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H.R. 522—FEDERAL DEPOSIT INSURANCE REFORM ACT OF 2003

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

MARCH 4, 2003

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H.R. 522—FEDERAL DEPOSIT INSURANCE REFORM ACT OF 2003

Tuesday, March 4, 2003

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to call, at 2:10 p.m., in Room 2128, Rayburn House Office Building, Hon. Michael Oxley [chairman of the committee] presiding.

Present: Representatives Oxley, Leach, Bereuter, Baker, Bachus, Royce, Kelly, Ryun, Manzullo, Biggert, Shays, Tiberi, Kennedy, Hensarling, Garrett, Brown-Waite, Barrett, Harris, Renzi, Maloney, Meeks, Inslee, Hinojosa, Lucas, McCarthy, Baca, Matheson, Miller, Emanuel, Scott and Davis.

The CHAIRMAN. [Presiding.] If the committee would please come to order.

Today, we are meeting to discuss legislation sponsored by my colleague and Financial Institutions Subcommittee Chairman Spencer Bachus, the Federal Deposit Insurance Reform Act of 2003. Chairman Bachus' legislation is the result of a thought-out, deliberative process laying the groundwork for reform of the nation's deposit insurance system. Last year, we had a great deal of success with the exact piece of legislation that we will be discussing today, the greatest success being the more than 400 votes the bill received on the House floor last year.

Today's hearing will focus on the views of FDIC Chairman Don Powell. Chairman Powell was instrumental last year in developing and passing comprehensive deposit insurance reform legislation out of the House. This year, with Chairman Powell's help, I am confident we can get that bill signed into law.

Today's hearing could not have occurred at a more appropriate time in the financial and economic cycle. While the deposit insurance system is the strongest it has ever been, it may be tested as the nation is confronted with an uncertain economic climate. Even so, I say with confidence that both the industry and the deposit insurance system are sound and the economic recovery, when it occurs, will be in large part determined by the ability of the financial services sector to remain vibrant and strong. A sound and responsive deposit insurance system is at the core of such vibrancy and strength.

The FDIC faces critical challenges, chief of which is the need to reform deposit insurance in a way that ensures that the system is equipped to respond to new and emerging risks. The FDIC must continue to adapt to address the challenges and risks posed by the

post-Gramm-Leach-Bliley environment, the integration of global financial service markets, and the interconnectedness of these events with our communities.

This is a tall order that will require the help of the Congress to provide the necessary legislative tools and the agency to make the necessary structural and program changes. This hearing will explore these issues and any insights that Chairman Powell may share for seeing to it that the system remains worthy of the public's confidence and appropriately and fairly treats all stakeholders and beneficiaries with respect to deposit insurance coverage and premium assets.

I look forward to hearing Chairman Powell's views today. I say with much conviction that the committee continues to have faith in our financial services industry and in the ability of the FDIC to implement comprehensive, meaningful and equitable reform.

Chairman Powell, thank you for your commitment to public service and to the FDIC at this most challenging of times. The committee will pursue any changes to the deposit insurance scheme with deliberation, thoughtfulness and a complete understanding of the attendant implications and benefits. The changes we are considering will affect the savings and investment decisions of millions of individuals and companies. The committee will not undertake this responsibility lightly. Again Mr. Chairman, welcome, and we are glad to have you with us.

The chair now recognizes the gentlelady from New York, Ms. Maloney, for an opening statement.

Mrs. MALONEY OF NEW YORK. Thank you, Mr. Chairman, and good afternoon Chairman Powell, and thank you very much for joining the committee. We look forward to your testimony.

For 70 years, our constituents have depended on the deposit insurance system to protect their savings and maintain the safety and soundness of the banking system. As I joined this committee at the close of the S&L crisis, I have since been committed to safety and soundness legislation and oversight of the banking system that builds on all we have learned since that disaster. We have to remember that standing behind the system is the full faith and credit of the United States and our constituent taxpayers.

I am pleased that we are conducting this hearing in an environment of bipartisan cooperation, and basically general consensus among the financial service regulators. As an original cosponsor of H.R. 522, the Federal Deposit Insurance Reform Act of 2003, I am supportive of the overwhelming majority of the provisions of the bill. It is long past time to merge the insurance funds. Additionally, eliminating the 23 basis point cliff and providing a new premium system that takes into account the past contributions of institutions are major steps forward.

The mechanism for determining credit for past contributions is based on an amendment I cosponsored with Congressman Bereuter last session. This provision is critically important as premiums banks pay to the FDIC limit their ability to make loans in the communities they serve. I thank Chairman Bachus for including this balanced amendment in the legislation, and I must add, for working so hard to build a consensus. When you had your first hearing

I thought we would never have a consensus. But by the end of the session, he had built a strong bipartisan piece of legislation.

While there is much to praise in the bill, I continue to be concerned about the increase in maximum account coverage from $100,000 to $130,000. As Federal Reserve Chairman Alan Greenspan's written testimony from last week stated, and I quote, our most recent surveys of consumer finances suggests that most depositors have balances well below the current insurance limit of $100,000, and those that do have larger balances have apparently been adept at achieving the level of deposit insurance coverage they desire by opening multiple insured accounts. The Fed, Treasury, OCC and OTS all oppose raising coverage. Only Chairman Powell supported tying coverage to inflation from its current $100,000 level. My position is that the overall improvements to the deposit insurance system in the legislation outweigh the challenges I have with this coverage increase, but I continue to hope this section can be modified in some way.

I thank the chairman and ranking member for their work on this legislation, and I yield back the balance of my time. I thank the chairman for this oversight hearing.

The CHAIRMAN. I thank the gentlelady.

The chair is now pleased to recognize the author of this important legislation, the gentleman from Alabama, Mr. Bachus.

Mr. BACHUS. Thank you, Mr. Chairman.

First of all, I want to commend you for your commitment to deposit insurance reform. You have made this legislation one of the top priorities of the committee. You did that last year, and I appreciate that.

I also want to say, Ms. Maloney, that this legislation did in fact result from a bipartisan coming together of almost every member of the House of Representatives. In fact, the legislation that I have introduced this year is the same legislation that passed 408-18 last year. You cannot get much more of a consensus on a major piece of legislation than that. This year, it has been reintroduced with 35 cosponsors from both sides of the aisle. Ranking Member Frank is one of the sponsors of the legislation.

Let me say this, deposit insurance reform has been the hallmark of our nation's banking system for almost 70 years. The reforms made by this legislation will ensure that the system that has served American savers and depositors so well for so long will continue to do so for future generations.

There has been a lot of discussion of what this legislation does. In that regard, let me stress this. There has been a lot of debate about coverage and what the level of coverage ought to be. The reason that there has been so much focus on coverage is the fact that all the other provisions of this legislation, there is complete consensus for the need for everything else—merging the insurance funds, complete agreement by Federal Reserve, Treasury, FDIC, all the regulators, the industry, no debate on that; eliminating the current system's pro-cyclical bias, complete agreement; addressing the so-called free-rider problem by requiring that large brokerage firms that sweep customer accounts for uninsured accounts into insured deposits will have to start paying their fair share, agreement on that.

The only disagreement is on coverage. Let me submit simply one statement on that fact and I will conclude my testimony, because I know Chairman Powell has a plane to catch at 4 o'clock, and I want the committee to have an opportunity to address him. Members should understand that if deposit insurance coverage had simply kept pace with inflation since 1980 when levels were last adjusted, it would now be more than $200,000. Even if one accepts the argument that an increase in 1980 from $40,000 to $100,000 was ill-advised, it is still the case that indexing from the $40,000 level in effect in 1974 would bring coverage today to $140,000. So the notion that raising coverage to $130,000 represents some kind of irresponsible expansion of the deposit insurance system is simply unfounded. In fact, using inflation-adjusted dollars, the protection that we are offering American depositors today is less historically than it has been in over 60 years.

With that, Mr. Chairman, I conclude my remarks. Mr. Powell, I appreciate your testimony. I do believe that to promote a stable and a sound banking system, that deposit insurance reform and deposit insurance coverage is a hallmark of that system. If we are to preserve that level of protection at historic levels, we will have to raise coverage. I say index it so we will not have to keep revisiting this every few years.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

Are there further opening statements?

Mr. ROYCE. Yes, Mr. Chairman.

The CHAIRMAN. Who seeks recognition? The gentleman from California, Mr. Royce.

Mr. ROYCE. Yes, not to belabor the point, but I would like to thank you again, Mr. Chairman, for reintroducing this bill, and certainly thank Subcommittee Chairman Bachus for reintroducing this legislation.

As he has articulated, this bill makes a number of much-needed statutory changes to the current deposit insurance fund. These changes are generally supported by banking regulators, but again there is one change which is not. I do want to go on record and say that I am reticent to give this bill my unqualified support as it contains two provisions that I find particularly troubling. One is an excessive increase in deposit insurance coverage limits, and a provision that levies additional assessments on banks to fund the so-called lifeline deposit accounts.

Extending the liability of the fund beyond its current $100,000 limit, again in the words of Federal Reserve Chairman Alan Greenspan, would increase the government subsidy to depository institutions, would expand moral hazard, and would reduce the incentive for market discipline without providing any clear public benefit. In addition to this opposition from the Federal Reserve, the Office of Thrift Supervision, the Office of the Comptroller of the Currency, and the U.S. Department of the Treasury all oppose increasing deposit coverage limits in the interest of safety and soundness.

Additionally, giving the FDIC the authority to levy fees from private institutions for purposes other than managing the safety of the fund, such as for federally subsidized checking accounts, is in my view ill-conceived and sets a bad precedent which may encour-

age future politically motivated encroachments upon the integrity of the fund. So it is my hope that as we fashion this bill, we can bring it back to the $100,000 limit and address these issues. The other provisions, as I have mentioned before, are very needed and I commend the authors.

Thank you.

[The prepared statement of Hon. Edward R. Royce can be found on page 36 in the appendix.]

The CHAIRMAN. The gentleman yields back. Are there further opening statements? The gentlelady from New York?

Mrs. KELLY. Thank you, Mr. Chairman.

It is well known that the FDIC has long played a critical role as a provider of confidence and stability in the financial system, and many members of this panel would agree that reforms to modernize our federal deposit system are long overdue. While I have a couple of reservations about the current bill, the fact that we are having this hearing so early in the session I think is a good indicator of this committee's strong commitment to enacting needed reforms in this Congress. I want to thank the chairman for making this a priority and for the work he has done on H.R. 522. The bill includes changes that ought to help us create a more efficient, equitable and flexible system that reflects our needs.

So I thank you, Chairman Powell, for being here today. I look forward to your testimony.

I yield back.

The CHAIRMAN. The gentlelady yields back. Yes, the gentleman?

Mr. SCOTT. I am Mr. Scott from Georgia.

Mr. Chairman, I understand that, as was stated before, that both you and Ranking Member Frank have both signed on as cosponsors of H.R. 522, and certainly given the support in the past and a large bipartisan vote that the House gave a similar measure last year, I have little doubt that H.R. 522 will certainly receive a solid vote from this committee. I certainly want to also thank Chairman Powell for appearing before the committee today.

From what I understand, H.R. 522 will allow for greater insurance coverage for retirement accounts, which benefits seniors, and raises the coverage for municipalities, which benefits community growth. Certainly given these challenges with the current economy, I certainly look forward to learning more about these benefits at today's hearing.

