

**H.R. 1185—THE FINANCIAL DEPOSIT
INSURANCE REFORM ACT OF 2005**

HEARING
BEFORE THE
SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED NINTH CONGRESS
FIRST SESSION

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H.R. 1185—THE FINANCIAL DEPOSIT INSURANCE REFORM ACT OF 2005

Thursday, March 17, 2005

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:34 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Royce, Lucas, Kelly, Tiberi, Hensarling, Pearce, Neugebauer, Price, McHenry, Sanders, Meeks, Gutierrez, Moore of Kansas, Hooley, Hinojosa, Baca, Green, Moore of Wisconsin, and Clay.

Mr. BACHUS. [Presiding.] Good morning. The subcommittee will come to order.

Today's hearing is on H.R. 1185, the Federal Deposit Insurance Reform Act of 2005. I want to first welcome FDIC Chairman Don Powell and express my appreciation for all the hard work that you have done on this issue and for your leadership at the FDIC.

You have done an incredibly superb job there. You are a credit to the administration and just one more example of the good people that George W. Bush, our President, has placed in the administration. I always enjoy listening to your testimony and look forward to it today.

I normally do not have a long opening statement, but since there are so few of us, I am going to put some things in the record. Deposit insurance reform has been thoroughly discussed and debated over several years.

During both the 107th Congress and the 108th Congress, we have introduced comprehensive deposit insurance reform legislation. The legislation was a byproduct of recommendations made by the FDIC in early 2001, a series of hearings held in the subcommittee on proposed reform to the Federal deposit insurance system, and broad-based bipartisan cooperation.

H.R. 3717 passed the House in the 107th Congress by a vote of 408 to 18. H.R. 522 passed the House in the 108th Congress by a vote of 411 to 11. Congresswoman Hooley and I introduced this same legislation last week with Chairman Oxley and Ranking Member Frank. There are currently 32 sponsors. I look forward to working on this legislation in the same cooperative vein as last year with Ranking Member Sanders and Mr. Frank.

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

What does the legislation do?

First, it merges the separate insurance funds that currently apply to deposits held by banks on the one hand and savings associations on the other, creating a stronger and more stable fund that will benefit banks and thrifts alike.

Second, the bill makes a number of changes designed to address the pro-cyclical bias of the current system, which results in sharply higher premiums being assessed at down-points in the business cycle when banks can least afford to pay them and when funds are most needed for lending to spur economic growth. By giving the FDIC greater discretion to manage the insurance funds, based on industry conditions and economic trends, the legislation will ease volatility in the banking system and facilitate recovery from economic downturns.

Third, the legislation includes modest increases in the amount of coverage available to depositors. Like other government programs that form part of the economic safety net for American families, deposit insurance should be periodically adjusted for inflation to ensure that its value does not erode over time. The system has gone 25 years without any such adjustment, the longest period in its history. The modest increases that are provided in our bill are critical if deposit insurance is to remain relevant. The alternative is to simply let deposit insurance wither on the vine, which is an unacceptable outcome for millions of Americans who depend upon it to protect their savings.

Much has been made of the fact that the Treasury Department and Federal Reserve oppose increasing deposit insurance coverage levels. What gets lost in the single-minded focus on coverage, however, is that the Treasury, the Fed and every other Federal banking agency broadly support all of the other key components of the reform package, including merging the funds, eliminating the current system's bias, and addressing the so-called "free rider" problem by requiring that large brokerage firms that sweep customer funds from uninsured accounts into insured deposits will have to start paying their fair share of premiums.

I remain hopeful that we can work with the Senate and the administration to resolve the coverage issue and get deposit insurance reform passed this year. All of us have heard from community bankers in our districts about the challenges they face daily in competing for deposits with large money-center banks that are perceived by the market rightly or wrongly as being too big to fail.

By strengthening the deposit insurance system, H.R. 1185 will help small neighborhood-based financial institutions across the country, and particularly in rural America, continue to play an important role in financial economic development.

The deposits that community banks are able to attract through the Federal deposit insurance guarantee are cycled back into those local communities in the form of consumer and small business loans, community development projects and home mortgages. If

this source of funds dries up, it would have devastating effects for the economic vitality of our smaller cities and towns.

Put simply, H.R. 1185 will promote the stability and soundness of the banking system. Moreover, it will provide assurance to working families, retirees and others who place their hard-earned savings in U.S. banks, thrifts and credit unions, that their FDIC-insured deposits are safe and secure. A pledge long made should not be reduced by inflation.

In closing, I want to thank Chairman Oxley, Mr. Sanders and Mr. Frank for working with me to develop this legislation, and thank all 32 cosponsors for making deposit insurance reform one of the committee's top legislative priorities this year.

I look forward to working with Chairman Oxley, with Congresswoman Hooley, Ranking Members Frank and Sanders and other members of the committee on this important issue.

The Chair now recognizes the Ranking Member of the subcommittee, Mr. Sanders, for his opening statement.

Mr. SANDERS. Thank you very much, Mr. Chairman.

Mr. Powell, thank you very much for being with us today. I am going to have to apologize early. I have not figured out how to be at two hearings at the same time, so I am going to have to leave earlier than I would have wanted.

Mr. Chairman, since this is the first hearing in our subcommittee during the 109th Congress, let me begin by expressing the hope that we can work together in a nonpartisan way to address some of the important issues that fall within our subcommittee's jurisdiction.

For example, I am proud to be an original cosponsor of your legislation to protect credit unions. That is an important issue. America's credit unions are one of the most vital, one of the most democratic institutions in America, and it is important that we do everything that we can to protect them.

Mr. Chairman, I also look forward to working with you to provide financial incentives to expand employee ownership throughout the country. I hope Mr. Powell takes some note of that as well.

I thought, in fact, that one of the more interesting hearings that we held last year dealt with the possibility of expanding employee ownership in this country. I look forward to working with you on the issue.

The fact is, there are already in Vermont and around this country many small-and medium-size businesses that are owned by the workers themselves, and those companies are not about to move to China or to Mexico. They are going to stay in their communities and do their best to provide good-paying jobs to the people in those communities. I hope that we can provide financial incentives to those ESOP efforts that are under way.

In addition, Mr. Chairman, I was pleased that we could work together in the last Congress to end what the banks refer to as "universal default" or what I refer to as the credit card bait-and-switch issue. I do not know how much familiarity Mr. Powell has with that issue, but it is to my mind a growing problem where.

And I am sure you have, Mr. Powell, received offers from credit card companies guaranteeing you zero interest, but if you read the fine print you find out that you could end up paying 28 percent or

30 percent interest. This is an alarming problem that is impacting millions of Americans.

I hope, Mr. Chairman, that in a nonpartisan way that we can move forward together. I do not think you want to see the American people ripped off, and you know that people are paying the amount of their loan over many times just in outrageously high interest rates. I hope that we could work together on that.

So there are a lot of important issues facing us, and I think the American people are looking forward to this committee standing up for consumers. It is no great secret that large banks and credit card companies exert an enormous amount of influence over this Congress. I hope that this committee will be representing consumers.

I thank you very much, Mr. Chairman.

Mr. BACHUS. I thank the Ranking Member. As you know, you and I worked as partners together to try to end the more egregious practice of bait and switch. I think it is something that unites Republicans and Democrats, poor, middle-class and affluent citizens. It is something that enrages us all and is, I believe, something that is a practice that is due more regulation. Thank you.

Are there other members?

I would like to recognize Ms. Hooley as the sponsor of the bill.

Ms. HOOLEY. Thank you, Mr. Chair, for calling this hearing today. I am happy to be working with you, Chairman Oxley and Ranking Member Frank in introducing the Federal Deposit Insurance Reform Act of 2005.

This is an effort that I truly believe continues the notable bipartisan working style of this committee and has allowed the attraction of a broad array of cosponsors. The legislation will give Americans an even more stable and secure insurance system for deposits in their banks, thrifts and credit unions.

These needed reforms will bring the deposit insurance system into the 21st century by enhancing the value of our insured deposits, improving retirement security for all Americans, and ensuring that the value, cost and benefit of deposit insurance is shared equally.

I look forward to hearing the views that the panel before us has on this legislation. I also look forward to hearing your views on other pressing issues facing our financial institutions.

I thank the panel for being here, and I look forward to your testimony.

Thank you.

Mr. BACHUS. Thank you.

And now I go to another cosponsor of the bill, Mr. Lucas, for any comments you have.

Mr. LUCAS. I have no statement.

Mr. BACHUS. Okay, if not, Mr. Hinojosa? I appreciate your participation.

