rates (current value of funds) for 1991 and 1990 was 8% and 9%, respectively.

Entrance and Exit Fees Receivable as of December 31 consisted of the following (in thousands of dollars):

	1991	1990
Entrance Fees Receivable	$ 10	$ 2
Entrance Fees Collected	(10)	(2)
Exit Fees Receivable	159,510	71,525
Exit Fees Collected	(53,358)	(12,991)
Unamortized Discount	(15,137)	(9,150)
	$ 91,015	$ 49,384

5. Due to the Bank Insurance Fund

On September 19, 1991, Southeast Bank, N.A., Miami, Florida which held deposits insured by BIF and SAIF pursuant to the "Oakar amendment" provisions (as explained in Note 1), was closed by its chartering authority. The BIF, which provided the funds and administers the resolution of Southeast Bank, N. A., has estimated the loss for the failure of Southeast Bank, N.A., and its affiliate Southeast Bank of West Florida, Pensacola, at $178 million, of which SAIF has responsibility for $21 million (its allocated share of the loss incurred). Accordingly, the SAIF has established a payable to the BIF for its estimated transaction cost. In addition, interest will accrue on the SAIF's obligation based on the quarterly FFB borrowing rate. During 1991 this rate ranged between 4.7% and 5.9%.

6. Assessments

Assessment Rate. The rate set for 1991 is 0.23 percent (23 cents per $100 of domestic deposits). Based on the present and projected status of the SAIF, and anticipated expenses and revenue for the next year, the ratio of the deposit insurance fund to insured deposits is not expected to exceed the current designated reserve ratio of 1.25 percent.

Transition Assessment. In September 1989, the FDIC allowed for a one-time transition assessment against SAIF members. A portion of this special assessment was claimed by the FICO for debt servicing needs and the remaining amount was allocated to the FRF. The $120,000 in interest remaining to be transferred to the FRF as of December 31, 1989, was paid in 1990.

Secondary Reserve Offset. The FDI Act authorizes insured savings associations to offset against any assessment premiums their pro rata share of amounts that were previously part of the FSLIC's "Secondary Reserve". The secondary reserve represented premium prepayments that insured savings institutions were required by law to deposit with the FSLIC during the period 1961 through 1973 to quickly increase FSLIC's insurance reserves to absorb losses if the regular assessments were insufficient. The allowable offset is limited to a maximum of 20 percent of an institution's remaining pro rata share for any calendar year beginning before 1993. After calendar year 1992, there is no limitation on the remaining offset amount.

The Secondary Reserve offset serves to reduce the gross SAIF-member assessments due (excluding assessments from "Oakar" banks), thereby reducing the assessment premiums available to the FICO, the REFCORP, the FRF and the SAIF. The remaining Secondary Reserve balance was $297,761,164 and $359,121,134 at year end 1991 and 1990, respectively.

1991 and 1990 assessments against SAIF members and "Oakar" banks were as follows (in thousands of dollars):

	1991	1990
SAIF assessments collected from SAIF members (net of Secondary Reserve offset and other adjustments/credits of $72,992 and $101,152 in 1991 and 1990)	$ 1,795,227	$ 1,811,443
SAIF assessments earned from "Oakar" banks	87,964	16,999
Total assessment earned from SAIF members and "Oakar" banks	1,883,191	1,828,442
Less: FICO assessment	(756,700)	(738,200)
REFCORP assessment	-0-	(1,061,495)
Funds recognized by the FRF	(1,038,527)	(11,748)
Funds owed to the SAIF	87,964	16,999

7. Pension Benefits, Savings Plans and Accrued Annual Leave

Eligible FDIC employees (i.e., all permanent and temporary employees with an appointment exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan integrated with the social security system in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees can also participate in a federally sponsored tax-deferred savings plan available to provide additional retirement benefits. The FERS is a three part plan consisting of a basic defined benefit plan which provides benefits based on years of creditable service and compensation levels, social security benefits and a tax-deferred savings plan. Further, automatic and matching employer contributions are provided up to specified amounts under the FERS. Eligible employees may participate in an FDIC sponsored tax-deferred savings plan with matching contributions. The SAIF pays the employer's portion of the related costs.

The SAIF's allocated share of pension benefits and savings plans expenses as of December 31, 1991 and 1990 consisted of the following (in thousands of dollars):

	1991	1990
Civil Service Retirement System	$ 771	$ 840
Federal Employee Retirement System (Basic Benefits)	1,303	1,187
FDIC Savings Plan	754	735
Federal Thrift Savings Plan	318	256
	$ 3,146	$ 3,018

The liability to employees for accrued annual leave is approximately $1,305,000 and $1,610,000 at December 31, 1991 and 1990, respectively.

Although the SAIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system, nor does it have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported and accounted for by the U.S. Office of Personnel Management.

8. FDIC Health, Dental and Life Insurance Plans for Retirees

The FDIC provides certain health, dental and life insurance coverage for its eligible retirees. Eligible retirees are those who have elected the FDIC's health and/or life insurance program and are entitled to an immediate annuity. The health insurance coverage is a comprehensive fee-for-service program underwritten by Blue Cross/Blue Shield of the National Capital Area, with hospital coverage and a major medical wrap-around; the dental care is underwritten by Connecticut General Insurance Company. The FDIC makes the same contributions for retirees as those for active employees. The FDIC benefit programs are fully insured. Effective January 1, 1991, the funding mechanism was changed to a "minimum premium funding arrangement". Fixed costs and expenses for claims are paid as incurred. Premiums are deposited for claims incurred but not reported. The premiums are held by the FDIC.

The life insurance program is underwritten by Metropolitan Life Insurance Company. The program provides for basic coverage at no cost and allows converting optional coverages to direct-pay plans with Metropolitan Life. The FDIC does not make any contributions towards annuitants' basic life insurance coverage; this charge is built into rates for active employees.