There is one somewhat troubling aspect that I would hope that your testimony might cover today. My understanding is that H.R. 522 would increase insurance coverage limits for in-state municipal deposits to the lesser of $2 million or the sum of $130,000, and 80 percent of the amount of the municipal deposit in excess of $130,000. I would like to get some indication of how you believe that this increase would promote community development in those areas where growth has historically been stagnant, particularly in some of the areas in the rural areas or some of the lesser-developed areas in areas of my state, for example, of Georgia.

I yield the balance of my time.

The CHAIRMAN. The gentleman from Georgia yields back. The chair apologizes. I am still trying to learn the new members' states.

Are there other opening statements? Noting none, we now turn to our good friend, the Chairman of the Federal Deposit Insurance Corporation, the Honorable Donald Powell.

STATEMENT OF HON. DONALD E. POWELL, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. POWELL. Thank you.

Chairman Oxley and members of the Committee, it is a pleasure to appear before you today to discuss deposit insurance reform. Deposit insurance reform is a top priority of the FDIC this year, and we appreciate the Committee's continuing interest in pursuing reform. The fact that this Committee was able to write legislation last year that attracted more than 400 votes in the House of Representatives was an extraordinary accomplishment.

I especially want to thank Chairman Oxley, Representative Frank, Representative Bachus and Representative Waters for introducing H.R. 522, and to thank their colleagues who are supporting the legislation. H.R. 522 is a reflection of the time and hard work the Committee has spent on these issues over the last year.

When the FDIC has raised issues, the Committee has been more than willing to listen to our concerns and to work with us. That continues to this day on both sides of the aisle, and we look forward to continuing working with you to get the best possible legislation for everyone concerned.

An effective deposit insurance system contributes to America's economic and financial stability by protecting depositors. For more than three generations, our deposit insurance system has played a key role in maintaining public confidence. While the current system has been effective to date, we are committed to working with you and the financial services sector to improve it. H.R. 522 incorporates all of the major reform recommendations put forward by the FDIC, and we appreciate the Committee's recognition of these important issues.

Today, I want to emphasize three elements of deposit insurance reform that would do just that: one, merging the Bank Insurance Fund and the Savings Association Insurance Fund; two, improving the FDIC's ability to manage the merged fund; and three, effectively pricing premiums to reflect risk.

First, merging the funds. As most of you know, the banking and thrift crisis of the last decade left the FDIC administering two deposit insurance funds—one to guarantee bank deposits and the other to guarantee thrift deposits. Now 10 years later, industry trends have left no meaningful distinction between the two. We should merge the funds into a single deposit insurance fund that will be stronger and will treat all deposits the same.

Second, improving the FDIC's ability to manage the merged fund. The FDIC is prohibited from charging any premiums to most banks in good economic times. That means that during difficult economic times, the FDIC is forced by law to levy steep premiums on the industry. Doing so would further stress our country's financial institutions at the very time when, as a matter of economic necessity, we would be asking banks to strengthen their balance sheets and to extend credit. Today, we announced that the reserve ratio of the BIF increased from 1.25 to 1.27 over the last quarter,

and the SAIF reserve ratio decreased from 1.39 to 1.37. Now is the perfect time to address deposit insurance reforms. The industry is strong and so are the insurance funds.

Third, effectively pricing premiums to reflect risk. Under the current law, safer banks are forced to subsidize riskier banks. This is unfair. Just as unfair is the fact that new deposits are able to enter the system in good times without paying for deposit insurance. Almost 1,000 banks have entered the system since 1996 without paying any premiums for federal deposit insurance. We have an opportunity, and in my view, a responsibility to the American people to remedy these problems.

The FDIC recommends the following: eliminating the hard targets and triggers in the current law; allowing the FDIC to manage the size of the insurance fund within a range; permitting the FDIC to charge steady, risk-based premiums to allow the insurance fund to build up in good times and to be drawn down during bad times; permitting the FDIC to charge all insured institutions appropriately for risk at all times so that safer banks do not unnecessarily subsidize riskier banks.

These methods for pricing and managing financial risk are best practices in the private sector, and we would like to manage our system in much the same way. With some flexibility in the fund management, we can alleviate the problems with the current system, while strengthening our ability to deal with any future crisis. We are not asking for absolute discretion. We recognize the need for accountability and will work with you to ensure that the system provides it.

The reforms I just described are critical to improving the deposit insurance system. Another issue that has been the subject of much discussion is deposit insurance coverage. Some have said coverage should be higher. Some have said coverage should be lower. Our position is simply to maintain its value through indexing.

Deposit insurance reform is not about increasing assessment revenue from the industry or relieving the industry of its obligation to fund the deposit insurance system. I want to repeat that. Deposit insurance reform is not about increasing assessment revenue from the industry, nor is it about relieving the industry of its obligation to fund the deposit insurance system. Rather, the goal of reform is to distribute the assessment burden more evenly over time and more fairly across insured institutions. This is good for depositors, good for the industry, and good for the overall economy.

Again, we appreciate the committee's leadership on the deposit insurance reform, and look forward to working with you to get the job done this year.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Donald E. Powell can be found on page 37 in the appendix.]

The CHAIRMAN. Thank you, Chairman Powell.

Let me begin. I notice that in your prepared testimony that you do not mention increased coverage limits for retirement accounts like 401(k)s and IRAs. Was that just an omission? Do you continue to still support that provision of last year's legislation?

Mr. POWELL. It was an omission. We do continue to support that.

The CHAIRMAN. Thank you.

As you know, we were following closely the hearing in the Senate last week. It certainly appeared from all the press accounts that there was a strong consensus among the regulators who testified, with the obvious exception of the amount of coverage. Is that correct?

Mr. POWELL. Yes, sir. I think there is consensus on 90 percent of the bill.

The CHAIRMAN. Let me ask you this, what about the issue of retirement accounts and municipal deposits? Is that split off from the $130,000 for individuals, or does the opposition go to the retirement accounts and the municipal accounts as well?

Mr. POWELL. I think the opposition goes to the retirement accounts and the municipals as well—with those who would oppose increasing coverage.

The CHAIRMAN. So you were outnumbered on that?

Mr. POWELL. Yes, outnumbered on that.

The CHAIRMAN. But you held your own.

Mr. POWELL. Well, I am not sure about that.

The CHAIRMAN. Yes, you did.

[LAUGHTER]

Let me ask you, in your testimony you point to several provisions that the FDIC supports and that are contained in H.R. 522 addressing the so-called "free rider" issue. These include removing statutory limitations on the FDIC's ability to charge premiums to all depository institutions and tying transitional assessment credits to past contributions to the funds. As you know, some have proposed giving the FDIC the authority to levy special premium assessments on rapid growth accounts that dilute the insurance funds as an additional way of addressing the free rider issue. What is your position on that particular issue?

Mr. POWELL. I think, first of all, the "free rider" is an issue, and I think deposit insurance reform does in fact speak to that. We believe that all institutions should pay. As I mentioned in my testimony, 1,000 institutions have entered the system since 1996, none of which have paid. I chartered an institution in Texas about four years ago. It was an FDIC-insured institution. We did not pay any premiums. That is wrong, that is unfair. It is not right. As for institutions that grow at a rapid pace, I am not sure that growth by its very nature should be penalized or should be assessed additional premiums. It is a factor. From a safety and soundness standpoint, there are other issues besides growth. I would not support a special assessment to those institutions that are growing at a more rapid pace perhaps, unless in fact, it is a safety and soundness issue. We would charge in the risk-based premium for that particular cause.

The CHAIRMAN. So you would not seek a special legislative—

Mr. POWELL. No, sir.

The CHAIRMAN. Okay. Very good.

As you know, Chairman Powell, a private company recently unveiled a product designed to allow small and mid-size banks to offer deposit insurance coverage well in excess of the current $100,000 limit by participating in a network of institutions that would share insured deposits. Some have suggested the availability of this product somehow undermines the case for high coverage lev-

els. One could also argue the product reflects a demand in the marketplace for exactly the kinds of higher coverage levels that H.R. 522 would provide. What is your view on those apparently competing ideas?

Mr. POWELL. Mr. Chairman, I do not think it is necessarily proper for me to comment on the private sector. Innovation occurs each and every day. We have not discussed that particular proposal in depth at the FDIC. My sense is that it will not in any way hurt deposit insurance reform. I think that is the private sector at work. Whether it is successful, I do not know, but it is not anything that we have any concern about.

The CHAIRMAN. Thank you.

The Chair's time has expired. The gentlelady from New York, Ms. Maloney?

Mrs. MALONEY OF NEW YORK. Thank you, Mr. Chairman.

I would like to follow up on Mr. Oxley's question on fast growth institutions. My understanding is that these new deposits are not the major reason for the reduction in the reserve ratio, but rather only responsible for roughly one-fourth of the 16 basis point drop in the ratio. Is that your understanding?

Mr. POWELL. I am not sure of the math. I think it is something like $80 billion of increase in deposits. I am not sure on the math.

Mrs. MALONEY OF NEW YORK. I have read that in several papers, that it was roughly one-fourth of the 16 basis point drop.

Mr. POWELL. I think that is correct.

Mrs. MALONEY OF NEW YORK. Okay. Additionally, I understand it is your position that fees for growth could make entry into the banking system more difficult for new institutions. Is that—?

Mr. POWELL. It is not anything that we would support.

Mrs. MALONEY OF NEW YORK. Okay. And do you think these fees go against the theme of expanding competition, which was the reason for Gramm-Leach-Bliley?

Mr. POWELL. Yes, ma'am, that would be part of the factor.

Mrs. MALONEY OF NEW YORK. Okay. I just wanted to further ask you, Chairman Powell, about the coverage question. The regulators uniformly do not want to raise coverage beyond $100,000. You agree, but would index it to inflation. That is my understanding. In your testimony, you call coverage limits, quote, "the most controversial, but least critical of the FDIC's recommendations." Do you think this is the least critical area because as a former banker you do not believe raising coverage will attract many additional deposits? Or as a regulator, are you concerned about increasing the liability to the government?

Mr. POWELL. Coverage is an issue that I have struggled with. I struggled with it when I was in the private sector, and I have struggled with it as a regulator. I have talked to bankers who believe that the coverage should be $200,000. I visit them at their institution, and come away understanding the rationale behind that. I was in the Midwest recently visiting an institution in excess of $40 billion. The CEO brought up the issue of coverage, and he said, "I am opposed to increasing coverage." I said that I recognized that, and that does not surprise me. He said, "Listen to me. I was opposed to it until I went downstairs and visited with new accounts folks and customer relations people at our institution, and they tell

me it makes a difference to the customers." I thought that was very interesting. Then I visited with bankers that have indicated to me they think the coverage is about right. In fact, some would say that it should be lower.

I do not know where the coverage should be. I just know that Congress established it in 1980 at $100,000, and it has served the American people and the industry very well during some good times and some bad times. I do know that most of the time we react in a crisis and fortunately we are not in a crisis today. It is my conclusion that the $100,000 level as established, in fact, has eroded in time down to about $47,000 today. But to take the issue away from the debate we should index it at the $100,000 level in order that it will not erode.

I favor, very frankly, the House bill that simply says if indexing is not working, I think the bill says six months prior to the announcement of any increase, that Congress can say "stop." So it seems to me the House bill offers the checks and balances against any unwarranted increase that would not serve the industry or the American people.