Mr. HINOJOSA. Chairman Bachus and Ranking Member Sanders, I want to express my sincere appreciation to both of you for holding this very important hearing today.

I especially want to thank you, Chairman Bachus, for introducing H.R. 1185, the "Deposit Insurance Reform Act of 2005" that we are considering here today. I look forward to cosponsoring this

legislation every Congress, but I hope that the winds are with us this time and the bill will finally become law this year.

As most of us here are aware, the full faith and credit of the United States stands behind trillions of insured deposits at banks and savings associations. This insurance guards depositors' accounts up to \$100,000, providing stability to banks and to the economy since its inception in the 1930s.

From the time I was appointed to this prestigious committee, we have been examining many proposals for changes to the Federal deposit insurance system for banks and savings associations and the share insurance program for credit unions.

Under your guidance, Chairman Bachus, we have considered legislation with provisions to balance the financial condition of insured institutions to ensure the financial strength of the insurance funds, and provide competitive equality among participating institutions, including Federally insured credit unions.

In the 108th Congress, this subcommittee reexamined all these issues. H.R. 522, the Federal Deposit Insurance Reform Act of 2003, sought to restructure the Federal Deposit Insurance Corporation, change the FDIC's pricing of insurance, and increase basic per-account coverage up to \$130,000, indexed to inflation.

It also provided increased insurance coverage of municipal deposits. H.R. 522 passed this committee with the Oxley-Frank manager's amendment and passed the House on April 2, 2003, but the Senate failed to act on that bill, and it died in the 108th Congress. I was proud to have been a cosponsor of H.R. 522.

While I am pleased to learn that the current Administration continues to support deposit insurance reform similar to that proposed in earlier Congresses, I am disheartened by its continued opposition to raising coverage of accounts to \$130,000. Possibly Mr. Powell can shed light on all this. Our financial institutions need this increase in coverage, especially our community banks.

During one of the many hearings on deposit insurance reform over the years, Chairman Alan Greenspan of the Federal Reserve contended that there will always be a niche for community banks, thus negating the need for increased deposit insurance coverage. I believe that he is mistaken and that our community banks are currently at a competitive disadvantage.

Consequently, I believe that H.R. 1185 will help create parity across the financial institutions landscape, and as stated earlier, hope that this bill will finally become law this year.

Having said that, Mr. Chairman, I yield back the remainder of my time.

Mr. BACHUS. Thank you.

I have been told that no members of the majority wish to speak. Is that correct? Is there anyone else that wishes to make an opening statement, Mr. Clay or Ms. Moore? No, okay.

At this time, if there are no further opening statements, we will recognize Chairman Powell for his statement.

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

Mr. POWELL. Thank you, Chairman Bachus, Representative Sanders and members of the subcommittee. It is a pleasure to appear before you this morning to discuss deposit insurance reform.

Deposit insurance reform is the top priority of the FDIC this year. We appreciate the committee making it an early priority as well. I would particularly like to thank Chairman Bachus and the other sponsors of H.R. 1185 for providing leadership on this issue and introducing deposit insurance reform legislation early in the 109th Congress.

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 and provided a safe place for savings and retirement funds.

While the current system is not in need of 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 and the need for that legislation increases with each passing year.

Ensuring that Americans are able to save for retirement, education or medical care has always been important. It is crucial that people continue to feel secure in placing their savings in accounts at insured depository institutions.

A strong deposit insurance system is crucial to maintaining the safety of these accounts and deposit insurance reform legislation as set forth in H.R. 1185 would enable the FDIC to keep the system strong and viable for generations to come.

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.

Today, I want to emphasize three critical elements of deposit insurance reform: one, merging the Bank Insurance Fund and 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 for bank deposits and one for thrift deposits. But 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 would 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 that, as a matter of economic ne-

cessity, we would be asking banks to strengthen their balance sheets and extend credit.

Third, effectively pricing premiums to reflect risk. Under 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 1,100 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 necessarily 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 much the same way.

Please note that an inability to implement such fundamental insurance principles is not merely a theoretical problem. The Pension Benefit Guaranty Corporation, for example, is unable to properly price its premiums for risk and this inability has contributed to its current deficit of over \$23 billion.

With some flexibility in fund management, we can alleviate potential problems, while strengthening our ability to deal with any future crisis.

However, we are not asking for absolute discretion. We recognize the need for accountability and will work with you to ensure a system that provides it. The reforms I have 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 that coverage should be higher, some lower. Our position is simply to maintain its value through indexing.

Again, we appreciate the committee's leadership on deposit insurance reform and look forward to working with you to get this job done this year. I believe that H.R. 1185 is consistent with the spirit of the FDIC's recommendations. Without a doubt, it would create a system that is significantly better than the existing system.

I look forward to your comments and questions.

Thank you.

[The prepared statement of Hon. Donald E. Powell can be found on page 38 in the appendix.]

Mr. BACHUS. Thank you, Chairman.

I first want to say I am pleased to hear you reaffirm in your testimony the FDIC's support for a provision in this legislation that provides for indexing coverage levels for inflation as a way of preserving the value of the coverage for depositors.

When people argue against indexing, aren't they really arguing for the elimination over time of deposit insurance, since over time inflation will completely erode the value of the coverage?

Mr. POWELL. Yes, to some extent I think they are, Chairman Bachus. As you know, with inflation, the \$100,000 has eroded over the past 25 years.

So our position at the FDIC is simply to address that issue with indexing. That way, we can put that issue to the side and the coverage can keep up with inflation.

Mr. BACHUS. I appreciate that.

I will not ask you to comment on this, but I have found in talking to different bankers and members of the public that sometimes the larger banks, there is a perception that they are too big to fail and the government will step in and save them, but some of your community banks and smaller banks I think are disadvantaged, particularly by not raising coverage. But I am not going to ask you to jump into that fray.

I will ask you to address something that Mr. Feeney and I and several other members of the majority, we wrote you, as you know, supporting the idea of including in any Social Security reform proposal a so-called "community bank option," where workers can put a portion of their Social Security monies into a CD-type product at community banks in addition to stock or bond index funds.

The community bank option becomes more important as workers approach or reach retirement age because it protects them against the effects of a significant market downturn.

This community bank option is very low-risk, FDIC-insured, and protects the worker's principal.

Is this a concept that you could support?

Mr. POWELL. I think obviously most Americans want a choice in how to invest their retirement funds. That is the reason that a great majority of Americans put their money in savings accounts and certificates of deposit in insured institutions, because they want the diversity that that offers. It is safe, as you indicated. It is insured by the full faith and credit of the United States.

Plus in many economic cycles, the interest rate is not bad. So you have a fixed-income option through the offering of certificates of deposit.

Mr. BACHUS. I, for one, have supported the President's call for personal retirement accounts because the rate of return of Social Security has been less than the inflation rate, where if we gave Americans the option we give federal employees to invest in the thrift savings account, the worst we would have done with federal employees would have been 4.8 percent, which would have been a rate of return of three times what Social Security had. And the best we would have done is 11 percent.

So all of us are somewhere between 4.8 percent and 11 percent, all federal employees. I just wish that my mother's Social Security investment had had that rate of return.

As the President said, Social Security is a key component of our retirement security system and something that he wants to preserve and make better. I believe that this community bank option, as well as something like all federal employees have.

In your home state of Texas, many counties have turned to this system and none of them have failed. They have all yielded a lot of return. We do not hear any of the horror stories that are really associated with people misunderstanding the President's proposal.

We go in order that the members appeared. Ms. Hooley is next.

Actually, Ms. Moore, you will be after Ms. Hooley on the Republican side, then Mr. Clay, Mr. Moore and Mr. Meeks and Mr. Gutierrez.

On our side, Mr. Lucas is no longer here. It will be Mr. Pearce, Mr. Hinojosa, Mr. Neugebauer, Mr. McHenry and Mr. Royce.

So at this time, I will recognize Ms. Hooley.

Ms. HOOLEY. Thank you, Mr. Chair.

Mr. Powell, thank you very much.

I was meeting with some of the community bankers in my state in Oregon, and asked them what is it that you would like to see changed if you had the ability to do that.

One of the more prevalent sentiments I heard, there seems to be an overabundance of regulators, agencies, rules, and red tape requirements for community banks, both at a State level and a Federal level. We know some of those regulations are important so that you have a system that works and people have confidence in that system.

But they said, would you go back and explore ideas for simplifying the financial regulatory system. I think the Federal Deposit Insurance Reform Act takes a small step in doing that by merging the insurance funds.

I was wondering, do you have any other suggestions for this committee about what we could do? Are there some things out there that make sense and still deal with the safety and soundness and making sure that people have confidence in a system that works?