The SAIF's allocated share of retiree benefits provided as of December 31 are as follows (in thousands of dollars):

	1991	1990
Health premiums paid	$ 27	$ 41
Dental premiums paid	1	4

The Financial Accounting Standards Board has issued Statement of Financial Accounting Standard No. 106, (Employers' Accounting for Postretirement Benefits Other Than Pensions), which the FDIC is required to adopt by 1993. The standard requires companies to recognize postretirement benefits during the years employees are working and earning benefits for retirement. Resulting estimated expenses will be allocated to the SAIF based on the relative degree to which expenses were incurred. Although the impact of the FDIC's adoption of the standard cannot reasonably be estimated at this time, the standard may increase reported administrative costs and expenses of the SAIF.

9. Commitments

The SAIF is currently sharing in the FDIC's lease of office space. The SAIF's lease commitments for office space total $1,976,000 for future years. The agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The SAIF's recognized leased space expense of approximately $1,668,325 and $3,383,000 for the years ended December 31, 1991 and 1990, respectively.

The SAIF's allocated share of leased space fees for future years, which are committed per contractual agreement, are as follows (in thousands of dollars):

1992	1993	1994	1995	1996
$ 684	$ 552	$ 391	$ 208	$ 141

10. Supplementary Information Relating to the Statements of Cash Flows

Reconciliation of net income to net cash provided by operating activities for the year ended December 31, 1991 and 1990 (in thousands of dollars):

	1991	1990
Net Income	$ 70,157	$ 16,999
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in amount due from the FSLIC Resolution Fund	(92,551)	(17,010)
Increase in entrance and exit fees receivable	(41,630)	(46,231)
Decrease (increase) in other assets	(119)	1,527
Increase (decrease) in accounts payable, accrued and other liabilities	(673)	1,947
Increase in amount due to the Bank Insurance Fund	20,723	-0-
Increase in exit fees and investment proceeds held in reserve	84,239	59,303
Net cash provided by operating activities	**$ 40,146**	**$ 16,535**

11. Subsequent Event

On March 27, 1992, the FDIC's Legal Division rendered the opinion that, under FIRREA, assessments paid on SAIF-insured deposits by "Oakar" banks must be retained in the SAIF, and, thus, are not subject to draws by the FICO, the REFCORP or the FRF. As FIRREA became effective in August 1989, the financial statements for 1990 have been restated. FRF received the assessments paid on SAIF-insured deposits in 1990 and 1991, therefore the effect of this restatement was to establish a receivable from FRF and to recognize assessment revenue of $17 million in 1990. Additionally, in 1991, the receivable from FRF was increased by $91 million and assessment revenue of $88 million and interest revenue of $3 million were recognized. In April 1992, SAIF received $108 million from the FRF for the 1991 principal and interest receivables.

and would drop by about $2.872 million—to approximately $272.8 billion—if the average risk-related rate were 0.28 percent.[7]

For these projections, it was assumed that banks' dividend rates remained unchanged from those reported in December 1991. However, if a bank's projected equity capital was 4 percent or less, the bank was assumed to retain all earnings. It was further assumed that the only source of new capital would be additions to retained earings. Consequently, under an average risk-related rate of 0.28 percent the $5,765 million in increased assessment costs projected over the next five years resulted in a $2,872 million decline in capital and a $1,582 million total reduction in dividends. The remaining portion of the assessment costs were offset by the tax benefit of deducting assessment expenses from taxable income.

Equally important to these overall reductions in industry capital is the distribution of these reductions across banks. Projections of individual banks' tangible capitalization through 1996 indicated a small increase in the number of poorly capitalized banks under the proposed assessment rates. During 1996, an average risk-related assessment of 0.28 percent was projected to raise the number of poorly capitalized banks—those with less than 3 percent tangible capital—by 28 banks (with average tangible assets of $325 million).

Long-term changes in profitability. If higher assessments result in a long-term reduction in bank profitability, capital will flow out of the banking industry, by way of lower retained earnings and a reduction in new stock offerings. If the flight of capital is substantial, it would result in shrinkage of the industry and have implications for credit availability.

In order to assess the impact of higher assessments upon bank profitability, estimates were made of the changes in returns on the book value of equity capital which might result under an average risk-related assessment rate of 0.28 percent. Specifically, banks' 1991 returns on book value equity capital were adjusted to reflect the increase in operating costs (after-taxes) which might result from increased assessment rates. These adjustments assumed that banks would bear the full after-tax cost of the assessment increase.

The analysis indicates that an increase in the BIF assessment rate to an average risk-related rate of 0.28 percent would reduce bank profitability slightly. Estimates presented in Table 2 (below) show that approximately 76.3 percent of BIF-insured banks, with 60 percent of industry assets, experienced at 0 to 5 percent reduction in their return on equity. In addition, 12.1 percent of BIF-insured banks with 18.3 percent of industry assets were estimated to incur a 5 to 10 percent reduction in return on equity. The median percentage change in return on equity was −2.56 percent.

While it is difficult to estimate the final impact upon industry capital, a moderate amount of industry shrinkage (relative to a situation without higher assessments) may result. Consolidation in the banking industry can occur, however, without increased bank failures. Indeed, the results of this analysis indicate that the impact of the proposed assessment rate increase upon bank earnings and capital will not be so severe as to result in a substantial increase in bank failures.

TABLE 2.—PERCENTAGE CHANGES IN RETURN ON EQUITY BASED UPON THE PROPOSED RISK-RELATED ASSESSMENT SCHEDULE AVERAGE RATE OF 0.28 PERCENT

[BIF-Insured Banks, $ Millions]

Percentage change in ROE [1]	Number	Assets
Below −50%	272	$209,822
−25% to −50%	263	161,723
−15% to −25%	389	265,931
−10% to −15%	465	147,751
−5% to −10%	1,484	665,279
0% to −5%	9,378	2,179,311
Missing data	37	4,495
All	12,288	3,634,312

[1] The percentage change in ROE was defined as the adjusted ROE minus the original ROE, divided by the original ROE, (ROE'−ROE)/ROE.

IV. Comment Period

The Board hereby requests comments on the proposed rule. Interested persons are invited to submit written comments during a sixty-day comment period.

List of Subjects in 12 CFR Part 327

Assessments; Bank deposit insurance; Financing Corporation; Savings associations.