Mrs. MALONEY OF NEW YORK. Again, following up on Chairman Oxley's questioning, now that you are able to open multiple insured accounts, and this is taking place in the private sector, in your opinion does that really moot this question about raising the limit—if you can quickly put it into multiple accounts?

Mr. POWELL. No, ma'am. I do not think so, because that has been available in the marketplace for many years. I think the average depositor, while he or she may be aware that they can in fact go into multiple accounts, it is not as simple as it may sound, because if the husband and wife are limited to what they can put into these accounts, in the retirement accounts, and while $100,000 is a lot of money to me, as time evolves some folks in fact reach that $100,000 in a relatively short period of time. Some bankers in smaller communities where there are one or two banks have also indicated to me that there are not many choices in these communities, and some of their customers are reaching retirement age. Some would have $300,000, $400,000, $500,000 in retirement accounts.

Mrs. MALONEY OF NEW YORK. With regard to these retirement accounts and municipal deposits, the bill really reflects a compromise. At one point, it was $5 million; now it is $2 million. Do you believe that raising the coverage on them has more legitimacy than on standard accounts?

Mr. POWELL. I think the Congress and the American people put a value on retirement accounts, and there are other incentives that would encourage people to place money in retirement accounts. So we support increasing retirement accounts. We do not support the increase in the municipal deposits.

Mrs. MALONEY OF NEW YORK. My time has expired. Thank you very much.

Mrs. KELLY. Thank you. Mr. Bachus?

Mr. BACHUS. Thank you.

Mr. Chairman, I think the one thing this hearing has pretty much reiterated is that the debate seems to be on coverage. I think

there is a consensus on everything else, so I am going to focus on really where the debate is.

Some have suggested—there have really been two arguments thrown out for not increasing coverage. One argument is, it is unnecessary; another argument is it puts the financial institution or the system in moral hazard, puts our financial system at risk. So let me focus first of all on the unnecessary. In fact, looking over in the Senate, I actually heard testimony which I did not hear challenged that only the very wealthy have an occasion to have over $100,000 in a bank account. You are a Texas banker. What is your real-life experience? Do people other than the very wealthy have over $100,000 in a banking account? Is there an occasion where they would legitimately have more than that amount?

Mr. POWELL. I am not sure that you and I would have the same definition of wealthy.

Mr. BACHUS. I am just going from what the statement in the Senate was, "only the very wealthy" have over $100,000.

Mr. POWELL. Everybody is wealthy compared to me. Anyway, as I indicated, I struggle with this issue. As a banker in the late 1980s and early 1990s, I will tell you the issue of moral hazard is one that I have learned more about since coming to Washington. Being a banker in Texas during the late 1980s and early 1990s, deposit insurance, in my view, did in fact contribute to the crisis, but it was not the only factor. High interest rates, oil prices and poor judgment also contributed.

I have made the comment publicly that I believe we in Texas, had the coverage limit been $25,000, $40,000, would have found ways to get the money into those institutions. What is important from a supervisory standpoint is what you do with that money, which takes the debate off the coverage issue. It is a safety and soundness issue, and really a supervision issue and a regulatory issue. We were making bad decisions with the money, and also we were making poor decisions on what interest rate we were paying for those deposits.

So there were a lot of issues as it relates to this issue of moral hazard. As I indicated earlier, I am not sure where that coverage should be. I just know that FDIC insurance during those times in my life, the late 1980s and early 1990s, was a symbol of confidence. From a liquidity standpoint, it was extremely important that we had the seal of the FDIC on our door just to remain open.

Mr. BACHUS. Thank you.

One thing I would just maybe suggest to you, and I am going to go on to the moral hazard argument, but that people today sell their house and when they sell it they deposit the proceeds into their bank account. Sometimes a husband or a wife dies, and there is insurance proceeds, often it is more than $100,000. Sometimes it is $500,000, but they deposit that normally into one bank account. That seems to be the experience. So there are times, I think, when other than the very wealthy have over $100,000 in their bank account.

The second thing is, and I will call Congressman Royce and Chairman Greenspan and Chairman Shelby over in the Senate, I will call them the big three. The big three have argued that there is a moral hazard; that if we increase it, we increase risky behav-

ior, and therefore we should not create moral hazard. Interestingly enough, the FDIC looked at this issue in a study in 2001. I want to point that out to you. This was prepared for the FDIC by two respected economists, including Federal Reserve Governor Alan Blinder. The point was made that if the FDIC is given the authority to charge risk-based premiums as H.R. 522, this legislation, does, quote, most objections based on moral hazard should evaporate. That is a quote from that report.

Professor Blinder goes on to state about coverage, quote, "in a world of properly priced deposit insurance, it seems more appropriate to ask the opposite question. Why have any coverage limits at all?" So at least on one report for the FDIC by these two eminent individuals, they addressed that. Recognizing that no one here is arguing for unlimited deposit insurance coverage, isn't Professor Blinder's underlying point a valid one, that if the FDIC has the ability to penalize banks for engaging in risky behavior through the assessment of risk-based premiums, the moral hazard concerns of those who oppose coverage increases seems unfounded?

Mr. POWELL. It is a factor. It is a factor, Congressman, as well as Congress establishing some other tools that regulators can use that would in fact limit moral hazard, such as prompt corrective action.

Mr. BACHUS. Thank you.

Mr. POWELL. Let me speak to your "wealthy" issue. Something just crossed my mind. I think there were 11 institutions that failed last year. Between 1992 and mid-2002 there were 9,600 accounts that were uninsured, representing about $245 million. Obviously, to those people it was very important.

Mr. BACHUS. Thank you.

I appreciate also your endorsement of Professor Blinder's remarks. Thank you.

Mrs. KELLY. [presiding] Thank you.

Ms. McCarthy?

Mrs. MCCARTHY OF NEW YORK. Thank you, Madam Chairman, and thank you, Mr. Powell.

I just want to go off on a different track. You are recommending that we bring together, and you have mentioned many times about the reasoning on why we should bring the bank insurance fund and the savings associate insurance fund, and why they should merge. I am just curious how long that would take, and what would the cost savings be, if there are cost savings, and would it become more efficient?

Mr. POWELL. How long would it take?

Mrs. MCCARTHY OF NEW YORK. Yes.

Mr. POWELL. I am not sure I can answer that. Staff probably could answer that. I would say in a reasonable period. It is an accounting issue. I would think it would be a matter of days.

Mrs. MCCARTHY OF NEW YORK. So it is just a matter of really—

Mr. POWELL. Yes, it is just a matter of bookkeeping entries that would go in. I think merging the funds would be much more efficient. I think it would be efficient for us at the FDIC, and more important I think it would be more efficient for the industry, because a lot of the banks have acquired S&Ls, S&Ls have acquired banks, and there is some confusion about keeping separate books

to make sure what is in which fund. So I think it is a win-win for everybody. There is almost unanimous support for that provision of the bill. I really have not heard very much opposition to it.

Mrs. MCCARTHY OF NEW YORK. I just want to make one comment, too. Fortunately when my husband died, and I did get an insurance check, not much, but it was over $125,000, and I am not wealthy. So I happen to agree with you. Thank you.

I yield back my time.

Mrs. KELLY. Thank you, Ms. McCarthy.

Mr. Baker?

Mr. BAKER. Thank you, Madam Chair.

I appreciate your appearance here today, Mr. Powell, and I have a really pretty simple question. To construct a risk-based premium system, one must have certain elements that you are going to put into the pot, which I understand are not yet fully determined. That presumes that you have the ability to see the data that is relevant to the concerns in some timely manner. I have had, and continue to have concerns about the 90-day-old retrospective reporting quality of call reports. Particularly if we are now going to move to a risk-based system to start assessing premiums, it would seem to me that real time, transparent disclosures and methodologies would be of real value to you.

I am going to get to the point of what I believe to be a pilot program that either has been initiated or soon to be initiated relative to extensible business reporting language, the acronym XBRL. I find it very interesting and of extraordinary value for a number of particular reasons. Is that methodology something that possibly, pursuant to this pilot program—I am not exactly sure what the goal of it is—but after your analysis, is that something that could be reviewed as a potential way for us to get a better and clearer understanding of the true risks within a financial institution?

Mr. POWELL. Absolutely. I share your concern. As a banker, it always caused me pause or discouragement frankly with the slowness and timing of information that we received from the FDIC. Most institutions know what their balance sheet and their income statement is at the close of business each day. Accordingly, the FDIC, with other Federal financial institutions exam council members, are currently planning a new call report system that would include the use of XBRL.

We are at the very beginning of that. We have developed some specs for vendors to submit for proposals to the FFIEC, all with the thought of being more timely, more accurate, and having more consistency in reporting. Real-time data is something that we have a goal at the FDIC to accomplish. I think we are going to get there. It will be slower than what I would like, but also as you mentioned, it will assist us in risk-based premiums.

Mr. BAKER. Good. I think it has an application even beyond financial institutions. I like the idea of extending this to publicly traded corporations, but I want to make sure that someone of the stature of the FDIC has thoroughly examined it and whenever it is appropriate, whatever observations or recommendations can be publicly made, I would certainly like to know them.

Mr. POWELL. We will keep you informed.

Mr. BAKER. Thank you very much.

Mrs. KELLY. Mr. Miller?

Mr. MILLER. Thank you, Mr. Powell.

The Office of the Comptroller of the Currency and the Office of Thrift Supervision have ordered federally chartered banks and thrifts to end their affiliation with pay-day lenders, based at least in part on safety and soundness considerations, although pay-day lenders receive astronomical interest rates. The average annual interest rate on a 12-day loan in my state of North Carolina is 547 percent. They are also very risky loans. They tend to be made obviously with very little or any underwriting. There is no security for the loans. They are obviously made to people who are very poor, which is why they are in the market for a substandard loan in the first place.

I know the FDIC has now issued an advisory for public comment on those affiliations. Do you see between FDIC-supervised thrifts and petty lenders, do you see that affiliation affecting the safety and soundness of banks under your supervisions? If so, what kinds of regulations are you considering?

Mr. POWELL. I do see it as a safety and soundness issue. Part of our guidelines speak to that one issue, safety and soundness. Accordingly, our guidelines also tell those institutions that we will be requiring capital equal to the outstanding indebtedness. We may also have other supervisory requirements for those institutions that participate in those loans. It is a safety and soundness issue.

My thinking, as a former banker, some of the requirements that we at the FDIC may impose upon those institutions may not make it economically viable to participate in the business. But if an institution so chooses, we will act accordingly from the safety and soundness standpoint.

I also think, Congressman, it is important that in this whole notion of pay-day lending, we think a little bit about literacy—economic literacy. We at the FDIC are committed to that. We have a program that we refer to as "Money Smart," and we would be happy to send you information about that. But education is part of the whole notion of resolving some of those practices that go on.

Mr. MILLER. Mr. Powell, the reason, of course, that there is that affiliation in the first place is simply that pay-day lenders can avoid state regulation by claiming a preemption of federal law. Obviously, North Carolina does not allow 547 percent interest rates under our usury laws. Have you contemplated simply a prohibition, the way the OCC and the OTS have—follow their lead?

Mr. POWELL. We have contemplated it. I think the best thing for us to do is wait until we have comments back from our proposal, and we would be happy to share those comments with you and share our conclusion after receiving those comments. But I think we need to make sure that we vet it in the marketplace to be sure that we are not missing anything.