Mr. POWELL. There is an ongoing effort led by Vice Chairman John Reich of the FDIC, together with all of the other banking regulators, to address this specific issue that you just mentioned, relief, burden relief. It is a constant cry from the industry that the burdens which they are under in order to conduct their business is in fact perhaps is number one or number two on their agenda.

That effort has been going on for about 6 months, where there has been lots of energy and lots of experience directed toward that effort. Vice Chairman Reich has reached out to all constituents, to the industry, to consumer groups and to Members of Congress. He is in the final stages of preparing a recommendation to Congress as it relates to specific regulatory relief.

Without getting into any of those issues, I can assure you that the recommendations will be given to this committee and to a committee in the Senate shortly, and ask that Congress act upon those recommendations.

Ms. HOOLEY. Thank you very much. I appreciate that you are doing that.

Again, we all know there has to be a certain amount of regulation or we do not have a system that works. And yet, what are those things that sort of go over the edge that are not critical to having that confidence in safety and soundness in the system.

Mr. POWELL. I appreciate that. That is the reason his outreach has been to all Americans.

Ms. HOOLEY. All the regulators.

Mr. POWELL. It has been to consumer groups. It has been to individuals and to the banking industry.

Ms. HOOLEY. I will look forward to seeing that report and having it come before our committee.

Thank you.

Mr. BACHUS. Thank you.

Mr. Pearce?

Mr. PEARCE. Thank you, Mr. Chairman.

I really appreciate your testimony. I appreciate what you are trying to do. It makes pretty good common sense.

As I take a look at your testimony on page four, you make the comment that in 93 percent of the institutions that are about equal in their capitalization that there are identifiable differences in the risk.

Can you kind of go through some of those things that would give us numerically an equivalency, but would create significant differences in risk?

Mr. POWELL. Ninety-three percent of the institutions in America today do not pay any premiums.

As with any insurance company, as we all know, risk is not all the same. An institution that may be rated a two or a one, they pose different types of risk. Maybe their concentration issue might be different. Their asset structure might be different. Their liability structure might be different. Their growth rate might be different. Management might be different. Capital might be different.

There are lots of areas that we would look at when determining what the premiums should be. There would be some subjective, obviously, and there will be objective data in there, but we are committed to three areas.

We are committed to making sure that it is fair, transparent, and we are committed also to making sure that the industry has the necessary feedback when we will be determining what the risks should be and how we would approach that risk as it relates to the premiums that they would pay. We would act not unlike an insurance company.

Mr. PEARCE. Again, I am just not so familiar with the exact structure, but what opportunities do banks have if we give you this latitude? And it looks to me like we should. But what responses can banks make if your actions do not seem so transparent or if they do not seem so fair?

Because I think you and your constituents right now in the department would do well, but it is the next group I am worried about.

Mr. POWELL. I think, first of all, they need to be engaged in this process from the very beginning. We seek and covet their input.

Second, if for some reason we are irresponsible in the way we assess these premiums, I think they can do two or three things. First of all, they can contact the FDIC, obviously, and we are going to listen. The folks at the FDIC will listen to that through their trade associations, through their elected officials.

I would expect them to contact members of this committee and members of their local congressional district, trade associations. If we are doing that, I think there would be an outcry.

Mr. PEARCE. I appreciate that.

You recommend later in your presentation that a broader base-point range would be desirable for you to have a little more flexibility. What range are you suggesting?

Mr. POWELL. My preference would be 1 to 1.5, with again some accountability, some reporting requirements back to whomever we should be reporting to.

The more flexibility we can have in managing that fund, I think we can better serve the industry during downtimes as well as good times.

Mr. PEARCE. The scoring of the entire proposal is somewhat different this time that it was last time. I was not around for that one, but do you have an opinion on the scoring of this bill? They have attached quite a cost to it.

Mr. POWELL. Our objective is for it to be revenue-neutral. I think that scoring obviously has some assumptions based upon some future predictability, but our desire is that it be revenue-neutral.

Mr. PEARCE. On the pricing differential for large banks, again I do not know exactly where in here, but you make a comment that we cannot necessarily just price on size alone, but you argue in your presentation that we do need to consider that.

Tell me a little bit more about that particular aspect.

Mr. POWELL. The most important thing is, as I mentioned earlier, we want it to be fair with no discrimination against large institutions or small institutions.

Having said that, the complexity of a large institution, depending upon what that institution may or may not be doing, poses certain risk. We would assess that risk based upon what we would find in their balance sheet, income statement, management and things of that nature.

Mr. PEARCE. Thank you, Mr. Powell.

Thank you, Mr. Chairman.

Mr. BACHUS. Thank you.

Ms. Moore?

Ms. MOORE OF WISCONSIN. Thank you, Mr. Chairman.

I am a brand new member of Congress and a brand new member of this committee. So I guess just by way of education for me, I would like some clarification about your belief that we need to do this merger in order to, I guess I am looking on page three, that it would eliminate the premium disparity between the BIF and the SAIF.

I am remembering from ancient history the collapse of the savings and loan industry. I am wondering right now if there are premium disparities between those folks who have not paid any premiums; between the thrift institutions and the banks.

In other words, is this merger going to cause one industry to subsidize another?

Mr. POWELL. No, ma'am.

Ms. MOORE OF WISCONSIN. And that is because?

Mr. POWELL. That is because they would be treated equally. I think the testimony says the "possibility" of premium disparity. I do not think if the funds in fact are merged, that there will be any disparity between thrifts and the banks.

Ms. MOORE OF WISCONSIN. Okay. What is the reserve ratio now, going into this merger?

Mr. POWELL. It is about 1.34.

Ms. MOORE OF WISCONSIN. So it is above par for what you expect?

Mr. POWELL. Yes, ma'am.

Ms. MOORE OF WISCONSIN. Can you just explain to me, it sort of follows the question that members on the other side asked about the numbers of institutions. You talked about the institutions that do not participate at all. Would they become a part of this new system?

Could you just explain to me how their premiums are going to be priced in a way that is equitable and they are insured, but that it will not cause the other institutions to subsidize?

I just do not understand that. If you could just roll me through it.

Mr. POWELL. Because of the current law, we do not assess premiums to most institutions, only those institutions that are undercapitalized and management is not up to par. It is very few institutions. Ninety-three percent of insured institutions in America do not pay any premium.

I was part of a bank that was chartered about 4 years ago, 5 years ago. We got into the system. We were insured and we did not pay any premium. I do not know of an insurance product that is free. These institutions are all insured and they are not paying any premiums.

Now, if they were here today, they would say, well, we have been paying premiums for a long time when we funded the program many years ago. However, there are a lot of institutions that have been organized after 1996 and they have not paid any premiums at all. So we are attempting to address that.

All institutions will pay based upon their risk profile. Everybody will pay.

Ms. MOORE OF WISCONSIN. So that would be going forward, so those folks who have paid the premium will not have any sort of a refund or credit?

Mr. POWELL. Yes. The proposal as the bill was passed and introduced last year, is that there would be some credit assessments based upon what they had paid into it as of December 31, 1996.

So if you are an institution and you have been paying the premiums, and I am an institution and have not been paying the premiums, I am going to write the check and you are going to get a credit.

Ms. MOORE OF WISCONSIN. Got you. That is what I needed to know. Thank you so much.

Thank you, Mr. Chairman.

Mr. BACHUS. Thank you. Let me commend you for your questioning. You certainly did not question like a new member. You did very well. Thank you.

Mr. HENSARLING?

Mr. HENSARLING. Thank you, Mr. Chairman.

First thing, with all of the television cameras in the hallway, I am tempted to ask the Chairman about possible steroid abuse at the FDIC.

[Laughter.]

I will refrain from that.

Mr. BACHUS. Are you on steroids?

[Laughter.]

Mr. HENSARLING. Although not a major league ballplayer, I know that our Chairman is a major league financial player and his leadership and his stewardship of the FDIC have been excellent, and I certainly commend him for that.

Chairman Powell, this is very old ground that has been tilled by this committee on a couple of occasions, so I do not care to keep you long.

I guess a question I had in the 108th Congress I would like to ask again, that is really to understand the implications for the American taxpayer of this proposal.

Particularly as I understand it, the flexibility that the FDIC seeks on the risk-based premium, that it is not your purpose to increase assessment revenue, merely to redistribute it.

If you do not increase the assessment, yet your deposit coverage limit goes up, aren't you inherently taking on more risk? If you have the same revenue, how can the taxpayer not be exposed to more risk?

Could you help me sleep a little better at night and illuminate this issue for me please?