For the reasons stated above, the Board proposes to amend part 327 of title 12 of the Code of Federal Regulations as follows:

1. The authority citation for part 327 continues to read as follows:

Authority: 12 USC 1441, 1441b, 1817–19.

2. Section 327.13(c) is revised to read as follows:

§ 327.13 Payment of assessment.

* * * * *

(c) *Assessment rate.* (1) The annual assessment rate for each BIF member shall be, for the semiannual periods of calendar year 1992, 0.23 percent; and

(2) The (annual or average) assessment rate for BIF members, shall be, for the first semiannual period of calendar year 1993 and for subsequent semiannual periods, 0.28 percent.

By order of the Board of Directors.

Dated at Washington, DC, this 12th day of May, 1992.

Federal Deposit Insurance Corporation.

Hoyle L. Robinson,

Executive Secretary.

[FR Doc. 92-11887 Filed 5-20-92; 8:45 am]

BILLING CODE 6714-01-M

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12 CFR Part 327

RIN 3064-AA96

Assessments

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Proposed rule.

SUMMARY: The Board of Directors ("Board"of the Federal Deposit Insurance Corporation ("FDIC") is proposing to amend part 327 of its regulations, 12 CFR part 327 ("part 327"), to increase the deposit insurance assessments to be paid by Savings Association Insurance Fund ("SAIF") members during the first semiannual period of calendar year 1993 and thereafter. The intended effect of this proposed rule is to recapitalize the SAIF within a reasonable period of time.

DATES: Written comments must be received by the FDIC on or before July 20, 1992.

ADDRESSES: Written comments shall be addressed to the Office of the Executive Secretary, Federal Deposit Insurance Corporation, 550—17th Street, NW., Washington, DC, 20429. Comments may be hand-delivered to room F-400, 1776 F Street, NW., Washington, DC 20429, on business days between 8:30 a.m. and 5 p.m.

FOR FURTHER INFORMATION CONTACT: William R. Watson, Director, Division of Research and Statistics, Federal Deposit Insurance Corporation, 550 Seventeenth St., NW., Washington, DC, 20429, (202) 898-3946.

[7] These projections may also be stated in terms of the ratio of tangible capital to tangible assets. As of year-end 1991, the tangible capital ratio for BIF-insured banks was 6.45 percent. The projected year-end 1996 tangible capital ratio under a uniform-rate assessment of 0.23 percent was 7.17 percent. Projected industry 1996 tangible capital ratios under the average risk-related assessment rate of 0.28 percent was lower, however, at 7.10 percent.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

No collections of information pursuant to section 3504(h) of the Paperwork Reduction Act (44 U.S.C. 3504(h)) are contained in the proposed rule. Consequently, no information has been submitted to the Office of Management and Budget for review.

Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601–612) does not apply to the publication of "a rule of particular applicability relating to rates." *Id.* at 601(2). Accordingly, the Act's requirements relating to an initial and final regulatory flexibility analysis (*Id.* at 603 & 604) are not applicable here.

Moreover, in connection with the current uniform-rate deposit assessment system (*i. e.*, one in which the same assessment rate applies to all insured depository institutions), the primary purpose of the Regulatory Flexibility Act is fulfilled as a matter of course, in that each institution's assessment is geared to the institution's size (as measured generally by domestic deposits).

Thus, the Board hereby certifies that the proposed increase in the deposit assessment rate, if adopted in final form and applied to the current uniform-rate asssessment system, would not have a significant economic impact on a substantial number of small entities within the meaning of the Act.

Also, as discussed below, concurrently with the publication of this proposal, the FDIC has proposed for comment a transitional risk-related deposit insurance system. That proposal is addressed elsewhere in this issue of the **Federal Register** as a separate notice of proposed rulemaking. As discussed in that proposal, the Board has determined that the proposed transitional risk-related assessment system, if adopted in final form, also would not have a significant economic impact on a substantial number of small entities within the meaning of the Act.

The Proposed Rule

I. Background for the Proposed SAIF Assessment Rate Increase

A. Related Proposed Transition From a Uniform-Rate to a Risk-Based Assessment System

The assessment rate paid by SAIF members presently is 0.23 percent per annum. Under the current uniform-rate system, all SAIF members calculate and pay their assessments based on the same rate. As discussed below, concurrently with the publication of this proposed rule, the Board also has proposed a transitional risk-related assessment system pursuant to which the assessment rate applicable to a SAIF member would depend on the risk-related assessment classification assigned to that institution by the FDIC. The proposed transitional risk-related assessment system is addressed in a separate notice of proposed rulemaking contained elsewhere in this issue of the **Federal Register** ("Proposed Transitional Risk-Related Assessment Regulation").

In accordance with the following discussion, the Board is proposing to increase the current SAIF member assessment rate to 0.28 percent per annum, effective for the first semiannual period of 1993 and thereafter. If the Board does not adopt a transitional risk-related assessment system to become effective January 1, 1993, then the assessment rate proposed herein would be a uniform rate applicable to all SAIF members. If the Board adopts a transitional risk-related assessment system to become effective at the same time as the proposed rate increase, then the increased assessment rate proposed herein would be the target average assessment rate applicable to SAIF members.[1] As explained in the Proposed Transitional Risk-Related Assessment Regulation, the actual assessment rate to be paid by each SAIF member would be based on the institution's risk-related classification and may deviate by certain specified gradations from the average assessment rate.

B. Designated Reserve Ratio

Section 7(b) of the FDI Act (12 U.S.C. 1817(b)), as implemented by part 327, requires that all FDIC-insured depository institutions pay to the FDIC semiannual assessments based on the types and dollar amounts of deposits held at such institutions.

Section 7(b) also states that "[t]he assessment rate for Savings Association Insurance Fund members shall be the greater of 0.15 percent or such rate as the [FDIC] Board of Directors, in its sole discretion, determines to be appropriate—(I) to maintain the reserve ratio at the designated reserve ratio; of (II) if the reserve ratio is less than the designated reserve ratio, to increase the reserve ratio to the designated reserve ratio within a reasonable period of time." *Id.* at 1817(b)(1)(D)(i).