Mr. MILLER. Thank you, Madam Chair.

Mrs. KELLY. Chairman Powell, I am interested in the financial literacy that you just spoke of. Can you tell me the name of that again?

Mr. POWELL. Money Smart.

Mrs. KELLY. Money Smart?

Mr. POWELL. Yes, ma'am.

Mrs. KELLY. It might not be a bad idea if the whole committee had a copy of that. Would you be willing to send us a copy?

Mr. POWELL. Absolutely. We are very proud of that. In fact, we are introducing it in Chinese—we have it obviously in English and Spanish and a Chinese version is going to be ready for the marketplace I think within 30 days.

Mrs. KELLY. Would you be willing to send us a Hispanic copy as well, please?

Mr. POWELL. Absolutely.

Mrs. KELLY. Thank you very much.

Mr. Royce?

Mr. ROYCE. Thank you, Madam Chairman.

I would like to ask Chairman Powell, as you may be aware, tomorrow this committee will be holding a hearing on the proposed interest on business checking legislation, proposed by Mr. Toomey and Ms. Kelly, which I support. However, the legislation as introduced would discriminate against industrial loan companies in my state—businesses that make a valuable contribution to keeping the financial services marketplace dynamic and keeping it competitive. Even though the FDIC regulates these companies and the NOW accounts they offer, they are not included in this legislation. I would like to know, would the FDIC be supportive of efforts to allow financial institutions to pay interest on NOW accounts held by businesses? I would just ask, in your view, is there any safety and soundness issues here?

Mr. POWELL. The FDIC would not object to paying interest by these financial institutions on NOW accounts held by businesses. We do not really perceive those any different from any other business accounts, and we do not see it as a safety and soundness issue.

Mr. ROYCE. I appreciate that very much, your answer on that score.

Also, returning to the question of the $100,000 coverage, you had indicated earlier that during the S&L crisis in the 1980s when we had the issue of whether moral hazard was a part of creating that climate, you said the higher deposit insurance did contribute to the crisis. In your view, there were other factors, but it was a contributor. We have the argument put forward in the Senate the other day, the thesis of why have any coverage at all. If you have coverage limits removed, but at the same time if you have a perfect construction of a risk-based premium model put in place, in theory you would not have moral hazard as a consequence.

I think the answer that Hawke, or certainly Alan Greenspan, because he has said it as well, would put forward—they would say, because ultimately the incentive for market discipline is preferable to attempts of government regulatory agencies to try to approximate the discipline of markets. They would say, to construct a risk-based premium system perfectly and do it by government oversight is inherently risky, especially when you start talking about the thesis of removing it altogether, the limit.

It is not only the moral hazard argument that has been put forward here, it is also the increase in government subsidy, which is an issue. It is reducing the incentive for market discipline. At the end of the day, you have the four regulatory agencies on the other

side of you arguing, do not do this; do not move forward with increasing the coverage. That is rather formidable opposition. I was going to ask you, how do you answer the opposition of every other financial institution regulator, who although they all agree that the rest of this legislation—this bill is badly needed. Everything else in this bill is a step in the right direction. They feel that this element is not. I wanted to get your response once more for the record.

Mr. POWELL. Thank you. Let me speak to the subsidy issue. It is a subsidy, but as a former banker, I used to say we pay for that subsidy. It is a franchise. We have a charter. We have a choice. It is a subsidy.

The second issue, market discipline. I am a free market guy. I struggle with the free market's instability. My experience says that in the free market when an institution is in trouble, the sophisticated depositor flees and the unsophisticated depositor stays. It is a matter of education. The other agencies—I appreciate and understand their views. I do believe that Comptroller Hawke at the Senate hearing said that he did not have any objection to indexing.

Mr. ROYCE. Thank you, Chairman. I appreciate it.

Mrs. KELLY. Thank you.

Mr. Scott?

Mr. SCOTT. Thank you, Madam Chairman.

I would like to go back to the point I mentioned in my opening remarks, if you could address it. We have a lot of communities that are stagnant in their growth. How will the increase in insurance coverage limits for in-state municipal deposits promote community development in those areas? I have a second part to that I will follow up on.

Mr. POWELL. Congressman, I think at the institution where I used to be CEO, we would bid on municipal deposits if we thought there was an economically viable way we could make a buck. There were days that we would bid on them, and days we did not because of competition. Had we been able to be the successful bidder on those deposits, we of course would loan money based on them, but that is very, very competitive in the marketplace. Most states have a central depository where they accept municipal deposits and they pay, very frankly, a rate that most bankers do not want to pay. It is a higher rate. Thus, that money goes to the central location, which takes the money out of the local marketplace. So, it is a matter of economics with lots of institutions. They want the money, but they want the money at their price. As you know, most states also require that those deposits be fully collateralized with treasuries or comparable-type securities.

I have not found that it causes any bankers any concern that municipal deposits are not insured. I have heard from members of Congress and I have heard from some bankers in Ohio where there was recently an institution that failed, and there were some losses of municipal deposits. To my knowledge, however, there has not ever been a municipal depositor who has lost any money in an insured institution that has failed, saving with the exception of one that occurred last year, and that was a result of fraud.

Mr. SCOTT. The other part of my question is that Chairman Greenspan made a statement in his testimony before the Banking Committee that by raising these coverages to $100,000 or above

would encourage banks to engage in risky behavior. Do you agree with that? And also, are there some incentives in here that would prevent banks from doing what Greenspan fears they would do?

Mr. POWELL. The best incentive is keeping their job. I appreciate and understand, and as I have mentioned before, I understand and recognize the principle of moral hazard. I do. But also recognize that most bankers want to operate an institution that serves the community, that is committed to the community, that returns a reasonable return, a good return to the shareholders. If they are making decisions that would cause that institution to be overly supervised by the regulators, or that depositors or customers would leave that institution because of poor decisions, the first person that is going to be replaced is management. Most of the time, management has ownership in the institution. Not only are they going to be replaced, but they are going to lose their investment.

Having said that, clearly there are temptations. It occurred in Texas in the late 1980s and early 1990s, to make poor decisions. As I have indicated, I respect and understand that deposit insurance was a factor, but in my opinion, it was not the main one.

Mr. SCOTT. Thank you. I yield back.

Mrs. KELLY. Thank you very much. It is now time for me to ask my questions, Chairman Powell.

We have been hearing from a lot of the banks and from a number of the people here on the committee that there are people who want higher coverage levels, and other people want a level to stay where it is. I wonder if the FDIC has studied the concept of giving the financial institutions the option to purchase additional municipal deposit coverage. That might give them flexibility that I was talking about earlier in my opening statement. I am wondering if you have ever studied it, and what your findings might have been.

Mr. POWELL. We have had some preliminary studies on that. I will confess to you I am not sure what the conclusions were. I will tell you that we would be more than happy to study that and come back to you and the other members of the committee and members of Congress with our conclusions.

Mrs. KELLY. Thank you. I think that would be interesting, if the banks could get extra coverage from the FDIC. It seems to make sense, and I would really appreciate your doing a study.

I would also like to get your thoughts on the appropriateness of programs to lower the premiums or the credits to the financial services that offer services to certain communities. As you may know, Congresswoman Waters had an amendment that would provide for a 50 percent discount in the assessment rate for deposits attributable to lifeline deposits and so forth. I would like to get your feelings on that.

Mr. POWELL. I support the initiative for all institutions to reach out to the un-banked in their community. It is very important that we make sure that all members of our community are part of the economic wealth of America.

Mrs. KELLY. Do you support the 50 percent discount?

Mr. POWELL. I do not support the 50 percent discount because I do not perceive it as a safety and soundness issue. Premiums, in my view, should be based on the safety and soundness of the institution, and I would not support the lifeline provision. Again, I want

to emphasize that we should find other ways, other incentives, in my view, to encourage financial institutions to reach out to the unbanked. Clearly, I support that.

Mrs. KELLY. Since I have a little bit more time, I would like to know what constants do you have currently in charging risk-based premiums, as authored by FDIC?. What information are you using in setting the risk-based premiums?

Mr. POWELL. I may need some help from the staff, but basically as you know, many—91 percent or 92 percent of the institutions now do not pay, and part of the law that we operate under is that well-managed and well-capitalized institutions should not pay. It has specific definitions—it is capital and supervisory rating, and that is it—the amount of the capital and our supervisory rating, the CAMELS ratios. Risk-based premiums under the proposed legislation would expand that, in my view, in a much more—not unlike the private sector. It would look at internal and external issues. As you know, we are attempting to make sure that the risk-based premiums are transparent; that they are fair; and that they have more objectivity than subjectivity in the cost.

Mrs. KELLY. Is there someone behind you who might talk to us a little bit about what exactly, besides fairness, transparency, and the cost—is there anything else that they would like to add, since you said that—

Mr. POWELL. I can add some things to be specific—balance sheet, growth, management, earnings, capital, liquidity, rating agencies. You might even look at stock price, secured liabilities, funding, growth.

Mrs. KELLY. It sounds like that pretty much covers it. Okay, great. Thank you.

I wanted to ask you about a bill that has been reintroduced in the House that has a flexible range that goes down to 1.15 percent. A Senate bill was introduced that allows the level to go down to 1 percent. Does the administration think that either of these floors for the fund is too low?

Mr. POWELL. Does the administration?

Mrs. KELLY. Yes.

Mr. POWELL. I have had some conversation with the folks at Treasury, and part of that conversation was they believe that the Senate bill in fact is too wide of a range. We at the FDIC obviously want a wider range. We think the 1 percent and perhaps the 1.15 percent in the House bill, to the 1.4 percent to the 1.5 percent—the larger the range, we believe the better that we will not have unintended consequences from the pro-cyclical issue.

Mrs. KELLY. Thank you very much. My time is up.

We go to Mr. Emanuel.

Mr. EMANUEL. Thank you.

Mr. Chairman, you have actually directed an answer to a few of the questions. This goes in the league of a softball. Take a breather. Relax here on this one.

Mr. POWELL. Thank you.

Mr. EMANUEL. Chairman Powell, at last week's Basel Accord hearing, we heard concerns about how Basel II could potentially create competitive inequalities among different classes of financial institutions. We had a discussion and back and forth some ques-

tions. Just your comments on how you see H.R. 522 in that same vein—whether you think it will create some of the inequalities that we asked about on Basel II—just from your perspective of how this bill would do.

Mr. POWELL. As it relates to large institutions and smaller institutions? We at the FDIC, treat them all the same. Hopefully, no one would interpret deposit insurance, or risk-based premiums or any other issue as being a favor to smaller institutions or larger institutions. They are all the same.

Mr. EMANUEL. Thank you very much.

Mr. BACHUS. [presiding] The gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

First, Chairman Powell, as a fellow Texan I want you to know I sleep better at night knowing that you are running this shop. I also want to congratulate you for your compelling and reasoned testimony. I read with great interest today that apparently, for the first time in our nation's history, FDIC-insured institutions topped $100 billion in earnings. So you and your people must be doing something right. I salute you for your stewardship.