Mr. POWELL. As you know, the ultimate backstop is the good faith and credit of the United States of America. Having said that, the current law, that duty of paying the premiums and funding any balance of the fund, if the fund gets down to zero, all banks must pay until the fund is adequate.

So we would have to go through a lot of capital, a lot of capital in the banking industry now in excess of \$1 trillion. They, in my view, could pay the necessary premiums without going to the taxpayer to supplement the fund if in fact it went down because of some crisis.

So again, the backstop is the taxpayer, but it first has to go through all of the insured institutions.

Mr. HENSARLING. Thank you very much.

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

Mr. BACHUS. Thank you.

Mr. Meeks?

Mr. MEEKS. Mr. Chairman, I will be brief.

Let me just ask real quick, in regards to municipal deposits, does the FDIC have any safety concerns about whether or not funds which are deposited into commercial banks as opposed to savings banks or credit unions, do you see any risk, any concerns?

Mr. POWELL. No, sir. Most of those funds, the municipal deposits in insured institutions, most states require that there be United States government obligations placed against those funds. We do not have any undue concern about that.

Mr. MEEKS. Has their been an analysis done to your knowledge as to what the DRR would rise to if the individuals who are not paying, the freeloaders were actually paying?

Mr. POWELL. I am sure we have done an analysis and I would be happy to get back to you on that and give you a copy of that

analysis. You are saying those, the free riders, if in fact they were paying, where would the fund be?

Mr. MEEKS. That is correct.

Mr. POWELL. Yes. It would be better, but I do not know how much better, but I would be happy to get that back to you.

[The following information can be found on page 48 in the appendix.]

Mr. MEEKS. Okay. Do you think that credits would kick in? Could it be that good, so much that there would be credits that would immediately kick in?

Mr. POWELL. I doubt that. I doubt that. Depending on what benchmark, would it be 1.5 or 1.3 or 1-whatever that benchmark might be. Most of these that have come on-stream are the smaller institutions, however nobody has paid since 1996, large, small, in between.

Mr. MEEKS. In regards to management of banks, now that the cost of insurance has increased from \$40,000 to \$100,000, have you seen any detriment or any substantial findings, or anything with regard to management of banks because of the increase?

Mr. POWELL. No, sir.

Mr. MEEKS. None at all?

Mr. POWELL. I think what you were referring to is because the coverage was raised, has that caused management to take additional risk or abnormal risk?

Mr. MEEKS. Absolutely.

Mr. POWELL. No.

Mr. MEEKS. Great.

Last question, then. In regards to changing the DRR from the hard 1.25 to a floating 1.15 or to 1.40, what circumstances would have to happen for you to change it or to move it from one direction to the other?

Mr. POWELL. With flexibility in there, and obviously if it started on the downward trend, it would be because of some failures to the system and charges to that particular fund, and that would be during down economic times.

Obviously, if in fact we start increasing the premiums because of that, that would cause some funds that would be normally going to credit and help the economy, it would be paying premiums to the FDIC.

So we would attempt to manage that process. The same thing would be true if the fund was rising, that during good times it may be necessary that we would rebate in the form of credits or in the form of cash rebates.

That would all have to be assessed depending on a global review of the industry and what affect we thought the current economic times and future economic times may cause on the fund.

Mr. MEEKS. Thank you.

I yield back.

And I would love to see that analysis.

Mr. POWELL. Thank you.

Mr. BACHUS. Thank you.

Mr. NEUGEBAUER? I note that you are a cosponsor of the legislation.

Mr. NEUGEBAUER. Yes. Thank you, Mr. Chairman.

Thank you, Chairman Powell, for being here today. I just want to comment and talk about a little, kind of a couple of different issues.

When you say 93 percent of the banks are not paying into the system today, and yet we know if you had an event like we had in Texas in the 1980s, you would have to go to an assessment situation if your reserve dropped below the statutory level. Would that mean that only 7 percent of the banks then would be paying into that? How would be the mechanics of that?

Mr. POWELL. We would start assessing premiums from all banks. In fact, the premiums can go as high as 23 percent to the fund if it's about the necessary benchmark. So all would pay.

Mr. NEUGEBAUER. And then when I think about the 1980s and then I think about today.

Mr. POWELL. I would not like to go back there.

Mr. NEUGEBAUER. I know. I don't either. Thank goodness we survived that.

I think the question that I have is in the marketplace today, Wall Street has devised all of these vehicles where people are putting in and they are saying they are insured accounts, and because there is not a crisis today, is there demand in the marketplace for people coming into financial institutions, is there a worry that, you know, are my funds insured?

Because I know some of my friends, I am kind of paranoid about that because I was in an area where that, but they do not give any thought to whether their funds are insured. What is your perception of the demand in the marketplace for higher insurance levels?

Mr. POWELL. That is a tough issue. I talk to a lot of bankers at large institutions, small institutions, metropolitan institutions, country banks and so forth.

I think it depends upon your market. It depends upon your market. Some folks believe that they would receive more deposits if in fact the coverage was raised. Others do not believe it is important because of the current economic times we are in, that their customer base is not concerned about increasing the coverage. They believe that \$100,000 is adequate.

We at the FDIC have tried to listen to all of those parties. We do know that it has not been changed in the last 25-plus years, and that it has deteriorated over time. Attempting to put that question behind us, that is the reason our recommendation is that it be indexed.

Mr. NEUGEBAUER. The third question I have, you mentioned the pension fund. It is in deficit. Do you think the current reserve level is based on the risk to FDIC at this particular point in time? Or are we at adequate levels? Or should we think about increasing that?

Mr. POWELL. Congressman, I think we are at adequate levels, based upon current economic data and the current condition of the industry. I think we are at a good level.

I do not know what tomorrow is going to bring, and that is the reason we are asking for more flexibility to manage that fund during good times and during bad times.

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

Mr. BACHUS. Thank you, Mr. Neugebauer.

Mr. Moore?

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman.

Mr. Chairman, I want to thank you for being here today and for your testimony and for your good work in this area. I am a cosponsor of H.R. 1185 and I appreciate your work there, and I certainly appreciate Chairman Bachus's work as well.

I have no further questions, but thank you, sir.

Mr. POWELL. Thank you.

Mr. BACHUS. Thank you, Mr. Moore.

Mr. McHenry?

Mr. MCHENRY. Low man on the totem pole. I always get forgotten.

Mr. BACHUS. You are an important new member of this committee. With a name like Patrick McHenry, I mean, how could you be anything but a patriot?

[Laughter.]

Mr. MCHENRY. Thank you, Mr. Chairman.

Unfortunately, the gentleman from Texas, Mr. Hensarling, took my joke. That is a mistake a freshman would make is telling a more senior member the good line he was going to use, and then he uses it about 20 minutes before he can.

But thank you for being here today. I certainly applaud the Chairman for taking on this task.

I am a new member of the committee. I am also a member of the Budget Committee. As such, I thought I would ask in terms of the budget impact. Certainly, I know the history here. In the past, it was scored as a net savings to the budget, and now it seems it is being scored as an additional cost to the American people.

I would hope that you could address that.

Mr. POWELL. Yes. We have reviewed that.

First of all, our intent is that it be revenue-neutral. I think it is revenue-neutral. Their analysis is based on some assumptions and some projections of the future that none of us have control over. Again, our hope is and our desire is and our intent is that it be revenue-neutral.

Mr. MCHENRY. Excellent.

In terms of how this will impact the average American, if you could speak in those terms. How will it affect the average American who goes to their community bank and makes their deposit? How is that going to affect the average community bank and how is that going to affect some of your average working men and women?

Mr. POWELL. I think the average customer of the "average" bank in America will not see any effect other than from the savings side. They are conscious of making sure that their funds are safe and secure in an insured institution. They understand what the FDIC is and what that means to financial stability, not only of their institution, but the financial stability of the banking system in America. So I think there is a keen awareness of that.

On the other side, I think what it really speaks to is that most Americans when we have an economic downturn, credit is restricted. You cannot borrow money in bad times. You can always

borrow money in good times, so credit is restricted. And that is the time that really we need banks extending credit.

With the current system, banks will be paying premiums, or they may be paying premiums, more premiums for their FDIC insurance than under this proposal. So that is the reason we have asked for flexibility as it relates to assessment to institutions to make sure that this pro-cyclical event does not occur again.

Mr. MCHENRY. Certainly. I certainly appreciate your testimony and answering the questions today. I certainly have a number of other questions for you, but not pertaining specifically to deposit insurance reform. I hope that we can discuss those at some point.

Mr. POWELL. I would be happy to come see you.

Mr. MCHENRY. Thanks so much.