In addition, section 7(b)(1)(D)(iv) of the FDI Act provides that from January 1, 1991, through December 31, 1993, "the assessment rate shall not be less than * * * 0.23 percent." *Id.* at 1817(b)(1)(D)(iv). Title II of the Omnibus Budget Reconciliation Act of 1990 (Pub. L. 101–508, 104 Stat. 1388) ("Reconciliation Act") amended the former version of this provision to, among other things, "eliminate the ceilings" on SAIF assessment rates. Prior to the enactment of the Reconciliation Act, specific statutory ceilings existed on SAIF assessment rates, including the 23 basis-point ceiling from January 1, 1991 through December 31, 1993. The Reconciliation Act empowered the Board to set the SAIF assessment rate above those former ceilings if the chosen rate would increase the SAIF reserve ratio to the "designated reserve ratio within a reasonable period of time," subject to the Board's consideration of the factors identified in section 7(b)(1)(D)(ii) of the FDI Act.

The SAIF's designated reserve ratio ("Designated Reserve Ratio") is 1.25 percent of estimated insured deposits. *Id.* at 1817(b)(1)(B). SAIF's current reserve ratio ("Actual Reserve Ratio") is approximately zero. In accordance with the following discussion, the Board is proposing to increase the SAIF member assessment rate from 0.23 percent to 0.28 percent for the first half of calendar 1993 and thereafter.

II. Proposed Transitional Risk-Based Assessment System

Section 302(a) of the FDIC Improvement Act amended section 7(b) of the FDI Act to require that the FDIC establish a risk-based assessment system, applicable to members of both SAIF and the Bank Insurance Fund, to become effective no later than January 1, 1994. Section 302(f) of the FDIC Improvement Act authorized the FDIC to "promulgate regulations governing the transition from the assessment system in effect * * * to [a risk-based assessment system]." As noted above, concurrently with the publication of this proposed rule, the Board also has issued for comment the Proposed Transitional Risk-Related Assessment Regulation. As also noted above, if such a transitional step toward implementing a risk-based assessment system becomes effective on January 1, 1993, it is anticipated that, on an industry-wide basis, the average assessment rate (as distinguished from the uniform rate) paid by SAIF members

[1] Given a risk-related premium schedule (as provided in the Proposed Transitional Risk-Related Assessment Regulation), the actual average assessment rate would depend on the distribution of savings associations by risk-related classification. Because this distribution would be subject to change over time, the actual average assessment rate may deviate slightly from the target assessment rate. The target average assessment rate will hereinafter be referred to as the "average assessment rate."

would be 0.28 percent, the rate proposed herein.

III. Factors Considered in the Proposed SAIF Assessment Rate Increase

Under section 7(b) of the FDI Act the Board is required to consider the following factors in setting the SAIF assessment rate: The SAIF's expected operating expenses, case resolution expenditures, and income; the effect of the assessment rate on SAIF members' earnings and capital; and such other factors as the Board deems appropriate. *Id.* at 1817(b)(1)(D)(ii). The following is a discussion of those factors.

A. Need for the Increase

As noted above, the Designated Reserve Ratio is currently set by statute at 1.25 percent of estimated insured deposits. The Actual Reserve Ratio is significantly below that level. As of December 31, 1991, the SAIF balance was approximately zero. As noted above, Section 7(b) requires that the SAIF reserve ratio be increased to equal the Designated Reserve Ratio within a reasonable period of time.

Under section 21 of the Federal Home Loan Bank ("FHLB") Act, the Financing Corporation ("FICO") has a claim on SAIF assessment income to fund the interest payments on bonds issued by FICO. *Id.* at 1441(f).[2] At present, satisfying this claim requires approximately 40 percent of the FDIC's SAIF assessment income.

Section 11A(b) of the FDI Act (*Id.* at 1821a(b)) requires that, "to the extent funds are needed," the sources of funds for the FSLIC Resolution Fund ("FRF") shall, during the period beginning on the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Pub. L. 101–73, 103 Stat. 183) ("FIRREA") on December 31, 1992,[3] include amounts assessed against SAIF members by the FDIC pursuant to section 7 of the FDI Act that are not required by FICO or the Resolution Funding Corporation ("REFCORP").[4] *Id.* at 1821a(b).

Through 1992, FICO and FRF will continue to claim all SAIF assessment income, except assessments paid on SAIF deposits by banks that have engaged in a transaction under section 5(d)(3) of the FDI Act (*Id.* at 1815(d)) ("Oakar Amendment Banks"). Consequently, the only assessment income to be added to SAIF prior to the beginning of 1993 will be the assessments paid by Oakar Amendment Banks on approximately $60 billion in SAIF deposits. At that time, SAIF will need approximately $9.5 billion to meet the Designated Reserve Ratio, given an estimated insured deposit base of $760 billion as of year-end 1991.

To achieve this balance in one year solely through industry contribution would require a special assessment rate of approximately 1.20 percent. This solution is not recommended, due to its possible adverse effects on the thrift industry.

In order to examine the issue of recapitalization over a period of time, staff developed projections for the SAIF balance based solely on assessments from SAIF-member institutions. Although certain Treasury payments are mandated by statute to supplement the SAIF,[5] the Board believes that Congress imposed such conditional obligations on the Treasury (and thus, the taxpayer) in order to provide a back-up in the event that the SAIF-insured industry was incapable of fulfilling its obligation to recapitalize the SAIF. Furthermore, appropriations for these supplemental funds have yet to be made, and the likelihood and timing of such appropriations is uncertain, particularly given that funding for continued operations of the Resolution Trust Corporation ("RTC") is currently uncertain. Consequently, staff projections are based solely on contributions from the thrift industry, and do not consider potential Treasury contributions.