I have a couple of questions. One, I wanted to follow up on Ms. Kelly's line of questioning. Obviously, as most of the members of this committee, I agree that we need to move to a risk-based premium system. In your testimony, you talk about eliminating the existing inflexible statutory requirements, and adding discretion and flexibility for the FDIC board of directors. Although I have never been a banker, I have been a businessman. When I had the misfortune of dealing with regulators, I always wanted there to be a tangible standard or metric that I knew that I could shoot for, and I was always concerned about any arbitrary application on the part of the regulator.

So I wish you could give us any further details about the current status of thought within the FDIC, about how we impose accountability and safeguards on this new system of discretion and flexibility.

Mr. POWELL. Thank you.

I am in a fiduciary role. I take accountability and responsibility very seriously. We would be happy to work with Congress and we would be happy to work with industry to make sure that we are in fact accountable. We would be happy to listen to any suggestions, any recommendations that would in fact hold us more accountable as it relates to this deposit insurance program.

But however, saying that, the hard targets, I do not think, have served us in the past, and we would again ask the Congress not to put in hard targets, especially as it relates to managing the funds; but we want to be accountable.

Mr. HENSARLING. Second question, moving to the issue of indexing the deposit insurance for inflation that you are advocating, I am new to this particular argument, and I have heard within this committee inquiries that give me some insight into the rationale. You mentioned in answering one of the questions, kind of some anecdotal evidence, speaking to some, I believe, new account officers at a bank. But I am curious, do you have any comprehensive stud-

ies or evidence to what extent the impetus is really consumer-driven here?

Mr. POWELL. I do not think there is any empirical data, Congressman. I do not think we have any empirical evidence that it should be at $90,000, $150,000. We have some surveys that we have participated in over the last four or five years, before my time, asking folks what they believe the coverage should be. It goes all over the board. So there is no empirical evidence that it should be at a certain level.

As I said earlier, repeating myself, I am not sure where it should be. I just know that it has served the American people and industry for the last 23 years, and most of the time we react to a crisis. That is what happened the last time it was raised from $40,000 to $100,000. I would hope that we will remove it from the crisis arena, put that issue to bed, and just index it. That is the reason I said I liked the provision within the House bill that says if in fact it gets away, Congress can say stop.

Mr. HENSARLING. I believe I understand the costs associated with the proposal, and that is increased exposure for the American taxpayer. I understand the scenario of the one-time insurance proceeds that may exceed $100,000. In trying to understand the benefits of the proposal, I am curious about other rationales or other benefits that you see associated with it.

Mr. POWELL. There is no question that the FDIC leverages the United States Treasury balance sheet. However, as you know, premiums are paid by the industry. Before we go to the United States Treasury, we would tap the industry. There is something like $750 billion of book value in the industry today. So we would have to expose $750 billion and then approach the United States Treasury balance sheet. Obviously, we leverage the United States Treasury balance sheet—we acknowledge that.

But with true risk-based premiums, it should move more in the direction of the private sector, where there are penalties for institutions that are not conducting themselves in a businesslike way, in a way that produces sound and effective policies. And it would reward those institutions that in fact do conduct their business using sound and safe policies. So there will be winners and there will be losers and hopefully these premiums will be an incentive to those who are doing some things that they should not be doing, so they would not have to pay the premium. That would be a management decision. Management may choose to say, you know, I do not care, I will pay the premiums, I am going to continue down the road in the business practices and the business model that I want to go to.

Mr. BACHUS. Thank you, Mr. Hensarling.

Mr. Davis?

Mr. DAVIS. Thank you, Mr. Chairman.

Mr. Powell, I have been felled with a bout of laryngitis the last few days, so I apologize for sounding like Don Corleone in advance.

Let me pull out a couple of things. I am a cosponsor of this legislation. One of the reasons is because I suspect that it would provide something of a competitive advantage or something of a competitive tool for small banks. I represent a district that contains a large contingent of rural areas, and as you know, it is a very difficult challenge to sometimes get banks to locate in those areas.

The only ones who are willing to do it are often your small banks, your community banks. I see this perhaps in answer to one of Mr. Hensarling's questions, I see this as an additional incentive or additional advantage of this legislation.

Having said that, let me ask you this set of questions. In response to Representative Kelly's questions about the criteria that would be used for setting premiums, the risk-oriented criteria that would be used for setting premiums, the majority of those criteria seem to me that they would favor larger, more established, better capitalized banks. So therefore, some of the advantage that could be gained by small banks could be lost as we moved to the other part of the process.

So address that concern for me, if you would—talk to me about what the FDIC can do to avoid putting the disadvantage back on small banks when the risk factors are calculated.

Mr. POWELL. I appreciate your concern, Congressman, and have had some bankers indicate the same concern to me. I have found that smaller institutions, the management of smaller institutions in the communities that you have described, are pretty solid. They are bright. They are very competitive. I do not think it is a disadvantage. I do not think our risk-based premiums will cause any disadvantage to small institutions, nor do I think it will cause disadvantage to large institutions. I think it will be very uniform across the small and across the large institutions.

Again, we are going to be very transparent in this. Every institution will have an opportunity to comment on the risk-based premium profile. It is not in any way the intent to favor one size of institution over another size.

Mr. DAVIS. Let me ask you one other question, Mr. Chairman. Given the fact that the weightiest argument of the opponents seems to be that raising the premiums, or rather raising the deposit insurance, will somehow provide an incentive for risky behavior on the part of banks. Are you amenable to some kind of a compromise in which the increase happens only for very low-risk banks instead of happening across the board?

Mr. POWELL. I think that is what a risk-based premium does. I think the coverage issue is a different issue. I think the coverage issue is one issue, but risk-based premiums will be based upon how a bank, in fact, performs.

Mr. DAVIS. Right. I understand that. I guess what I am asking is, is it possible that we could have some kind of a formula in which we calculate the degree to which certain banks fell in a high risk or low risk category, and then we only increased the insurance for banks that were not low-risk?

Mr. POWELL. I think it would be very confusing for the marketplace. I think there would be more disruption in the marketplace than benefits. It may be that considering—someone asked a moment ago how one might get additional coverage—the study we talked about paying additional premiums for that. But I think having one institution having coverage at one level and another institution having coverage at another, I think would disrupt the marketplace.

Mr. DAVIS. Would you be open to any scenario in which if a bank saw its rating fall, for example, from one risk category to another,

that it would lose the level of insurance, or something that would at least provide incentives towards sound conduct on the part of the bank?

Mr. POWELL. Hopefully, we can do that through charging them more for the product.

Mr. DAVIS. Okay. I will yield back the balance of my time, Mr. Chairman.

Mr. BACHUS. Thank you, Mr. Davis.

Mr. Davis is from Alabama, and he yielded back some of his time. He was very prompt—also a Harvard graduate. He knows how valuable time is.

The gentlelady from Florida?

Ms. BROWN-WAITE. Thank you very much, Mr. Chairman.

Chairman Powell, the administration and the Federal Reserve have expressed opposition to the portion of the bill that increases the coverage limits. Can you explain what the primary concerns are, because I have not received the details of it. You may have gone over this previously. I came in a little late to the meeting. If you have, I apologize. If you have not, I would appreciate hearing your interpretation of their opposition.

Mr. POWELL. Thank you. Here is my interpretation of their view. I think the moral hazard issue is an issue that was raised by the Federal Reserve and Treasury. I think also they believe there is opportunity in the marketplace to distribute one's money among insured institutions and insured accounts. The system is working the way it is okay. These are probably some of their views—I am not doing them very good service, but primarily the moral hazard issue, and there is no compelling reason to increase coverage by consumers.

Ms. BROWN-WAITE. My second question relates to the arbitrariness of going to $130,000. I think you may have addressed that, but if there were a formula that you had that brought us to the $130,000, other than it appears to be arbitrary, because if you look at the inflation factor, it does not match up with inflation. Is $130,000 what you think is the path of least resistance?

Mr. POWELL. I am not sure that, again I repeat myself to some extent, where that number should be. I just believe that the House bill does not cause any concern for us at the FDIC from a safety and soundness issue. And the cost to the industry, if we in fact merge the funds, I do not think would be a burden.

Ms. BROWN-WAITE. Thank you. I yield the rest of my time.

Mr. BACHUS. I thank the gentlelady.

Mr. Meeks?

Mr. MEEKS. Thank you, Mr. Chairman.

Chairman Powell, let's say this is an ideal world, and just as you want it—you know, deposit insurance reform is enacted just as you want it. What would the FDIC do if an institution then shifted a very large amount of previously uninsured funds into an insured bank, causing the fund to drop below the lowest allowable reserve ratio?

Mr. POWELL. Under deposit insurance reform, that institution would immediately start paying premiums on these funds to the FDIC. We would also base our premiums upon the risk profile of that institution. If, in fact, the institution was doing some things—

growing too fast, undercapitalized, poor management, business plan in a fog—they would be paying additional premiums.

Mr. MEEKS. So let me just make sure, so you are saying all FDIC-insured banks would pay these additional?

Mr. POWELL. Yes, sir—all pay.

Mr. MEEKS. Let me ask another question. I believe you testified to this. I was not here, but I know there has been some concern about the fact that newcomers since 1997 have not paid into the deposit insurance system. If we made premium requirements more flexible, how would you propose to charge such newcomers when the DRR is above the ratio target?

Mr. POWELL. Under deposit insurance reform in the House proposal, the DRR would be a flexible number determined by the FDIC, with accountability. Remember, all institutions would pay immediately—everybody will pay, again based upon the risk profile.

Mr. MEEKS. Okay. One other question. If you have the flexibility to move the DRR within a range, what are some of the factors that would cause you to move the DRR up and down within that range?

Mr. POWELL. That is a good question. I think there would be several factors. I think the condition of the industry would be the primary factor. We would act just like a life insurance company, just like any other insurance company would act depending upon what we believe the risk is to the insurance company—condition of the industry; where the deposit fund balance was; history; and obviously some economic data. Through our supervision and cooperation with other agencies and their input, we could come, I believe, to an appropriate decision.

Mr. MEEKS. Thank you. I yield back.

Mr. BACHUS. Thank you.

The former Chairman of the full committee, Mr. Leach?

Mr. LEACH. Thank you, Mr. Chairman.

I would like to talk a little bit about history from two perspectives, if I could, Mr. Chairman. This concept of why the S&Ls got in trouble, and whether there was a tie to deposit insurance is a judgmental concern. First, let me describe very precisely the difficulty when the S&Ls came in, how it tied to deposit insurance, and why it may not be as directly relevant to this debate as has been placed on the table.

The S&Ls got in trouble in the first instance because they were an industry that lent long and borrowed short. When interest rates rose, this caused serious difficulty. They got in trouble in the second instance when—and here there is a tie to deposit insurance—the regulators did not have the backbone to recapitalize when their capital base eroded, often to the point of less than zero.

Then they got in trouble in the third instance when public officials, often at the state level, with some support from a national regulator, decided to give them powers that had never been given to a particular industry. This elongated the losses.

The tie to deposit insurance is that an institution can operate effectively in an unregulated environment—that is, it can have less than zero capital—and can attract deposits because you have deposit insurance, there is an incentive to attract more money at higher interest rates, to pay yourself more if you run the institu-

tion, and to dividend yourself more if you own the institution. So there was a cascading phenomenon.

The reason I emphasize this is, deposit insurance is not in and of itself a problem, except when it is tied to failure of regulators to be firm and thoughtful. The real fault is regulation that was infirm and unthoughtful. Deposit insurance was a footnote, although a very important footnote. But if one assumes proper regulation, increasing deposit insurance is no particular problem. That is the point of view that I think should be on the table today.