Thank you, Mr. Chairman. I yield back my time.

Mr. BACHUS. Mr. Royce?

Mr. ROYCE. Thank you, Mr. Chairman.

I welcome you, Chairman Powell. I want to indicate I am a strong supporter and advocate of merging the BIF and the SAIF. I am very much in favor of the flexible DRR provision that is in this bill. But what gives me pause is the increase in the deposit insurance limit. I cannot support the bill with that in it. I have heard Chairman Greenspan lay out an argument, a case that I would just like to repeat briefly here.

He says that extending the liability of the fund beyond the \$100,000 limit would do the following. I would like to get your thoughts on that. He says it would increase the government subsidy to depository institutions. It would expand moral hazard and it would reduce the incentive for market discipline without providing any clear public benefit. I thought I would ask you for your response to Chairman Greenspan.

Mr. POWELL. I agree with his first point.

On number two, I would have a different view. I understand his view on number two and number three, moral hazard. I was in the banking business almost 40 years and was in Texas during the worst downturn we have ever had in the banking business. I can assure you, Congressman, that deposit insurance coverage did not dictate my management style or my management decisions. I do not think it dictated any banker in Texas.

What that really implies is that because of the subsidy, I am going to take additional risk. When I take additional risk, I may lose my job. I may lose my investment in the bank and the bank may fail. So that has to be measured depending upon lots of things in the marketplace. It is a factor. It is a factor and I do not deny that at all. But I do not think it is an overwhelming factor. Obviously, if we did not have deposit insurance, I would not have the funding to make loans and any loan poses some risk.

The third one is, I can again understand that view. It really relates to the second one.

Mr. ROYCE. Yes. I understand you.

Mr. POWELL. I think deposit insurance clearly provides stability in the marketplace. We do not have runs on it, and I think the FDIC still stands for the symbol of confidence. That is powerful. That is powerful in the economic free markets that we have in America. I think we are the envy of the world, and for lots of rea-

sons. I think deposit insurance contributes to that stability and that confidence that Americans have when they deposit their money in a bank.

Mr. ROYCE. I understand that argument. The moral hazard argument, though, is one that has been persuasive not just with the Federal Reserve that is opposed, but also the Office of Thrift Supervision and with the Office of the Comptroller of the Currency, and also with the Treasury Department. All of these agencies oppose increasing the deposit coverage limits because of their concerns about safety and soundness.

The second question, or last question, I wanted to ask you is this. I think an argument has been made that as the insurance limit increases, individual depositors are less likely to become another check out there on the bank's management. In other words, a bank will not have to be as well managed during troubling times to attract more deposits because the money is guaranteed by the FDIC. Chairman Greenspan calls this phenomenon reputation risk. He says under this kind of scenario, there is no reputation risk. As members of this committee, shouldn't we be concerned about this argument?

Mr. POWELL. Let me go back to your first question, because I want to respond to that.

Mr. ROYCE. Sure, absolutely.

Mr. POWELL. We at the FDIC are not recommending increasing coverage. I want to be sure you understand. We are recommending that coverage not be diluted in any way. The \$100,000 we believe has served America okay. We just want it to keep its value so therefore we are indexing. So we are not recommending coverage.

Your second question, again, it is a fair view. There is a balance there. I do not think the average American depositor could understand the condition of a bank anyway. I do not think they could read a financial statement, a balance sheet and an income statement and come away with making some judgment of whether they should put their money in that institution.

I think Congress made that decision many years ago when they established the FDIC, that it was in the best interest of America that we provide some stability, the taxpayers provide some stability of where I could put my money in and not be sophisticated and know that it is safe.

Whether it should be \$100,000, that is a debate for another issue, but clearly deposit insurance was a policy issue that the American people I think wanted because of them being not sufficient to determine in fact if that is a safe investment.

That is the reason we have other choices. That is the reason a consumer can put it in a non-insured institution. That is the reason they can put it in the stock market. That is the reason they can put it in some other thing, but in an insured institution, it provides safety that one can have.

I think obviously because of that subsidy, banks are regulated. Banks have to do certain things that others do not, that is not there. I think also banks have provided a tremendous economic engine. I am not sure they could have done that without "the subsidy" and the regulation because of that subsidy, the regulation

that that imposes upon them and puts discipline into the system that perhaps you would not have.

Because of that economic engine, I think we are all better off in America from an economic standpoint.

Mr. ROYCE. Thank you, Chairman Powell.

Thank you, Chairman Bachus.

Mr. BACHUS. Thank you, Mr. Royce.

I will recognize Mr. Baca, and then I would like to ask another follow-up question to Mr. Royce, and might actually yield to him when I do that.

Mr. Baca?

Mr. BACA. Thank you very much, Mr. Chairman.

Mr. Powell, as you know, H.R. 1185 increased the amount of coverage for retirement accounts to \$260,000 and requires the retirement coverage level to be indexed every 5 years in order to protect the value of the safety net.

Given the sensitivity of the retirement savings issue after the Enron and WorldCom downfalls, do you think the increased coverage level for retirement accounts and municipal deposits is sufficient? And if so, why?

Mr. POWELL. I think it is sufficient, but I am not sure I can tell you why. That number just doubles the \$130,000, and that number could have been \$200,000. There have been a lot of studies. I think there is \$225 billion in the banking industry in the form of retirement funds, but that is not very much compared to the global retirement deposits in all types of institutions.

As Americans become older and savings are increasingly important to all of us, that could be revisited from time to time. But I think where it is today, we at the FDIC have been neutral on that particular dollar amount.

Mr. BACA. Because apparently there seems to be a lack of trust by the American people, especially with what happened with Enron and WorldCom recently. So it appears that we really have to go back and revisit this because people are very much concerned with their future in terms of what happens.

Even right now with Social Security, when you look at the year 2042, when we are really going to have a crisis. We do not have a crisis right now, but could have a crisis if we do not begin to move in the right direction.

Mr. POWELL. I agree.

Mr. BACA. Okay.

Thank you very much, Mr. Chairman. No further questions. I yield back the balance of my time.

Mr. BACHUS. Thank you, Chairman Powell.

Mr. Royce had to leave for another hearing, but I was kind of curious to see if you had any thoughts on, he mentioned Chairman Greenspan and the Treasury Department under Secretary Rubin.

They took a position against insuring Americans who deposited their money for over \$100,000 in American institutions. They said it created a moral hazard and that the government should not be in the job of insuring deposits. In fact, Chairman Greenspan has said he would just as soon let it wither on the vine. He does not think the government ought to be guaranteeing things.

My question for Mr. Royce, I guess, and for you is, why has the Federal Reserve and the Treasury bailed out some 77 different institutions, including Mexico, for several billion dollars, and Long Term Capital Management which did not pay a dime into any insurance fund?

It just mystifies me how Chairman Greenspan would say that the American people who invest \$120,000 in a savings account, why we should let them lose their money, but we ought to bail out Long Term Capital Management, a massive hedge fund, which only had multimillionaire investors, that we ought to bail that out?

Because when these institutions go belly up, then it affects the whole economy.

I would think that when a little bank in Texas or a little bank in Georgia or a little bank in California goes under, that the Federal Government, that the people who paid into the insurance fund and who are willing to pay for more coverage, that they are entitled, basically, to be covered, as opposed to Long Term Capital Management, with several billion dollars in 1998, the same folks that you are now quoting rushed to their defense. They had not paid a dime into the government or to the taxpayers, and the taxpayers picked up billions of dollars. Mexico, several other large institutions, and they stepped in and insured it to the limit.

Mr. ROYCE. If the gentleman would yield just for a minute.

Just for the record, Mr. Chairman, I wanted to make it clear that I argued at the time and voted against the bailout for Mexico and other bailouts as well.

So for me, the moral hazard argument is a philosophical argument. When I hear others put that argument forward, and I am mindful of past experience with moral hazard, that is why I brought it up today with Chairman Powell.

Mr. BACHUS. I guess I am just asking you and Chairman Powell, don't you agree that it is more egregious? I do not think it is egregious if people want to pay into insurance \$120,000. But you know that is a question of policy. I am just saying that you quoted Chairman Greenspan, and the Treasury Department, Bob Rubin, they bailed out Mexico. What was the reason for that?

Mr. ROYCE. I debated that argument. I talked to Secretary Rubin at the time about that and raised my concerns that the bailout of Mexico, the moral hazard there, might lead to other risky behavior. I feel that subsequently it led to a little more risk taken in the markets in Asia.

Mr. BACHUS. I agree.