The length of time necessary for SAIF to reach the Designated Reserve Ratio depends on the performance of the thrift industry, which is uncertain for several reasons. First, despite recent improvements in aggregate thrift industry profitability, there is evidence that the industry is becoming increasingly bipolar with respect to capital adequacy. Second, the recovery of real estate markets nationwide will affect the number and timing of future thrift failures. Third, there is uncertainty surrounding the long-term competitive ability of thrifts. Finally, it is not clear what the state of the thrift industry will be once SAIF resumes resolution responsibility on October 1, 1993.[6]

The long-term condition of the SAIF depends directly on the number, size and timing of future thrift failures, the costs of resolving failures, and the amount of assessment income provided by thrifts. Given a set of assumptions about these factors, it is relatively straightforward to project the SAIF over a multi-year period. However, analysis based on a single set of assumptions ignores the considerable uncertainty surrounding these factors.

To deal with this uncertainty, the FDIC staff examined a range of values for failed thrift assets, resolution costs, total failed thrift assets resolved by the RTC (as opposed to SAIF), and deposit growth. For each of these factors, the assumptions range from what was considered to be reasonably optimistic to reasonably pessimistic values. For each value, the staff assigned a probability based on historical relationships and the informed judgment of staff rather than on explicit statistical techniques applied to historical data. The assumptions and probabilities for each factor are summarized below in Table 1.

For analytical purposes, staff projected the SAIF over a fifteen-year

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[2] FICO was established by the Competitive Equality Banking Act of 1987 (Pub. L. No. 100–86, 101 Stat. 552 (1987)) ("CEBA") for the purpose of providing funds to the FSLIC Resolution Fund. Assessments on SAIF members is one source of funding for certain of FICO's financial obligations. See section 21 of the FHLB Act (12 U.S.C. 1441). Section 7(b)(1)(E) of the FDI Act (12 U.S.C. 1817(b)(1)(E)) states that "[n]otwithstanding any other provision of this paragraph, amounts assessed by the Financing Corporation and the Funding Corporation under sections 21 and 21B of the Federal Home Loan Bank Act against [SAIF] members, shall be subtracted from the amounts authorized to be assessed by the Corporation under this paragraph."

[3] This date was extended from December 31, 1991 to December 31, 1992 by section 202 of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991. Public Law 102–233, 105 Stat. 1761.

[4] Section 21B(e)(7) of the FHLB Act requires that SAIF assessment income be used, if necessary, to fund REFCORP's "principal fund." *Id.* at 1441b(e)(7). Because REFCORP's principal fund is fully funded, SAIF assessment income is no longer required for REFCORP purposes.

[5] Section 11(a)(6) of the FDI Act (12 U.S.C. 1821(a)(6)) requires that the Secretary of the Treasury make available funds to supplement SAIF in 2 ways: First, as revenue supplements to SAIF annual assessments net of FICO contributions to ensure annual revenues of $2 billion for each of the fiscal years 1993 through 2000; and second, as payments to maintain the net worth of the SAIF according to a designated schedule starting at $0 for the beginning of Fiscal Year 1992 through $8.8 billion for the beginning of Fiscal Year 2000. The Treasury net worth payments are limited to $2 billion in each of the fiscal years 1992 and 1993 and a cumulative total of $16 billion, and payments are suspended once the fund reaches the Designated Reserve Ratio of 1.25 percent.

[6] As amended by section 103 of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (Pub. L. 102–233, 105 Stat. 1761), section 21A(b)(3) of the FHLB Act (*Id.* at 1441a(b)(3)) requires, in relevant part, that the Resolution Trust Corporation resolve savings associations (including those insured by the FSLIC prior to the date of enactment of FIRREA) for which a conservator or receiver is appointed after December 31, 1988 and before October 1, 1993. In general, the SAIF will be responsible for savings association failures that occur on or after October 1, 1993.

period under numerous scenarios.[7] Each scenario represented a combination of the values for each of the factors and was assigned a probability based on the combination of probabilities for each of the factors. Staff performed this exercise for different assessment rates ranging from 23 to 35 basis points over the next 15 years.

I. Failed Thrift Assets, Billions of Dollars (1992–1995)

TABLE 1.—ASSUMPTIONS FOR SAIF PROJECTIONS

1992	1993	1994	1995	Total	Probability (percent)
25	15	5	5	50	15
50	35	10	5	100	20
50	50	30	20	150	30
60	60	50	30	200	20
70	70	60	50	250	15

Assumes that SAIF assumes resolution responsibility on October 1, 1992.

II. Failed Thrift Assets (1996–2006)

Percent of total assets	Probability (percent)
0.2	30
0.4	45
0 6	18
0.9	5
1.2	2

III. Ratio of Resolution Costs to Failed Thrift Assets

Ratio (percent)	Probability (percent)
14	25
17	50
20	25

IV. Deposit Growth

Rate (percent)	Probability (percent)
6	40
2	40
−2	20

The analysis identified the scenarios under which the SAIF would reach the designated ratio of 1.25 percent of insured deposits by year-end 2006. By adding the probabilities assigned to each scenario, staff calculated the subjective probability that the fund would meet the designated ratio for a given assessment level within 15 years.

As indicated in Table 2 (below), under the indicated assumptions and probabilities, the major results of analysis are the following. If assessments were maintained at an average of 23 basis points for the next 15 years, there would be only a 15 percent chance that the SAIF would meet the Designated Reserve Ratio within 15 years. If assessments were an average rate of 27 basis points, there would be a 37 percent chance that the fund would reach the Designated Reserve Ratio. At 30 basis points, it would be more likely than not that the goal will be met. At higher levels, there is a greater margin of comfort that the Designated Reserve Ratio would be achieved. At 32 basis points there would be a 65 percent chance of reaching the target, while the probability would rise to 79 percent at 35 basis points.

Given the current assessment rate of 0.23 and a range of possible variables affecting the thrift industry, there would be a 15 percent chance of reaching the Designated Reserve Ratio within 15 years based on contributions from SAIF members. The Board believes that this is not consistent with the statutory requirement to achieve 1.25 percent within a reasonable amount of time.