Now, if one assumes that bank regulators are asleep at the switch—that means the FDIC, the OCC, the Fed and all the State regulators—then the case for increasing deposit insurance is nonexistent. If one assumes that they are pretty credible, the case can be rather powerful. I am of the view the regulators today are pretty credible and that they learned a lot from previous experiences. Therefore, the case for increasing deposit insurance to me is persuasive.

Then you have the question of how much coverage should be increased. There is pretty good consensus from yourself, from others, that COLA adjustments are pretty reasonable. I think so, too. Then the barometer becomes at what point do you tag them? Do you tag them starting immediately? Do you tag them starting with the last increase? I am on the generous side of that issue, but there might be some room for compromise.

I think the discussions that revolve around deposit insurance causing the S&L crisis must be measured against the totality of the circumstance and not simply catergorized as a cause because the cause was only tied to imprudent regulation.

There is one other footnote to all of this. The first cause, which relates to the issue of an industry borrowing long and lending short, the positive aspects of that industry, whether done by a bank or an S&L today, is the new techniques of laying off risk in ways that did not really exist, at least as a general practice, in the mid- to late-1970s, when the escalating inflation problem developed. But that particular industry, which is housing, is one of the steadiest and one of the best risk layer-offers, without the use of sophisticated derivatives, although at the Fannie and Freddie level there is some use of derivatives, but that is a separate sort of circumstance. It does not relate directly to a financial institution that has deposit insurance.

So my own personal view is that the administration should not be so reluctant and the use of the phrases S&L problem and deposit insurance may be hiding other competitive judgments that should not really be part of the equation. I think this is a small institution issue principally, although not exclusively, and that small institutions are right.

But anyway, that is a judgment circumstance, and I would appreciate your comment.

Mr. POWELL. Well said, Congressman, well said. I agree with you 100 percent.

Mr. LEACH. Thank you. I yield back the balance of my time.

Mr. BACHUS. I would like to also associate with the remarks of the former Chairman, Mr. Leach.

At this time, I would like to recognize one of your fellow Texans, Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Chairman Bachus.

Before I make a statement, I wish to request that my entire written statement, which I was going to present earlier, but I was in another committee meeting, be included in the record.

Mr. BACHUS. Without objection.

[The prepared statement of Hon. Rubén Hinojosa can be found on page 34 in the appendix.]

Mr. HINOJOSA. Thank you.

I am very pleased that my colleagues before me have asked so many questions and given clarification to your position on H.R. 522. I saw where in last week's Senate Banking hearing you indicated your support for indexing individual deposit insurance coverage to inflation. Some of us have a strong feeling for seeing it being increased to the $130,000 from the current $100,000 level, but I certainly respect your reasons for how you feel.

Having answered so many of the questions that were on my mind as to how you felt and why, I simply want to use this time to commend you, Chairman Powell—you and the FDIC—for your money smart financial literacy program for adults. Both the English and the Spanish versions are being disseminated in my congressional district, and hopefully will help educate my constituents on checking, savings, credit and other types of financial products necessary to improving one's economic situation in life.

I have a large percentage that do not use banks and do not have banking accounts. So this type of financial literacy will be very helpful. I just want to go on record that I personally thanked you, and that I am pleased that you came to speak to us this afternoon.

Mr. POWELL. Thank you. I will pass your comments on to the staff that worked on Money Smart.

Mr. HINOJOSA. I yield back the balance of my time, Mr. Chairman.

Mr. BACHUS. Chairman Powell, we have one more questioner. The gentleman from Connecticut?

Mr. SHAYS. I thank the gentleman. Thank you, Mr. Chairman, and Chairman Powell.

I have come late, but I have had a chance to read your statement. I just want to get into one area that deals with the deposit insurance. I am very concerned, as you point out in your statement, that you could have a thousand new charter institutions with more than approximately $880 billion in insured deposits that have never paid premiums for the deposit insurance they receive. That just seems to me to be kind of crazy.

So I like the idea that we would require everyone to pay. I also recognize that there is a point at which you do not want to build up the fund to absurdity, obviously, and take out money that could be used to help build a community. So I like the idea of requiring all to deposit and then to provide a rebate, in essence, when the fund gets up to a certain point.

The area of my question is, though, who should decide what goes back to the banks? While I could draw comfort in the fact that you could decide, and you would be reasonable, should not the Congress set some parameters in deciding how large that fund should be and

make sure that we are not taking too much out? In spite of my budget instincts, I have always wanted to have a lot of protection.

Mr. POWELL. Yes, Congressman. I think Congress should, and I think the ranges in the House bill, I would hope they might be expanded, and I think would in fact call for certain things, if in fact the fund grows beyond the 1.4. We at the FDIC recognize and understand, and it is not our intent to increase premiums or to assess the industry unnecessarily. So we would be obviously happy to work with Congress about any assessment credits or rebates back to the industry when it reaches a certain level.

Mr. SHAYS. And just so I am clear on one part here, and I tend to reveal my ignorance by my questions, but I learn. As we increase the deposit insurance, we would then clearly be requiring more to be placed in the fund. Correct?

Mr. POWELL. I am sorry?

Mr. SHAYS. As we allow for protection of from $100,000 to $130,000, we would want more money set aside?

Mr. POWELL. There would be more exposure. Yes, there would be more exposure. Fortunately, the fund now, if we in fact combine the two funds, it would not be material from a safety and soundness issue.

Mr. SHAYS. And one last question, where is the greatest resistance to combining the two funds? I mean, this has been an issue that we have debated.

Mr. POWELL. Combining the funds—I have not heard anyone opposing merging the funds.

Mr. SHAYS. So why—I mean, years ago we talked about this.

Mr. POWELL. I—

Mr. SHAYS. Okay. Let's get it done.

Mr. BACHUS. Thank you. Is the gentleman through?

Mr. SHAYS. I am yielding back. Thank you, and I appreciate your talking to me.

Mr. BACHUS. Chairman Powell, we beg your indulgence, the gentleman from Georgia would like to ask you one final question.

Mr. POWELL. Sure.

Mr. BACHUS. Then that will conclude the hearing. We also know that you have a plane to catch, so after this question, feel free to hurry from the room and do not feel that you have to stay here and talk to anyone. The Chairman of the full committee, Mr. Oxley, and I both want to tell you publicly how much we appreciate your professionalism and your ability. You are a credit to the Bush Administration. You are a credit to this country. We both strongly feel that you are a very good Chairman for the FDIC and have done a wonderful job.

Mr. POWELL. Thank you.

Mr. BACHUS. Thank you.

Mr. Scott?

Mr. SCOTT. Yes, thank you very much, Mr. Chairman, and thank you for your indulgence. I will be very brief, but I do want to say that your appearance before the committee has been very helpful and beneficial to me.

I was just wondering in looking at H.R. 522, I notice that the maximum per account was raised from $100,000 to $130,000. However, when we get to the retirement accounts, that number is dou-

bled to $260,000. I was just wondering, what data are you basing that on, and is it just in the Senate to get more Americans to invest and save for their retirement?

Mr. POWELL. I do not think there is any magic in that number, Congressman. History says that the Congress has been willing to give a special incentive to those who save. The Congress has decided that not only through 401(k)s and IRAs, but in fact deposit insurance for retirement accounts was raised in years past, ahead of the individual coverage. But we would be happy to listen to any number.

Mr. SCOTT. Thank you.

Mr. BACHUS. Part of the reason—I will also add that the committee felt that in light of the history we had over the last two or three years of people losing their retirement security and retirement accounts, we felt good public policy would be to protect those retirement securities for senior citizens.

Mr. SCOTT. Thank you.

Mr. BACHUS. This concludes our hearing. The hearing is adjourned.

[Whereupon, at 3:45 p.m., the committee was adjourned.]

A P P E N D I X

March 4, 2003

STATEMENT OF THE HONORABLE
Wm. Lacy Clay
Before
The Committee on Financial Services

"H.R. 522, The Federal Deposit Insurance Reform Act of 2003"

March 4, 2003

Mr. Chairman, I commend you for holding hearing to consider this bill early in the legislative year. This bill, H.R. 522, is almost identical to H.R. 3717 that I supported and was passed in the last congress. The bill passed by such overwhelming numbers (408-18) that it should be dispensed with in the shortest time possible as general agreement has already been reached by most Members. I commend you for your expeditious action in presenting this legislation today.

The "Waters provision" in the bill is an excellent one in that it gives institutions credit towards their premiums for deposits held in lifeline banking accounts. These credits are needed as incentives to banking institutions to provide accounts for persons who might otherwise not be able to afford basic banking services such as low-cost or free checking and savings accounts.

There are also concerns about the bill that have to be addressed during this hearing. Most prominent of these is the disparity that exists among institutions in regard to the payment of insurance premiums. When one considers that the system is financed almost entirely by institutions that paid premiums prior to 1997; that over 1000 new institutions have been added since 1997, with approximately $84 billion in reserve, without ever paying premiums; and currently 91% of institutions pay no deposit insurance premiums, this suggests that scrutiny of the fairness of payments is dictated.

In our discussion today with Mr. Powell, Chairman of the FDIC, hopefully we will be able to draw some conclusions as to how to more reasonably allocate the combination of assessment credits and risk-based premiums. Additionally, we hopefully will have positive communications on the effects of rapid or unexpected levels of growth of some of the institutions.

Mr. Chairman I ask unanimous consent to enter my statement into the record.

RAHM EMANUEL
5TH DISTRICT, ILLINOIS

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March 4, 2003

Statement of the Honorable Rahm Emanuel
U.S. House of Representatives
Committee on Financial Services

I would like to thank Chairman Oxley for holding this important hearing on Deposit Insurance Reform. I also appreciate that our distinguished guest, FDIC Chairman Donald E. Powell, has taken the time to share his views with us on this topic.

I am a cosponsor of H.R. 522, as are many of my colleagues on this Committee. H.R. 522 is a bipartisan attempt to make changes to the federal deposit insurance system so that it reflects the realities of the modern financial services landscape. I support H.R. 522 because it represents an overall improvement to the deposit insurance system.

H.R. 522 represents a serious effort to reform the current deposit insurance system. Among the bill's strong points are that it: merges the Bank Insurance Fund and Savings Association Insurance Fund into one entity, the Deposit Insurance Fund, resulting in administrative cost savings; makes the system less pro-cyclical by permitting the FDIC to charge risk-based assessments at all times; eliminates the "cliff" of extremely high required assessments by regulators should the fund fall below required reserve ratios for an extended period; provides flexibility in reserve ratios; allows the FDIC to coordinate the imposition of assessments with the FED; indexes deposit insurance limits to inflation; and deals with the problem of "free-riders," those institutions that have not made their required premium payments. Important industry groups such as the Independent Community Bankers Association and the American Bankers Association support the overall approach taken by H.R. 522.

In the last Congress, this Committee passed a virtually identical bill overwhelmingly with bipartisan support. The bill was later passed on the floor by a vote of 408 to 18. It was subsequently referred to the Senate Banking Committee but no action was taken before the last Congress adjourned. The United States Senate is currently considering deposit insurance reform legislation. However, none of the Senate bills include provisions for increased coverage levels. I am hopeful that the House and Senate will be able to resolve the coverage level issues in the days and weeks ahead, keeping in mind the concerns of those who warn against the unintended consequences of higher premiums and greater risk-taking by bank officials.