Mr. ROYCE. As a consequence of the moral hazard of bailing out Mexico, we set up the institutions in the United States and our investors to over-invest in a hot market in Asia, and as a consequence of that mal-investment, we then went through a second phase. And so, as a matter of fact I had breakfast with Chairman Greenspan at the time in order to lay out that argument about the bailout in Mexico. So I just for the record wanted to clarify.

Mr. BACHUS. I did not know if he at the time gave you some explanation, at the same time he was saying to my constituents back in Greenville, Alabama, or a little town that wanted \$120,000 worth of coverage for their retirement income, why he did not want to cover that, but he was willing to go to Mexico or bail out a bunch

of millionaire hedge fund owners that had not paid a dime into any fund. I just did not know what the explanation was, if he offered you an explanation for why they were for that. Was it just the Washington view?

Mr. ROYCE. I think that the views expressed by all of the agencies that we have discussed I would hope indicate that they have learned something from the bailout of Mexico. My real hope would be that the more we move toward free market solutions and the more we move away from subsidies, the less likely we will be to see something like the Asian meltdown or the situation in Mexico in the future.

I think the answer to this is to get back to market-based economic principles and to move away from implied subsidies and moral hazard.

Mr. BACHUS. You would actually be for abolishing the guarantee altogether?

Mr. ROYCE. Well, I was not aware that I was going to be a witness here today.

[Laughter.]

But let me make this point, if I could, Mr. Chairman.

I am for not compounding a problem that I have witnessed in the past with regard to what happened in the S&L industry, with regard to what happened in the bailout of Mexico.

I mean, as I look at this economic conundrum that results whenever we create an incentive for money to move where there is an implied government guarantee of a bailout, I think we inevitably run into some moral risk questions and problems.

That is why I raised it today. I did raise it because many of the regulatory institutions that have oversight have raised that argument, but they are not witnesses here today. They have not been invited here today.

I just thought that at this hearing with Chairman Powell, at least the economic arguments should be put forward. That is why I raised it.

Mr. BACHUS. I do not think there is an implied guarantee. I think people pay into the insurance fund and it is a guarantee. I do not think there is anything implied about the guarantee to depositors.

Mr. ROYCE. No, in this case it is a direct guarantee.

Mr. BACHUS. I think Mexico is a good example.

Mr. ROYCE. In many other cases, we are advancing implied guarantees, and that is also a concern to me and that is why I raised that issue as well.

Mr. BACHUS. I just think it is healthy, and I think that it is consistent with wanting to raise coverage to keep up with inflation, to do what Chairman Greenspan, to say that he does not believe in deposit insurance. He would just as soon it wither on the vine.

I just think it is more important that we guarantee deposits in our institutions. I think the savings and loan crisis would have been lots worse if there had been no guarantee. Boy, I cannot imagine what the recovery would have been like.

Mr. ROYCE. Arguably, if the gentleman would yield, I think the argument can be made that without the types of guarantees and

encouragement that existed there, and without Congress expanding and increasing that guarantee, which this institution did.

It took the amount, it doubled the amount at one point, and then it allowed all types of additional investment, and as a consequence of that it created an environment where at least economists believe it incentivized this risk-taking, and as a consequence of that we had the comeuppance of the failures—

Mr. BACHUS. The other thing is, and even Chairman Greenspan has said part of the savings and loan problem was the problem that Congress came with new legislation and authorized the savings and loans to do a lot of things they had not been doing, and it was that that caused the system to fail, not the deposit insurance guarantee which had existed since the Depression.

So it was not deposit insurance that caused the system to fail. If it had been that, it would have failed before, and the banks did not fail. That had to be something to do with the savings and loans. The banks did not fail.

Mr. ROYCE. The Chairman of this committee at the time, and this certainly predates our election to the Congress, but the Chairman of the Banking Committee at the time, as memory serves, sponsored a bill to double the deposit insurance in that industry, for the S&L industry.

Anyway, I just wanted to raise these economic points, and I appreciate your forbearance in allowing me to do so.

Thank you, Mr. Chairman.

Mr. BACHUS. I appreciate that, Mr. Royce, because I think when we have these discussions—did you have any comments you wish to make?

Mr. POWELL. No, sir.

[Laughter.]

Mr. BACHUS. I was pretty sure of that.

I just hope that the money that is paid into FDIC will be used to insure deposits and not be used to, that or the Federal Reserve or any other government money will be used to bail out hedge funds or Mexico or other countries, which has been the case in 77 different instances.

If there are no other questions. Oh, Mr. Price?

Mr. PRICE. I just enjoyed the colloquy.

[Laughter.]

Mr. BACHUS. You can see that we are working toward a bipartisan solution to this problem.

I will say this, one thing you said this morning is increasing the range. I will tell you that my thought on this was that we ought to at least bring it down to 1 or 1.1. I do not know why 1.5, if anything, if it is going to go from 1.25, it ought to go in the same direction, the same distance.

I will say that I believe anything above 1.4 could create a drain and could make banks noncompetitive, and that is the last thing we want to do. If I had my druthers, I would say 1 to 1.35. I do think that moving it down, that there would probably be very little resistance from this committee if someone offered an amendment to that effect.

I thank you for your attendance.

Mr. POWELL. Thank you, sir.

Mr. BACHUS. I have always admired your leadership, and I feel like you have brought is you have brought representation from mainstream America and from financial institutions, and from constituents outside the beltway. I think that is very refreshing.

Mr. POWELL. Thank you.

[Whereupon, at 10:50 a.m., the subcommittee was adjourned.]

A P P E N D I X

March 17, 2005

Prepared, not delivered

Opening Statement
Chairman Michael G. Oxley
Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit
March 17, 2005

Hearing on H.R. 1185, the Federal Deposit Insurance Reform Act of 2005

Thank you, Chairman Bachus, for holding this hearing on your recently introduced legislation to reform the Federal deposit insurance system, which I am proud to cosponsor. I join you in welcoming Chairman Powell back to the Committee. We always benefit from your wise counsel, not only on deposit insurance reform, but on the whole range of issues and challenges facing our nation's banking system.

With respect to deposit insurance reform, we have obviously been around this track before. Thanks in no small measure to the energetic leadership and commitment of Chairman Bachus, the House has passed comprehensive reform legislation in two successive Congresses, both times with well over 400 votes, only to watch it die in the Senate. The swearing in of a new Congress brings hope that the other body will take a fresh look at the need for this critically important legislation. I take Chairman Shelby at his word that deposit insurance reform will receive consideration in his Committee in this Congress, and I know that there are many Senators on both sides of the aisle who stand ready to help him move the process forward.

The reasons for reforming the deposit insurance system are every bit as compelling and urgent today as they were three years ago when we first embarked upon this journey. Merging the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into a single deposit insurance fund will create administrative efficiencies and promote fundamental fairness in the system. Giving the FDIC more flexible tools for managing the insurance funds according to changing economic conditions, while at the same time ensuring that funds are returned to the industry in the form of rebates and credits when circumstances warrant, promotes economic stability and addresses the current system's pro-cyclical bias. All of these reforms command broad consensus among banking regulators and in the banking industry.

On the issue of deposit insurance coverage levels, which have now gone a record 25 years without being updated, Chairman Bachus' legislation provides for incremental increases that promote retirement security and help to keep municipal deposits in the communities where they originated, to serve as a funding source for loans and other development initiatives. Chairman Bachus and I have indicated previously that while we believe the coverage increases that have received overwhelming support in the House are fully justified on public policy grounds, we are willing to entertain compromise on that issue if it is the price of achieving the other important reforms contained in the legislation.

As Chairman Powell has reminded us on more than one occasion, the time to reform deposit insurance is now, while the banking industry is enjoying record profitability, bank failures are at historically low levels, and the insurance funds are well capitalized, **not** when conditions have deteriorated and we find ourselves legislating (as we so often do) in a crisis environment.

Before closing, I also want to take this opportunity to commend Chairman Powell for his leadership in achieving consensus with other Federal banking regulators on a significant (and long overdue) revision of the regulations implementing the Community Reinvestment Act (CRA). By raising the asset threshold for streamlined CRA examination treatment and building greater flexibility into the CRA compliance process, the new regulations give much-needed regulatory relief to America's smaller banks, while at the same time ensuring that these institutions continue to serve the needs of their communities.

I hope that the same spirit of inter-agency cooperation that informed the new CRA regulations can produce meaningful recommendations later this year for relieving other unnecessary regulatory burdens on the banking industry, as part of the so-called EGRPRA process on which the FDIC is taking the lead among the Federal banking agencies.

I look forward to Chairman Powell's testimony, and I yield back the balance of my time.