TABLE 2.—SUMMARY STATISTICS BY ASSESSMENT RATE

Assessment rate	Probability that SAIF reaches 1.25%
23	15.0%
24	20 0%
25	28.2%
26	33.8%
27	37.4%
28	46.2%
29	49 6%
30	55.3%
31	62.0%
32	65 0%
33	68.2%
34	73.6%
35	78.8%

Thus, in essence, there are two reasons for increasing the SAIF member assessment rate. First, under reasonable assumptions, a 0.23 percent assessment rate has an unlikely probability of achieving a 1.25 percent reserve ratio within 15 years. The Board believes that this is not consistent with the statutory requirement to achieve the Designated Reserve Ratio "within a reasonable period of time." Second, given the uncertainty regarding the industry, it is prudent to ensure that SAIF grows toward its Designated Reserve Ratio as soon as reasonably possible, subject to the statutory considerations discussed below. In order to do so, the Board is proposing to increase the average assessment rate to 0.28 percent starting with the first semiannual period of 1993. In light of the aforesaid uncertainties, the Board anticipates that it will reconsider the adequacy and appropriateness of the SAIF assessment rate as conditions warrant.

B. Impact on Industry Capital and Earnings

1. *In general.* Increases in deposit insurance assessment rates necessarily add to insured thrifts' operating costs. These cost increases will have a measurable effect upon thrifts' profitability and capitalization. FDIC staff analyzed the impact of the proposed assessment rate increases on thrift industry capital and earnings. Several assumptions guided the analysis. To start, increases in deposit insurance assessment expenses do not necessarily lead to equally proportionate declines in thrift profits. There are at least two factors which can reduce the adverse impact of increased assessments upon thrifts' profits and capital.

First, some portion of the assessment increase may be passed along to customers in the form of higher borrowing rates, increased service fees, and lower deposit rates. The extent of cost sharing will be dependent upon the level of competition faced by thrifts; those facing little competition should be able to pass a larger portion of the increase in assessment costs on to customers than would thrifts facing greater competition. For the purposes of this analysis, it was assumed that thrifts would not pass on any of the assessment increase to customers.

Second, deposit insurance assessments are a tax-deductible operating expense for thrifts. Therefore, the increase in assessment expenses can be used to lower taxable income, thereby reducing the effective after-tax cost of SAIF assessments.[8]

The impact of the proposed assessment increase upon thrifts' book capital is also dependent upon assumptions about dividend policies and new capital issues. If thrifts

[7] The staff chose a fifteen-year period solely for analytical purposes. As noted in the text, the statutory requirement for attaining the Designated Reserve Ratio is "within a reasonable period of time."

[8] In event a thrift is incurring losses before assessment costs, the additional assessment expense may be used to offset prior-period or future income (loss carry back or loss carry forward), thereby reducing taxes. For simplicity, this analysis assumed no loss carry forward nor loss carry back. This assumption results in a more conservative estimate of the tax benefits from higher assessments. In addition, the average tax rate paid by a thrift in 1991 was assumed to apply in future periods for the purposes of projecting thrift profits.

maintain dividend levels despite the increase in operating costs, book capital will decline by the full amount of the after-tax cost of the assessment borne by thrifts (assuming no new capital issues). That is to say, if dividends are not reduced, increased operating costs will be reflected in lower retained earnings.

Furthermore, for the projections presented here, it is assumed that the thrifts' average dividend rates remained unchanged from those reported for calendar year 1991.[9] However, if a thrift's projected post-dividend tangible capital was 2 percent or less, the thrift was assumed to pay dividends up to an amount that would allow it to remain at 2 percent tangible capital. Dividends were not included in the projections unless post-dividend capitalization was greater than 2 percent.

To provide meaningful results from an impact analysis, the FDIC deemed it necessary to analyze the effect of the proposed insurance assessment increase on the institutions that will compose the thrift industry following the completion of the RTC's mandated resolution responsibilities. To accomplish this, the projections estimated the reduction in net income and capital for the "core group" of 1,897 thrifts holding $721 billion in assets. These institutions were identified using the Office of Thrift Supervision ("OTS") Regulatory Monitoring System ("RMS") and supervisory evaluations.[10]

FDIC staff used two approaches to assess the impact of the proposed increases in deposit insurance assessment rates on SAIF-insured thrifts. The first approach was to project thrift earnings and capital through 1995 under two deposit insurance assessment rates: The present rate of 0.23 percent and the proposed rate (uniform and average) of 0.28 percent. Such projections make it possible to consider the impact of increased assessment costs in light of individual thrifts' projected earnings and tax status. Short-term projections, however, will not capture the full impact such cost increases may have upon the thrift industry. To address this shortcoming, a second analysis was performed that analyzed the potential long-term implications of reductions in thrift profitability, which involved an analysis of changes in return on equity.

If investors felt the reductions in profitability were long term, several results can be anticipated. First, stock market prices on thrift equity would fall as investors revise estimates of anticipated earnings. Consequently, any thrift/thrift holding company attempting to raise capital through new issues could receive less in invested capital. Assuming no other significant changes in thrift earnings or risk, share prices would have to fall in proportion to the decline in returns in order to maintain market value based profit rates (returns on market value of equity). Second, shareholders might also have less incentive to reinvest capital within the thrift, given the reduced profitability. Reduced retention rates will result in less growth in book capital over time, compared to an economy without higher SAIF assessment rates.

While it is difficult to estimate the final impact upon industry capital, a moderate amount of industry shrinkage due to a flight of capital (relative to a situation without higher assessments) may result, and credit availability may be impacted. Consolidation in the thrift industry can occur, however, without increased thrift failures. Indeed, the results from both analyses discussed below indicate that the impact of the proposed assessment rate increases upon the core group of thrifts' earnings and capital would not result in a substantial increase in thrift failures.

In interpreting the results of the long-term impact analysis, one point must be noted. Under both the uniform rate and the transitional risk-related average rate, the staff's long-term profitability analyses revealed a number of thrifts which had large estimated changes in return on equity due to the proposed assessment increases. This occured because at any point there are a number of thrifts earning near zero profits (or very small losses). In these situations, moderate increases in the assessment rate (for example, 5 to 7 basis points) will result in large percentage changes in profitability.[11] It is reasonable to expect, however, that thrifts earning near zero returns on equity will, in time, either fail or move toward higher levels of profitability. For these reasons, one should focus on the impact on the majority of thrifts' profitability when analyzing Tables 3 and 4 (below).

