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Statement by
Alan Greenspan
Board of Governors of the Federal Reserve System
before the
Committee on Banking and Financial Services
U S House of Representatives
March 19, 1996

Mr Chairman, you have invited me to appear before this Committee to discuss the Savings Association Insurance Fund. I testified before this Committee last August and September, and our position on the *difficult issues raised by an undercapitalized SAIF has not changed*. I would like to review some of the issues and principles raised in that earlier statement, as well as, of course, respond to the request for my views on the policy options raised in the Chairman's letter of invitation.

The deposit insurance provided by BIF and SAIF is identical. For identical insurance, depository institutions are rational to seek the one available at the lowest cost. Since a substantial difference in deposit premiums exists between SAIF and BIF, SAIF institutions will pursue BIF insurance unless there is some other reason to remain with their current fund. It is critical to underline that even if there were no problem with two different insurance premiums, the existing deposit insurance system, with its reliance on two funds, is inherently unstable.

Congress can attempt to legislate barriers that try to stop institutions from shifting deposits between entities insured by the other fund, but the history of efforts to legislate against such strong financial incentives is not encouraging. Under the current system, we are, in effect, attempting to use government to enforce two different prices for the same item—namely, government-mandated deposit insurance. Such price differences only create efforts by market participants to arbitrage the difference. Given the large financial gains to SAIF institutions if they move deposits to BIF, they will continually strive to do so.

The only winners created by continuation of the current deposit premium difference between SAIF and BIF deposits will be those depositories able to "game" the system, and leave SAIF first. The solution to this problem is to end this game and merge SAIF and BIF.

The merger of the savings and loan charter into a commercial bank-like charter also should be undertaken as soon as practicable. The specific details of a charter consolidation are less important than making measurable progress in developing a set of insured depository institutions subject to as identical set of rules and incentives as possible. However, at a minimum, removal of tax incentives that inhibit more diversified thrift portfolios should be enacted along with legislation recapitalizing the SAIF. Such legislation is part of the Balanced Budget Act.

Mr. Chairman, you requested my views on each of five options. The principles outlined earlier, in my judgment, apply in evaluating each of them. The same price should apply for the same deposit insurance and insured depository institutions should not be artificially induced to specialize. Implementation of these principles implies that the premium differential should be eliminated, the SAIF fund should be recapitalized and then merged with the BIF, the bad debt reserve recapture should be repealed, and the thrift charter replaced with a bank-like charter.

The first option would have the taxpayer pick up both the FICO obligation and the cost of recapitalizing the SAIF. The Congress did decide in 1989 in favor of taxpayer funding of the failed deposit insurer of the

savings and loan industry Up to now, you have chosen not to use the same option for FICO or SAIF The decision, of course, is a political one

The second option of resubmitting the legislation that was included in the Balanced Budget Act would be a major step forward, although it leaves merger of the insurance funds and the bank-thrift charter to a second step

I believe that the third option of no action is simply not viable economically, for reasons noted earlier I have no view on the fourth option of using Fannie Mae or Freddie Mac to fund FICO Like the fourth option, the fifth option, to fund FICO from Oakar and Sassar premiums, does not result in elimination of either the premium differential or of the separate insurance funds offering the same insurance, though it does delay FICO insolvency

We should not lose sight of first principles A deposit insurance system that focuses the attention of banks and thrifts on the relative status of their funds, and a system that rewards those who can jump ship first, is, to say the least, counterproductive What is needed is a deposit insurance system whose status is unquestioned so that the depositories can appropriately focus their attention on the extension and management of credit in our economy

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