Once again, I extend my thanks to Chairman Powell for appearing before this Committee. I look forward to working with my colleagues as we continue to take steps to improve the deposit insurance reform system.

March 4, 2003

Opening Statement by Congressman Paul E. Gillmor
House Committee on Financial Services
Full Committee Hearing on HR 522, the Federal Deposit Insurance Reform Act of 2003

I would like to thank both Chairman Oxley and Subcommittee Chairman Bachus for their important leadership on the issue of FDIC reform. Last Congress, this committee and the full House of Representatives passed a comprehensive reform package, HR 3717. However, due to the Senate's lack of action we are here again this morning to begin debate on HR 522, the Federal Deposit Insurance Reform Act of 2003.

I am very glad to have been included in the negotiations on this proposal again in the 108th Congress and was pleased to see the text of my "Municipal Deposits Insurance Protection Act," included in HR 522 as introduced.

With the constructive changes from the text originally considered in the 107th Congress, this legislation would provide increased coverage for municipal deposits equal to the lesser of $2 million or $130,000 plus 80% of the amount of deposits in excess of the new standard.

Providing this essential coverage will help local communities keep public moneys in their area, improving the economic climate by enabling local banks to offer more loans for cars, homes, education and community needs.

Currently, municipalities are faced with a hard choice when deciding where to place their deposits. Local officials care about their communities and would like to foster economic development by putting their funds in local banks. However, without the guarantee of FDIC coverage, they are often forced instead to put the money in large out of state institutions.

It may also be the case that small banks are not even in a position to accept such deposits. Many states require institutions to collateralize municipal deposits. This makes it harder for community and small banks to compete for these funds with larger banks. Many community banks are so loaned-up that they do not have the available securities to use as collateral.

Just last year, the FDIC closed a bank in my congressional district, the Oakwood Deposit Bank in Oakwood, OH. Local municipalities and other public entities that held deposits at this institution were put at risk due to the $100,000 cap in FDIC coverage.

In cases of fraud such as this one, securitization was not adequate insurance, as many bonds and securities appearing on the bank's balance sheet were not actually held. In this situation, Paulding County, Ohio lost approximately $150,000, Paulding County Hospital $1.3 million dollars, and Wayne Trace School District around $1 million even with the

current FDIC coverage. This risk is simply too high for any community in this country and can have a devastating impact on local budgets.

Again, I applaud both Congressmen Oxley and Bachus and their staff for all their hard work on this issue and, for again in the 108th Congress, crafting this responsible reform proposal.

I trust our committee and the full House of Representatives will again take the necessary action to reform and modernize the Federal Deposit Insurance System by swiftly passing this legislation and that the new Senate leadership will follow suit.

REMARKS OF CONGRESSMAN RUBÉN HINOJOSA
HOUSE COMMITTEE ON FINANCIAL SERVICES
HEARING ON H.R. 522, THE FEDERAL DEPOSIT INSURANCE REFORM ACT
MARCH 4, 2003

I want to thank Chairman Oxley, Ranking Member Frank, Financial Institutions Subcommittee Chairman Bachus and Ranking Member Sanders for holding this very important hearing on deposit insurance reform. This issue has come before Congress several times, and I hope that this will be the year for it to pass and be enacted into law. The Administration agrees with much of what is contained in the bill before us, H.R. 522, the Federal Deposit Insurance Reform Act, of which I am an original cosponsor. Similar legislation has been introduced in the Senate. Hopefully, both houses will arrive at a consensus on this legislation and send it to the President.

In the beginning of the 107th Congress, I was appointed to serve on the newly-formed Financial Services Committee with its broad jurisdiction. This pleased me for several reasons, but especially for the opportunities it would provide me to help the people and businesses of the 15th Congressional District of Texas.

H.R. 522 will help the people and businesses of my district as well as the nation as a whole.

This legislation will benefit community banks, large banks, credit unions, savings associations and consumers. They will benefit by replacement of the current fixed statutory reserve ratio of 1.25 percent with a provision allowing the FDIC to set a flexible designated reserve ratio between 1.15 percent and 1.40 percent. They will benefit from the requirement that the FDIC charge all institutions an insurance premium. Consequently, my community will benefit.

Merging the Bank Insurance Fund and the Savings Association Insurance Fund will help solidify the banking market. By increasing the deposit insurance coverage from the current $100,000 to $130,000, the legislation will encourage more people to place their funds in banks, thrifts, or credit unions, thus increasing the savings rate in the United States and helping to improve the overall economy. Increasing coverage for retirement accounts from $100,000 to $260,000 will also encourage more growth.

After having said all of this, I must admit that I realize that three out of the four regulators who testified before the Senate Committee last week on deposit insurance reform legislation opposed increasing individual deposit insurance coverage to $130,000 from $100,000 or even indexing it to inflation. Regardless, they have found common ground on other areas of the bill. The bill will move forward. It is good for the country and good for my community.

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Statement of Congressman Steve Israel
Committee on Financial Services
Hearing on H.R. 522, the Federal Deposit Insurance Reform Act
March 4, 2003, 2:00 p.m.

Mister Chairman, thank you for holding this hearing, and thank you, Chairman Powell, for coming in to talk about deposit insurance and the options we have to reform the system.

I believe that raising deposit insurance limits is common-sense public policy. It has been 23 years since the coverage limits were last raised. In 1980, the limit was $40,000. Congress wisely recognized that this was too low, and raised the limit to the current $100,000. The Federal Deposit Insurance Reform Act of 2003 will further raise the limit by a modest 30%.

I am aware that there is considerable opposition to this bill. In fact, Chairman Powell, you are quite courageous in being here today, given Federal Reserve and Administration opposition. I understand and share the concerns of the bill's opponents. I am sure that the possibility of increased risk is something about which the Chairman has devoted considerable thought.

Fundamentally, however, I do not believe that banks will act in the reckless fashion that the bill's opponents assume. And just in case, premium levels are tailored to a bank's riskiness, not unlike consumer life insurance: if you smoke, you pay more; if not, you pay less.

This bill will also make a substantial change in how the FDIC imposes premiums. The current system has the perverse result of not charging premiums when banks can most afford to pay them, and sending a bill when banks are at their most vulnerable. H.R. 522 will address this situation by giving the FDIC flexibility in charging premiums. The result will be a more predictable and stronger system of deposit insurance.

Mr. Chairman, this bill is good for American depositors and it is good for the American financial system. I offer my strong support and look forward to hearing Chairman Powell's comments.

Opening Statement
Congressman Ed Royce (CA-40)
4 March 2003
Federal Deposit Insurance Reform Act of 2003 Hearing

Thank you, Mr Chairman, for calling this hearing today to discuss the Federal Deposit Insurance Reform Act of 2003. I would like to commend Chairman Oxley and Subcommittee Chairman Bachus for reintroducing this legislation and for making it a Financial Services Committee priority in the 108th Congress. I would also like to take this opportunity to thank Mr Powell, Chairman of the Federal Deposit Insurance Corporation (FDIC), for his attendance and for his willingness to share his insights on deposit insurance reform and other relevant matters with the members of this committee

The Federal Deposit Insurance Reform Act of 2003 is a strong, well-crafted bill that has attracted the bipartisan support of 34 cosponsors, including myself. It makes a number of much-needed statutory changes to the current deposit insurance system, and these changes are generally supported by a number of banking regulators. This bill would merge the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into a single fund that would reduce the fund's overall exposure to risk and its volatility. By creating a flexible designated reserve range (DRR) and authorizing the FDIC to charge premiums at all points in the business cycle -- not just when conditions are deteriorating -- this legislation would address the fund's current pro-cyclical bias and prevent institutions from having to pay sharply-increased premiums when they are least able to pay them. By providing for the refund, credit and dividend of assessments collected in amounts greater than what is necessary to maintain the safety and soundness of the fund, depositary institutions can be sure that their capital is not misallocated and can be used for its most efficient purposes, such as making loans to help to jumpstart domestic economic growth.

However, I am reticent to give this bill my unqualified support, as it still contains two provisions that I find particularly troubling: an excessive increase in deposit insurance coverage limits and a provision that levies additional assessments on banks to fund so-called "life-line" deposit accounts. Extending the liability of the fund beyond its current $100,000 limit, in the words of Federal Reserve Chairman Alan Greenspan, would "increase the government subsidy to depository institutions, expand moral hazard, and reduce the incentive for market discipline without providing any clear public benefit." In addition to this opposition from the Federal Reserve, the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency and the US Department of the Treasury all oppose increasing deposit coverage limits in the interest of safety and soundness. Additionally, giving the FDIC the authority to levy fees from private institutions for purposes other than managing the safety of the fund, such as for federally subsidized checking accounts, is ill conceived and sets a terrible precedent which may encourage future politically motivated encroachments upon the integrity of the fund.

I appreciate this opportunity to clarify my position on the Federal Deposit Insurance Reform Act of 2003. While I strongly support deposit insurance reform, I cannot support putting the American taxpayer at risk by increasing insurance coverage levels or by allowing the FDIC to levy additional assessments for the purpose of providing subsidized checking accounts. I look forward to Chairman Powell's testimony and insights and I yield back the balance of my time.

STATEMENT OF

DONALD E. POWELL
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

DEPOSIT INSURANCE REFORM

before the

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

March 4, 2003
Room 2128, Rayburn House Office Building

Chairman Oxley, Representative Frank, and members of the Committee, it is a pleasure to appear before you this afternoon to discuss deposit insurance reform. This remains the top priority of the Federal Deposit Insurance Corporation and I appreciate the Committee's continuing interest in pursuing reform.

The fact that the Committee was able to write legislation last year that attracted more than 400 votes in the House of Representatives was an admirable accomplishment. I especially want to thank again Chairman Oxley, Representative Frank, Representative Bachus, and Representative Waters for introducing H.R. 522, and to thank their colleagues who are supporting the legislation.

An effective deposit insurance system contributes to America's economic and financial stability by protecting depositors. For more than three generations, our deposit insurance system has played a key role in maintaining public confidence.

While the current system is not in need of a radical overhaul, flaws in the system could actually prolong an economic downturn, rather than promote the conditions necessary for recovery. These flaws can be corrected only by legislation.

Today, I want to emphasize three elements of deposit insurance reform that the FDIC regards most critical—merging the funds, improving the FDIC's ability to manage the fund and pricing premiums properly to reflect risk. These changes are needed to provide the right incentives to insured institutions and to improve the deposit insurance

system's role as a stabilizing economic factor, while also preserving the obligation of banks and thrifts to fund the system. There is widespread general agreement among the bank and thrift regulators for these reforms.

MERGING THE BIF AND THE SAIF

The Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) should be merged. There is a strong consensus on this point within the industry, among regulators and within Congress.

A merged fund would be stronger and better diversified than either fund standing alone. From the point of view of the insured depositor, there is virtually no difference between banks and thrifts. Moreover, many institutions currently hold both BIF- and SAIF-insured deposits. More than 40 percent of SAIF-insured deposits are now held by commercial banks.