2. *Alternative analyses.* The following are alternative impact analyses with one based on the proposed increase in the uniform assessment rate to 0.28 percent and the other based on the Board's adoption of a transitional risk-related assessment system with an average assessment rate of 0.28 percent.

a. *Impact analysis based on a uniform assessment rate of 0.28 percent—Projected capital and earnings: short-term impact.* for purposes of this analysis, FDIC staff developed short-term projections on "core group" thrift earnings and capital between 1992 and 1995 under the assumptions concerning cost-sharing, tax deductibility and dividend rates described above. The analysis used 1991 data on net income, dividends and tax rates as the basis for these projections. To test the sensitivity of the results from the projection analysis to the use of 1991 as the benchmark for thrift industry returns, the staff repeated the analysis using 1990 data on the same institutions.[12]

The tangible capitalization of all SAIF-insured thrifts as of December 31, 1991 was approximately $38.7 billion.[13] An assessment rate of 0.28 percent, commencing with the first 1993 semiannual assessment, would raise an additional $347.5 million annually, just under 0.9 percent of fourth-quarter 1991 industry tangible capital.

FDIC staff estimates that by year-end 1995 the core thrift industry tangible capitalization would be just over $55.3 billion if the 0.23 percent rate remains in place. If the rate is raised to 0.28 percent, industry tangible capital would fall to approximately $54.8 billion, representing an 1.0 percent reduction. Under this scenario, core industry net income would fall over the period by $0.62 billion, approximately 3.5 percent of the pre-increase net income of $18.0 billion.

An assessment increase to 0.28 is projected to raise the number of thinly capitalized core thrifts by 2 institutions, defined as those with less than 2 percent tangible capital, through 1995. The

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[9] For institutions paying more than 100 percent of 1991 net income in dividends the average rate set to 98 percent of net income for the purpose of the projections.

[10] This core group is an estimate of the institutions that will not be placed into conservatorship or otherwise be resolved before October 1, 1993, the statutory deadline for the RTC's acceptance of failed savings associations. The core group is composed of SAIF-insured thrifts that are not in one of the following categories: conservatorship, insolvent, RMS–IV, RMS–III: Critically Undercapitalized or Potentially Critically Undercapitalized or lowest composite supervisory rating.

[11] To see this, consider the example of a thrift with a 5 percent equity capital and a 1 percent return on equity. In addition, assume that the thrift had an average tax rate of 25 percent and had assessable deposits equal to 80 percent of thrift assets. In this situation, a 7 basis point increase in the assessment rate would result in an 84 percent reduction in return on equity.

[12] For this core group of thrifts, the post-tax return on average assets ("ROAA") was approximately 33 percent greater in 1991 than it was in 1990. On average, the institutions with the lowest capital-to-asset ratios showed the greatest increase in ROAA over this time period.

[13] Tangible capital is reported on a consolidated basis. The number includes RTC conservatorships.

number of core thrifts holding more than 3 percent tangible capital is projected to decrease by 1 institution.

Sensitivity of the earnings and capital projections to 1991 return data. As indicated above, there was considerable improvement in the return on average assets ("ROAA") for the SAIF-insured thrift industry between 1990 and 1991. This improvement may be attributable to various factors, including the advantageous interest rate environment, the resolution of marginally solvent competitors and increased capital levels for the industry.[14]

To test the sensitivity of the results to reduced thrift operating margins, staff repeated the projections using the ROAAs for the core thrifts in 1990. Using 1990 ROAA as the benchmark return, FDIC staff estimates that by year-end 1995 the core thrift industry tangible capitalization would be just over $50.7 billion if the 0.23 percent rate remains in place, and would decline to approximately $50.1 billion if the rate is raised to 0.28 percent. This would reduce core industry capital by approximately 1.1 percent. Under this scenario, core thrift industry net income would fall over the period by $0.66 billion, approximately 5.3 percent of the pre-increase net income of $12.4 billion.

By the end of 1995, an assessment increase to 0.28 is projected to raise the number of thinly capitalized core thrifts by 5 institutions. The number of core thrifts with more than 3 percent tangible capital is projected to decrease by 12 institutions.

Long-term changes in profitability. In order to assess the long-term impact of higher assessments on thrift profitability, estimates were made of the changes in returns on the book value of equity capital which might result under an assessment rate of 0.28 percent. Specifically, thrifts' 1991 returns on book value equity capital were adjusted to reflect the increase in operating costs (after-taxes) which might result from increased assessment rates.[15]

Using 1991 return on equity ("ROE") as the benchmark, a 5 basis point ("bp") increase in the insurance premium from 23 to 28bp would be expected to lower the average institution's ROE by less than 5 percent. A total of 1,151 thrifts holding $511 billion in assets would have their ROEs reduced by less than 5 percent. An additional 492 institutions with $142 billion in assets would suffer a reduction in ROE of between 5 and 10 percent. The remaining 254 institutions with $68 billion in assets would have their ROE reduced by more than 10 percent. These results are presented in Table 3 (below).

TABLE 3.—PERCENTAGE CHANGES IN RETURN ON EQUITY ASSOCIATED WITH A 0.28 PERCENT ASSESSMENT RATE

[SAIF-Insured Thrifts, $ Millions]

Percentage change in ROE [1]	Number	Asset
Below −50% [2]	30	$6.906
−25% to −50% [3]	32	5,632
−15% to −25%	81	26,637
−10% to −15%	111	29,352
−5% to −10%	492	141,854
0% to −5%	1,151	510,687
Missing data	37	4,495
All	1,897	721,069

[1] The percentage change in ROE was defined as the adjusted ROE minus the original ROE, divided by the absolute value of the original ROE, (ROE'-ROE) /abs(ROE).