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**OPENING STATEMENT OF CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER
CREDIT
H.R. 1185, THE FEDERAL DEPOSIT INSURANCE REFORM ACT OF
2005**

Good morning. The subcommittee will come to order. Today's hearing is on H.R. 1185, the Federal Deposit Insurance Reform Act of 2005. I want to first welcome FDIC Chairman Don Powell and express my appreciation for all of the hard work that he has done on this issue. I always enjoy hearing what you have to say and look forward to hearing your testimony today.

Deposit insurance reform has been thoroughly discussed and debated over several years. During both the 107th (H.R. 3717) and 108th (H.R. 522) Congress, I introduced comprehensive deposit insurance reform legislation. The legislation was a byproduct of recommendations made by the FDIC in early 2001, a series of hearings held in my Subcommittee on proposed reforms to the Federal deposit insurance system, and broad-based bipartisan cooperation. H.R. 3717 passed the House in the 107th Congress by a vote of 408-18, and H.R. 522 passed the House in the 108th Congress by a vote of 411-11.

Congresswoman Hooley and I introduced this same legislation last week with Chairman Oxley and Ranking Member Frank. H.R. 1185, the Deposit Insurance Reform Act of 2003 currently has 32 sponsors. I look forward to working on this legislation in the same cooperative vein as last year.

Federal deposit insurance has been a hallmark of our nation's banking system for almost 70 years. The reforms made by this legislation will ensure that this system that has served America's savers and depositors so well for so long will continue to do so for future generations.

What does the legislation do? First, it merges the separate insurance funds that currently apply to deposits held by banks on the one hand and savings associations on the other, creating a stronger and more stable fund that will benefit banks and thrifts alike.

Second, the bill makes a number of changes designed to address the “pro-cyclical” bias of the current system, which results in sharply higher premiums being assessed at “down” points in the business cycle, when banks can least afford to pay them and when funds are most needed for lending to jumpstart economic growth. By giving the FDIC greater discretion to manage the insurance funds based on industry conditions and economic trends, the legislation will ease volatility in the banking system and facilitate recovery from economic downturns.

Third, the legislation includes modest increases in the amount of coverage available to depositors. Like other government programs that form part of the economic safety net for America’s families, deposit insurance should be periodically adjusted for inflation to ensure that its value does not erode over time. The system has gone 25 years without such an adjustment – the longest period in its history – and the modest increases provided for in our bill are critical if deposit insurance is to maintain its relevance. The alternative is to simply let deposit insurance wither on the vine, which is an unacceptable outcome for the millions of Americans who depend upon it to protect their savings.

Much has been made of the fact that the Treasury Department and the Federal Reserve Board oppose increasing deposit insurance coverage levels. What gets lost in the single-minded focus on coverage, however, is that the Treasury, the Fed and every other Federal banking agency broadly support

all of the other key components of this reform package, including merging the insurance funds, eliminating the current system's pro-cyclical bias, and addressing the so-called "free rider" problem by requiring that large brokerage firms that sweep customer funds from uninsured accounts into insured deposits will have to start paying their fair share of premiums. I remain hopeful that we can work with the Senate and Administration to resolve the coverage issue and get deposit insurance reform passed this year.

All of us have heard from community bankers in our districts about the challenges they face in competing for deposits with large money-center banks that are perceived by the market – rightly or wrongly – as being "too big to fail." By strengthening the deposit insurance system, H.R. 1185 will help small, neighborhood-based financial institutions across the country, particularly in rural America, continue to play an important role in financing economic development. The deposits that community banks are able to attract through the Federal deposit insurance guarantee are cycled back into local communities in the form of consumer and small business loans, community development projects, and home mortgages. If this source of funding dries up, it will have devastating consequences for the economic vitality of small-town America.

Put simply, H.R. 1185 will promote the stability and soundness of the banking system. Moreover, it will provide assurance to working families, retirees, and others who place their hard-earned savings in U.S. banks, thrifts, and credit unions that their FDIC-insured deposits are safe and secure.

In closing, I want to thank Chairman Oxley for working with me to develop this legislation, and for making deposit insurance reform one of the Committee's top legislative priorities this year. I look forward to working

with him, Congresswoman Hooley, Ranking Member Frank and other Members of the Committee on this important issue.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement he would like to make.

March 17, 2005

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
Hearing on H.R. 1185, the Federal Deposit Insurance Reform Act of 2005

Thank you, Mr. Chairman, for calling this hearing today to discuss the merits of H.R. 1185, the Federal Deposit Insurance Reform Act of 2005. Furthermore, I welcome you here today Chairman Powell, and look forward to your testimony and comments.

As an original cosponsor of H.R. 1185, I am particularly pleased to see that this important reform measure again incorporates a measure that I re-introduced last month, H.R. 544, the Municipal Deposit Insurance Protection Act of 2005. Of note, such language increases 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 neighborhood, improving the economic climate by enabling local banks to offer more loans for cars, homes, education and other community needs.

Currently, local government entities, such as villages, towns, counties and school districts, 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 and often times community banks are so “loaned-up” that they do not have the available securities to use as collateral.

As I have mentioned numerous times throughout our panel’s deposit insurance debate history, in 2002, 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. This risk is simply too high for any community in this country and can have a devastating impact on local budgets. The community in Oakwood is still feeling the effects of this failure. The village was forced to miss a federal loan payment for its sewers and was forced to lay off municipal employees, all because of the funds it lost. Wayne Trace Local school district and Paulding County Hospital were also harmed by this lack of coverage.

Again, I applaud the Chairman for bringing this important issue to the table in the 109th Congress, am remain hopeful that our panel can move forward and present another meaningful reform bill on the House floor. I yield back the remainder of my time.

**OPENING REMARKS OF THE HONORABLE RUBEN HINOJOSA
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
“H.R. 1185, THE DEPOSIT INSURANCE REFORM ACT OF 2005”
MARCH 17, 2005**

Chairman Bachus and Ranking Member Sanders,

I want to express my sincere appreciation for you holding this very important hearing today, and I especially want to thank you, Chairman Bachus, for introducing H.R. 1185, the “Deposit Insurance Reform Act of 2005” that we are considering here today. I look forward to cosponsoring this legislation every Congress, but I hope that the “winds” are with us this time and the bill will finally become law.

As most of us here are aware, the full faith and credit of the United States stands behind trillions of insured deposits at banks and savings associations. This insurance guards savers’ accounts up to \$100,000, providing stability to banks and to the economy since its inception in the 1930s.

From the time I was appointed to this prestigious Committee, we have been examining many proposals for changes in the federal deposit insurance system for banks and savings associations and the share insurance program for credit unions. Under your guidance, Chairman Bachus, we have considered legislation with provisions to balance the financial condition of insured institutions, ensure the financial strength of the insurance funds, and provide competitive equality among participating institutions, including federally-insured credit unions.

In the 108th Congress, this Subcommittee re-examined all these issues. H.R. 522, the “Federal Deposit Insurance Reform Act of 2003,” sought to restructure Federal Deposit Insurance Corporation (FDIC), change the FDIC’s pricing of insurance, and increase basic per-account coverage to \$130,000 and for future inflation. It also provided greater insurance of municipal deposits. H.R. 522 passed the Committee with the Oxley-Frank Manager’s amendment and passed the House on April 2, 2003, but the Senate failed to take a similar approach to deposit insurance reform. I was proud to cosponsor that legislation.

While I am pleased to learn that the current Administration continues to support deposit insurance reform similar to that proposed in earlier Congresses, I am disheartened by its continued opposition to raising coverage of accounts to \$130,000. Our financial institutions need this increase in coverage, especially our community banks. During one of the many hearings on deposit insurance reform over the years, Chairman Alan Greenspan of the Federal Reserve contended that there will always be a niche for community banks, thus negating the need for increased deposit insurance coverage. I believe that he is mistaken and that our community banks are at a competitive disadvantage of their larger counterparts. Consequently, I support H.R. 1185 and hope that it finally becomes law.

Having said that Mr. Chairman, I yield back the remainder of my time.

Opening Statement
Congressman Ed Royce (CA-40)
17 March 2005
"H.R. 1185, the FDIC Reform Act of 2005"

Thank you, Mr. Chairman, and thank you for holding this hearing on "H.R. 1185, the FDIC Reform Act of 2005." I would like to commend the Chairman for his continued leadership of the Subcommittee.

In my view, there are a number of positive provisions in H.R. 1185. In particular, I am a strong supporter and advocate of merging the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). Merging BIF and SAIF into a single fund would reduce the fund's overall exposure to risk and its volatility. Additionally, 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 -- addresses the fund's current pro-cyclical bias and prevent institutions from having to pay sharply-increased premiums when they are least able to do so.