In addition, a merged fund would eliminate the possibility of a premium disparity between the BIF and the SAIF. As long as there are two deposit insurance funds, with independently determined assessment rates, the prospect of a premium differential exists. Such a price disparity has led in the past, and would inevitably lead in the future, to wasteful attempts to circumvent restrictions preventing institutions from purchasing deposit insurance at the lower price. The potential for differing rates is not merely theoretical. The BIF reserve ratio on September 30, 2002, stood at 1.25 percent, the absolute minimum required by law, while the SAIF reserve ratio stood at 1.39 percent.

For all of these reasons, the FDIC has advocated merging the BIF and the SAIF for a number of years. Any reform plan must include merging the funds.

FUND MANAGEMENT AND PREMIUM PRICING

Two statutory mandates currently govern the FDIC's management of the deposit insurance funds. One of these mandates can put undue pressure on the industry during an economic downturn. The other prevents the FDIC from charging appropriately for risk during good economic times. Together, they lead to volatile premiums.

When a deposit insurance fund's reserve ratio falls below the 1.25 percent statutorily mandated designated reserve ratio (DRR), the FDIC is required by law to raise premiums by an amount sufficient to bring the reserve ratio back to the DRR within one year, or charge mandatory high average premiums until the reserve ratio meets the DRR. Thus, if a fund's reserve ratio falls slightly below the DRR, premiums need not necessarily increase much. On the other hand, if a fund's reserve ratio falls sufficiently below the DRR, the requirement for high premiums could be triggered.

The statutory provisions requiring a 1.25 percent DRR and mandatory high premiums when a fund falls sufficiently below the DRR were designed to protect the taxpayers and prevent the deposit insurance funds from becoming insolvent, as the Federal Savings and Loan Insurance Corporation (FSLIC) became during the 1980s. However, these provisions, intended as protections, could cause unintended problems. During a period of heightened insurance losses, both the economy in general and depository institutions in particular are more likely to be distressed. High premiums at such a point in the business cycle would be pro-cyclical and result in a significant drain

on the net income of depository institutions, thereby impeding credit availability and economic recovery. As I will discuss later, there are ways to protect the taxpayers while avoiding some of the pro-cyclicality of the present system.

When a fund's reserve ratio is at or above the 1.25 percent DRR (and is expected to remain above 1.25 percent), current law prohibits the FDIC from charging premiums to institutions that are both well-capitalized, as defined by regulation, and well-managed (generally defined as those with the two best CAMELS examination ratings).[1] Today, 91 percent of banks and thrifts are well-capitalized and well-managed and pay the same rate for deposit insurance - zero. Yet, significant and identifiable differences in risk exposure exist among these 91 percent of insured institutions. To take just one example, since the mid-1980s, institutions rated CAMELS 2 have failed at more than two-and-one-half times the rate of those rated CAMELS 1.

This provision of law produces results that are contrary to the principle of risk-based premiums, a principle that applies to all insurance. The current system does not charge appropriately for risk, which increases the potential for moral hazard and makes safer banks unnecessarily subsidize riskier banks. Both as an actuarial matter and as a matter of fairness, riskier banks should shoulder more of the industry's deposit insurance assessment burden.

In addition, the current statute also permits banks and thrifts to bring new deposits into the system without paying any premiums. Essentially, the banks that were in

[1] CAMELS is an acronym for component ratings assigned in a bank examination: Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk. The best rating is 1; the lowest is 5. A composite CAMELS rating combines these component ratings, again with 1 being the best rating.

existence before 1997 endowed the funds, and newcomers are not required to contribute to the ongoing costs of the deposit insurance system. Since 1996, almost 1,000 new banks and thrifts have joined the system and never paid for the insurance they received. Other institutions have grown significantly without paying additional premiums.

These problems can be addressed by eliminating the existing inflexible statutory requirements and by giving the FDIC Board of Directors the discretion and flexibility to charge regular risk-based premiums over a much wider range of circumstances than current law now permits.

Fund Management

The FDIC recognizes that accumulating money in the insurance fund to protect depositors and taxpayers means less money in the banking system for providing credit. The current system strikes a balance by establishing a reserve ratio target of 1.25 percent. The existing target appears to be a reasonable starting point for the new system—with a modification to allow the reserve ratio to move within a range to ensure that banks are charged steadier premiums. *The point of the reforms is neither to increase assessment revenue from the industry nor to relieve the industry of its obligation to fund the deposit insurance system; rather, it is to distribute the assessment burden more evenly over time and more fairly across insured institutions.*

Under the FDIC's recommendations, the reserve ratio would be allowed to move up and down within a specified range during the business cycle so that premiums can remain steady. The key to fund management would be to maintain the fund within the statutory range and to bring the fund ratio back into the range in an appropriate timeframe

when it moves outside in either direction. As the reserve ratio moves, the Board should have the flexibility to use credits, rebates, or surcharges in order to keep the ratio within the range. Moreover, the greater the range over which the FDIC has discretion to manage the fund, the more flexibility we will have to eliminate the system's current pro-cyclical bias.

The FDIC would prefer to steer clear of hard triggers, caps and mandatory credits or rebates. Automatic triggers that "hard-wire" or mandate specific Board actions are likely to produce unintended adverse effects, not unlike the triggers in the current law. They would add unnecessary rigidity to the system and could prevent the FDIC from responding effectively to unforeseen circumstances. To manage the insurance fund effectively, the Board must have the flexibility to respond appropriately to differing economic and industry conditions.

While I believe that the FDIC Board needs greater discretion to manage the fund, we are not suggesting the FDIC be given absolute discretion -- there is a need for accountability. The FDIC will work with Congress to develop parameters for an appropriate range for the fund ratio. The FDIC also will work with Congress to provide direction for the FDIC Board's management of the fund ratio levels and to develop reporting requirements for the FDIC's actions to manage the funds.

Charging Premiums Based upon Risk

How would premiums work if the FDIC could set them according to the risks in the institutions we insure? First, and foremost, the FDIC would attempt to make them fair and understandable. We would strive to make the pricing mechanism simple and

straightforward. The goals of risk-based premiums can be accomplished with relatively minor adjustments to the FDIC's current assessment system.

I am aware of the concern about using subjective indicators to determine bank premiums. We will be sensitive to that issue and work to ensure that objective indicators are used to the extent possible to measure risk in institutions. Any system adopted by the FDIC will be transparent and open. The industry and the public at large will have the opportunity to weigh in on any changes we propose through the notice-and-comment rulemaking process.

Using the current system as a starting point, the FDIC is considering additional objective financial indicators, based upon the kinds of information that banks and thrifts already report, to distinguish and price for risk more accurately within the existing least-risky (1A) category. As the result of many discussions with bankers, trade-group representatives and other regulators, as well as our own analysis, we are looking at several possible pricing methodologies. We actively seek input from the industry and Congress regarding possible pricing schedules that are analytically sound.

For the largest banks and thrifts, it will be necessary to augment the financial information banks report with other information, including market-based data. The final risk-based pricing system must be fair and must not discriminate in favor of or against banks merely because they happen to be large or small.

In short, the right approach is to use the FDIC's historical experience with bank failures and with the losses caused by banks that have differing characteristics to create sound and defensible distinctions. However, we will not follow the results of our

statistical analysis blindly—we recognize that there is a need to exercise sound judgment in designing the premium system.

ASSESSMENT CREDITS FOR PAST CONTRIBUTIONS

One result of the FDIC's current inability to price risk appropriately is that the deposit insurance system today is almost entirely financed by institutions that paid premiums prior to 1997. Almost 1,000 newly chartered institutions, with more than approximately $80 billion in insured deposits, have never paid premiums for the deposit insurance they receive. Many institutions have greatly increased their deposits since 1996, yet paid nothing more in deposit insurance premiums.

New institutions and fast-growing institutions have benefited from the assessments paid by their older and slower-growing competitors. Under the present system, rapid deposit growth lowers a fund's reserve ratio and increases the probability that additional failures will push a fund's reserve ratio below the DRR, resulting in an immediate increase in premiums for all institutions. One way to address the fairness issue that has arisen and to acknowledge the contributions of the banks and thrifts that built up the funds during the early 1990s is to provide transitional assessment credits to these institutions.

A reasonable way to allocate the initial assessment credit would be according to a snapshot of institutions' relative assessment bases at the end of 1996, the first year that both funds were fully capitalized. Each institution would get a share of the total amount to be credited to the industry based on its share of the combined assessment base at yearend 1996. For example, an institution that held one percent of the industry

assessment base in 1996 would get one percent of the industry's total assessment credit. Relative shares of the 1996 assessment base represent a reasonable proxy for relative contributions to fund capitalization, while avoiding the considerable complications that can be introduced by attempting to reconstruct the individual payment histories of all institutions.

Institutions that had low levels of deposits on December 31, 1996, but subsequently experienced significant deposit growth would receive relatively small assessment credits to be applied against their higher future premiums. Institutions that never paid premiums would receive no assessment credit. Institutions that made significant contributions to the deposit insurance funds would pay a lower net premium than institutions that paid little or nothing into the fund. Such an assessment credit would provide a transition period during which banks that contributed in the past could offset their premium obligations through the use of credits.

The combination of risk-based premiums and assessment credits tied to past contributions to the fund would address the issues related to rapid growers and new entrants. Regular risk-based premiums for all institutions would mean that fast-growing institutions would pay increasingly larger premiums as they gather deposits. Fast growth, if it posed greater risk, also could result in additional premiums through the operation of the FDIC's expanded discretion to price risk.

DEPOSIT INSURANCE COVERAGE

The reforms just described are critical to improving the deposit insurance system. Let me conclude my discussion with the most controversial, but least critical, of the

FDIC's recommendations, the recommendation on coverage. The FDIC's recommendation is simple: whatever the level of deposit insurance coverage Congress deems appropriate, the coverage limit should be indexed to ensure that the value of deposit insurance does not wither away over time. If Congress decides to maintain deposit insurance coverage at its current level, indexing will not expand coverage or expand the federal safety net. It will simply hold the value of coverage steady over time. In addition, without arguing about the causes and contributing factors of the thrift crisis, indexing the limit on a regular basis may prevent possible unintended consequences of large adjustments made on an ad hoc basis in the future.

CONCLUSION

Federal deposit insurance was created in a period of economic crisis to stabilize the economy by protecting depositors. By any measure, it has been remarkably effective in achieving its goals over the years. It is no less important today.

Deposit insurance reform is not about increasing assessment revenue from the industry or relieving the industry of its obligation to fund the deposit insurance system. Rather, the goal of reform is to distribute the assessment burden more evenly over time and more fairly across insured institutions. This is good for depositors, good for the industry and good for the overall economy.

The responsibility of prudently managing the fund and maintaining adequate reserves are taken very seriously by the FDIC—I reiterate: it is extremely important to depositors, the industry and to the financial and economic stability of our country. We have only to look back at the bank and thrift crises of the 1980s and 1990s to understand

this. The existing deposit insurance system has served us well, and we must be mindful of this in contemplating changes.

The FDIC's recommendations would retain the essential characteristics of the present system and improve upon them. While Chairman, I will ensure that the FDIC manages the insurance fund responsibly and is properly accountable to Congress, the public and the industry. Our recommendations will ensure that future Chairmen will do so as well.

Congress has an excellent opportunity to remedy flaws in the deposit insurance system before those flaws cause actual damage either to the banking industry or our economy as a whole. The FDIC has put forward some important recommendations for improving our deposit insurance system. We appreciate the Committee's leadership on this issue and look forward to working with each of you to get the job done this year.