2 As noted above, thrifts with near zero earnings will experience a large percentage change in return on equity.

3 *Id.*

b. *Impact analysis based on a transitional risk-related assessment system—Impact on thrift capital and earnings.* As noted above, it is unlikely that thrifts would be able to pass on the customers the proposed assessment increase. This assumption is even more applicable under a risk-based premium structure that under a uniform premium structure. Under a risk-based structure, thrifts face enhanced intra-industry competition. Institutions paying higher premiums face additional competition from those institutions paying lower premiums, further reducing the thrift's ability to pass on costs to customers.

Projected capital and earnings: short-term impact. Consistent with the approach used for the uniform rate analysis discussed above, for purposes for this analysis, FDIC staff also developed short-term projections on thrift earnings and capital between 1992 and 1995 under the deposit insurance premiums and assumptions described above. The analysis used 1991 data on net income, dividends and tax rates as the basis for these projections.

Based upon the proposed average assessment rate of 0.28, FDIC staff estimates that by year-end 1995 the core thrift industry tangible capitalization would be just over $55.3 billion if the 0.23 percent rate remains in place. If the average rate is raised to 0.28 percent, industry tangible capital would fall to approximately $54.9 billion, representing an 0.8 percent reduction. Under this scenario, core industry net income would fall over the period by $0.52 billion, approximately 2.9 percent of the pre-increase net income of $18.0 billion.

An average assessment rate 0.28 is projected to raise the number of thinly capitalized core thrifts by 2 institutions, defined as those with less than 2 percent tangible capital, through 1995. The number of core thrifts holding more than 3 percent tangible capital is projected to decrease by 3 institutions.

Sensitivity of the earnings and capital projections to 1991 return data. Consistent with the approach used for the uniform assessment rate analysis discussed above, to test the sensitivity of the thrift industry's 1991 ROAA results to reduced thrift operating margins, staff repeated the projections using the ROAAs for the core thrifts in 1990. Using 1990 ROAA as the benchmark return, FDIC staff estimates that by year-end 1995 the core thrift industry tangible capitalization would be just over $50.7 billion if the 0.23 percent rate remains in place, and would decline to approximately $50.2 billion if the average rate is raised to 0.28 percent. This would reduce core industry capital by approximately 1.0 percent. Under this scenario, core thrift industry net income would fall over the period by $0.55 billion, approximately 4.4 percent of the pre-increase net income of $12.4 billion.

By the end of 1995, an average assessment increase to 0.28 is projected to raise the number of thinly capitalized core thrifts by 5 institutions. The number of core thrifts with more than 3 percent tangible capital is projected to decrease by 10 institutions.

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[14] Another factor that may influence ROAA is any deviation from a normal level of reserving for loan losses. However, the ratio of average loan loss provisions on interest bearing assets to assets did not change significantly between 1990 and 1991 for most core institutions.

[15] A simple expression can be derived to show how these factors will affect profitability.

(1.) ROA' = [ROA—(Rate Increase) * (Assessment Base/Assets) * (1—T)]

Where:

ROA' = adjusted return on assets, reflecting an increased assessment rate

ROA = thrift's original return on assets (net income/assets)

Rate Increase = new assessment rate − old assessment rate

T = thrift's average tax rate

The resulting impact on the return on equity will vary with thrifts' financial leverage.

(2.) ROE' = (ROE') * [assets/equity]

Equation two states that the adjusted return on equity (ROE') is the product of the adjusted return on assets (ROA') and the equity multiplier (assets/equity).

Data on individual thrifts' 1991 average tax rates were used to adjust for the tax deductibility of assessments. In the event a thrift incurred losses in 1991 and/or received a tax credit, its tax rate was set to zero. Although thrifts' earnings and hence capitalization will be reduced with higher assessments, for the purposes of this analysis, the adjusted ROEs were estimated using year-end 1991 assets-to-equity ratios in equation 2.

Long-term changes in profitability. Using 1991 ROE as the benchmark, a 5pb increase in the average insurance premium from 23 to 28bp would be expected to lower the average institution's ROE by less than 5 percent. A total of 1,377 thrifts holding $510 billion in assets would have their ROEs reduced by less than 5 percent. An additional 275 institutions with $114 billion in assets would suffer a reduction in ROE of between 5 and 10 percent. The remaining 245 institutions with $97 billion in assets would have their ROE reduced by more than 10 percent. These results are presented in Table 4 (below).

TABLE 4.—PERCENTAGE CHANGES IN RETURN ON EQUITY ASSOCIATED WITH A 0.28 PERCENT ASSESSMENT RATE

[SAIF-Insured Thrifts, $ Millions]

Percentage change in ROE [1]	Number	Assets
Below −50% [2]	34	$7,554
−25% to −50% [3]	39	14,775
−15% to −25%	73	26,674
−10% to −15%	99	48,537
−5% to −10%	275	113,533
0% to −5%	1,377	509,696
Missing data	37	4,495
All	1,897	721,069

[1] The percentage change in ROE was defined as the adjusted ROE minus the original ROE, divided by the absolute value of the original ROE: (ROE'- ROE)/abs(ROE).

[2] As noted above, thrifts with near zero earnings will experience a large percentage change in return on equity.

[3] *Id.*

IV. Comment Period

The Board hereby requests comments on the proposed rule. Interested persons are invited to submit written comments during a sixty-day comment period.

List of Subjects in 12 CFR Part 327

Assessments; Bank deposit insurance; Financing Corporation; Savings associations.

For the reasons stated above, the Board of Directors of the Federal Deposit Insurance Corporation proposes to amend part 327 of title 12 of the Code of Federal Regulations as follows:

1. The authority citation for part 327 continues to read as follows:

Authority: 12 U.S.C. 1441, 1441b, 1817–19.

2. Section 327.23(d) is revised to read as follows:

§ 327.23 Manner of payment.

* * * * *

(d) *Assessment rate.* (1) The annual assessment rate for each SAIF member shall be, for the semiannual periods of calendar year 1992, 0.23 percent; and

(2) The (annual or average) assessment rate for SAIF members shall be, for the first semiannual period of calendar year 1993, and for subsequent semiannual periods, 0.28 percent.

By order of the Board of Directors.

Dated at Washington, DC, this 12th day of May, 1992.

Federal Deposit Insurance Corporation.

Hoyle L. Robinson,

Executive Secretary.

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