Despite the many favorable components of this legislation, I cannot support H.R. 1185 as it contains provisions allowing for an increase in deposit insurance coverage from \$100,000 to \$130,000 and an indexing of the \$130,000 thereafter. 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 Treasury

Department all oppose increasing deposit coverage limits in the interest of safety and soundness.

I appreciate this opportunity to clarify my position on the Federal Deposit Insurance Reform Act of 2005. While I strongly support deposit insurance reform, I cannot support putting the American taxpayer at risk by increasing insurance coverage levels. I look forward to Chairman Powell's testimony and insights and I yield back the balance of my time.

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STATEMENT OF

**DONALD E. POWELL
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION**

on

DEPOSIT INSURANCE REFORM

before the

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT**

of the

**COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES**

**March 17, 2005
Room 2128, Rayburn House Office Building**

Chairman Bachus, Representative Sanders, and members of the Subcommittee, it is a pleasure to appear before you this morning to discuss deposit insurance reform. This remains the top priority of the Federal Deposit Insurance Corporation and I appreciate the continuing interest in pursuing reform on the part of this Subcommittee and the Committee on Financial Services.

The fact that the Committee has twice been able to write legislation that has attracted more than 400 votes in the House of Representatives is an admirable accomplishment. I especially want to thank Chairman Bachus for recently introducing H.R. 1185, The Federal Deposit Insurance Act of 2005. I would also like to thank Committee Chairman Oxley, Representative Frank, Representative Hooley, and others for cosponsoring the bill.

Your commitment to deposit insurance reform and your perseverance in getting reform legislation passed, even in the absence of a current crisis, are in the finest traditions of public service. I remain convinced that our continued persistence will produce reform legislation that is in the best interests of the economy, the public and the industry.

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 and provided a safe place for savings and retirement funds. This aspect of security becomes more important as Congress looks at alternative savings and retirement vehicles.

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, and the need for that legislation increases with each passing year.

The banking industry has been experiencing rapid change. Unfortunately, the deposit insurance system itself has not kept pace. We are increasingly forced to apply an old fashioned system to a modern, complex and rapidly evolving industry.

Of the FDIC's proposals to reform the deposit insurance system, I want to emphasize today just the three elements of reform that the FDIC regards as most critical: merging the funds, improving the FDIC's ability to manage a merged 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 agreement and support among the bank and thrift regulators for these reforms.

THE FDIC'S RECOMMENDATIONS

Merge 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. In addition, a merged fund would eliminate the possibility of a premium disparity between the BIF and the SAIF. For these reasons, the FDIC has advocated merging the BIF and the SAIF for a number of years as part of a reform of our insurance system.

Give the FDIC Discretion to Price for Risk and Manage the Fund

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 sufficiently below the DRR, the requirement for high premiums could be triggered. Since such a large fall is most likely during a recession or depression, the statute could impose a significant drain on the net income of depository institutions when they can least afford it, thereby impeding credit availability and economic recovery. As I will discuss later, there are ways to protect taxpayers while avoiding some of the pro-cyclicality of the present system.

When a fund's reserve ratio is at or above the 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.

Today, 93 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 93 percent of insured institutions.

Pricing for Risk

The current system prevents the FDIC from charging 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. The failure to abide by fundamental insurance principles is not merely a theoretical problem. The Pension Benefit Guaranty Corporation, for example, is unable to properly price its premiums for risk, and this inability has contributed to its current deficit of over \$23 billion.

The current statute governing deposit insurance premiums also permits banks and thrifts to bring new deposits into the system without paying any premiums. Essentially, the banks that were in existence before 1997 endowed the funds, and newcomers have not been required to contribute to the ongoing costs of the deposit insurance system. Since 1996, almost 1,100 new banks and thrifts, which hold \$262 billion in assessable deposits, have joined the system and never paid for insurance. Other institutions have grown significantly without paying additional premiums. Through premiums paid up to 1996, in effect, older and more slowly growing institutions are subsidizing these new and fast-growing institutions.

These problems can be addressed by combining two complementary approaches. First, provide an initial, transitional assessment credit to institutions that capitalized the funds during the early 1990s. Such a credit would provide a transition period during which banks that contributed in the past could offset their future premium obligations through the use of credits. Allocating the initial assessment credit according to institutions' relative assessment bases at the end of 1996, the first year that both funds were fully capitalized, reasonably approximates relative contributions to the funds' capitalization, while avoiding the considerable complications that can be introduced by attempting to reconstruct the individual payment histories of all institutions.

The second approach is to eliminate the existing inflexible statutory requirements and give 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.

If the FDIC is allowed to set premiums according to the risks in the institutions we insure, we will attempt, first and foremost, to make premiums fair and understandable. We will also strive to make the pricing mechanism simple and straightforward, and we will temper statistical analysis with common sense. 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.

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. The primary thrust of these methodologies is to incorporate a variety of

financial and other measures to distinguish and price for risk more accurately. For the largest banks and thrifts, it may be necessary to have a different pricing system from the rest of the industry, but the pricing system must not discriminate in favor of or against banks merely because they happen to be large or small. We are actively seeking input from the industry and Congress regarding possible pricing systems that are analytically sound.

Managing the Fund

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 assessments more evenly over time and more fairly across insured institutions.

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 attempts to strike a balance by establishing a reserve ratio target of 1.25 percent. Under the proposed reforms, allowing the reserve ratio to move within a statutorily established range around 1.25 percent will help ensure that banks are charged steadier premiums during the business cycle. The key to fund management will 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 surcharges or rebates and credits to keep the ratio within the range.

Index the Deposit Insurance Coverage Limit

The reforms just described are critical to improving the deposit insurance system. Let me also mention 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 real value of coverage steady over time. In addition, indexing the limit on a regular basis may prevent possible unintended consequences of large adjustments made on an ad hoc basis in the future.

Legislation

Almost any bill of importance represents a compromise among competing interests and is rarely the bill that any one person would craft, if left to his or her own devices. However, generally speaking, I believe that H.R. 1185 is consistent with the spirit of the FDIC's recommendations. Without a doubt, it would create a system that is significantly better than the existing system.

However, I would like to make just a few general comments on the specifics of legislation, including H.R. 1185.

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. H.R.

1185 would effectively create a 22.5 basis point range, from 1.15 percent to 1.375 percent.¹ I would suggest a somewhat broader range.

The FDIC would also 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 and changing economic and industry conditions. Thus, I would prefer to make rebates discretionary rather than mandatory.

While I believe that the FDIC Board needs greater discretion to manage the fund, we are not suggesting the FDIC be given absolute discretion. We recognize the need for accountability and will work with you to ensure a system that provides it.

CONCLUSION

The FDIC takes its responsibility to prudently manage the fund and maintain adequate reserves very seriously. I want to reiterate a promise I made to the full Committee two years ago. 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 do so as well.

We have been fortunate, in that Congress continues to have an excellent opportunity to remedy flaws in the deposit insurance system before they cause actual

¹ H.R. 1185 would require that the FDIC issue dividends equal to one-half of the amount in the fund above 1.35 percent whenever the fund was between 1.35 percent and 1.40 percent, and dividends equal to the entire amount in the fund over 1.40 percent whenever the fund was over 1.40 percent. The effect of these provisions would have been to cap the fund at 1.375 percent.

damage either to the banking industry or our economy as a whole. We appreciate the Subcommittee's leadership and continuing efforts on this issue and look forward to working with each of you to get the job done this year.



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington DC 20429

DONALD E. POWELL
CHAIRMAN

March 25, 2005

Honorable Gregory W. Meeks
House of Representatives
Washington, D.C. 20515

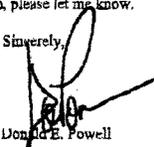
Dear Congressman Meeks:

This is to follow up on your question during the hearing on deposit insurance reform before the Subcommittee on Institutions and Consumer Credit on March 17. You asked about the effect on the designated reserve ratio (DRR) if "free riders," insured institutions that have not paid into the deposit insurance system or that have grown significantly since the insurance funds became fully capitalized, were to pay premiums.

We do not know exactly how much we would charge the highest rated institutions if deposit insurance reform were implemented. However, we estimate that charging well-capitalized, well-managed institutions that are either newly chartered or fast growing one basis point per year beginning in 2000 would have made the combined fund reserve ratio at least 1.37 percent as of December 31, 2004. This ratio would be 6 basis points higher than the actual combined fund ratio of 1.31 percent.

I very much appreciate your continued support of deposit insurance reform legislation. If I can provide any further information, please let me know.

Sincerely,


Donald E. Powell