EMBARGOED
until August 2, 10:00 A. M.

Testimony
of
Jonathan L. Fiechter, Acting Director
Office of Thrift Supervision

concerning the

Savings Association Insurance Fund

before the

Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives

August 2, 1995

Office of Thrift Supervision
Department of the Treasury

1700 G Street N.W.
Washington D.C. 20552
202•906•6288

THE SAVINGS ASSOCIATION INSURANCE FUND

Summary of Testimony
Jonathan L. Fiechter, Acting Director, Office of Thrift Supervision
before the
Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives
August 2, 1995

NATURE AND CONSEQUENCES OF THE SAIF's PROBLEMS

Problem One: The SAIF is undercapitalized and is likely to remain undercapitalized for years to come.

As of March 31, 1995, the SAIF had reserves of $2.2 billion to cover $704 billion in insured deposits -- a reserve ratio of 0.31%, or one-quarter of the 1.25% reserve ratio mandated by statute. There is no reasonable likelihood that, under current conditions, the SAIF will achieve its designated 1.25% reserve ratio before the next century.

Responsibility for resolving SAIF-insured institutions that fail was transferred from the RTC to the SAIF on July 1, 1995. The failure of SAIF-insured institutions with assets of $15 billion or more would exhaust the SAIF's current reserves.

Problem Two: The BIF/SAIF premium disparity is likely to result in a reduction in SAIF's assessment base.

The FDIC board has proposed to lower the average BIF premium from 23.5 basis points to an average of 4.5 basis points once the FDIC verifies that the BIF has reached the mandated 1.25% reserve ratio, but to leave SAIF premiums at their current level. If these proposals are adopted, average SAIF premiums will become almost six times greater than average BIF premiums.

The premium disparity is likely to have a significant adverse impact on SAIF-insured institutions and on the SAIF. First, the premium disparity will place pressure on management of SAIF-insured institutions to reduce their exposure to SAIF premiums, thereby reducing SAIF income. Second, the premium disparity may make it difficult for SAIF members to attract and retain capital, further increasing the SAIF's resolution costs. Third, the premium disparity may increase the risk profiles of SAIF members, thereby increasing SAIF resolution costs. Finally, the disparity could adversely affect the U.S. housing market.

Problem Three: There is a significant risk of default on the FICO bonds.

Interest on FICO bonds is paid out of draws that FICO is authorized to make against the SAIF premium income stream. Currently, these draws (up to $793 million annually) can only be made against that portion of the SAIF income stream attributable to SAIF-member savings associations. SAIF assessments paid by SAIF-insured banks are not subject to the FICO draw.

In the most recent assessment year (1994), FICO's draw consumed 67% of all savings association SAIF assessments. Since FIRREA, the SAIF assessment base has shrunk by an average of 5% per year, but the savings association portion of the assessment base has declined at an average rate of 10.7% annually.

If the SAIF's savings association assessment base continues to decline at this rate, FICO could default on its interest payments as early as 1998. A default could have serious public policy ramifications.

THE JOINT PROPOSAL

First, SAIF-insured institutions would be required to pay a special premium to capitalize the SAIF fully as of January 1, 1996. The special premium may need to raise $6.6 billion; this is about 85 to 90 basis points of the SAIF assessment base.

Once the SAIF is fully capitalized, the SAIF premium schedule would initially be set at a level equivalent to the BIF premium schedule. Thereafter, SAIF premiums may have to be raised (i) to maintain the 1.25% required reserve ratio and (ii) if BIF premiums are raised in order to maintain the BIF at 1.25%. This would ensure that BIF-insured institutions, which under the proposal would be required to share the FICO obligation, do not end up paying higher insurance premiums than SAIF members.

The FDIC board would also be authorized to exempt weak institutions from the special premium when the board determines that payment of the special premium would increase the risk to the SAIF. Exempted institutions would be required to continue paying insurance premiums under the current SAIF premium schedule until the end of 1999; they would have the option of paying a pro-rated portion of the special premium during the subsequent four year period in order to drop down to the lower premium schedule.

Second, responsibility for FICO interest payments would be spread among all FDIC-insured institutions on a pro rata basis. We estimate that each FDIC-insured institution will initially pay an amount equivalent to approximately 2.5 basis points of their deposits.

Third, the BIF and the SAIF would be merged into a single federal deposit insurance fund as soon as practicable.

In addition, the OTS and FDIC support making unspent RTC funds available as a backstop to the SAIF until the BIF and the SAIF are merged. These RTC funds would be available only to cover any catastrophic and unexpected SAIF losses.

EVALUATION OF THE JOINT PROPOSAL

The Joint Proposal seeks to achieve a workable, long-term solution that is comprised of a reasonably fair distribution of resolution costs. The Joint Proposal places the greatest onus on surviving SAIF-insured institutions, and calls for BIF-insured institutions to contribute by

assuming, along with SAIF-insured institutions, pro rata responsibility for the FICO obligation. The annual FICO burden amounts to 11 basis points of the current SAIF assessment base, but only 2.5 basis points of the combined BIF and SAIF assessment base.

The OTS has reviewed the impact of an 85 basis point special premium on the thrift industry. The burden will be substantial as industry capital would be reduced by 7.8%. Most OTS-regulated thrifts, however, have sufficient capital to absorb the special premium without a change in their regulatory capital status and can generate earnings to rebuild capital.

Although we do not anticipate that the viability of any SAIF-insured institutions will be threatened as a direct and immediate consequence of the special premium, a small number of weaker institutions would be seriously impaired by the special premium. The Joint Proposal, therefore, authorizes the FDIC board to exempt weak institutions from the special premium if an exemption would reduce the risk to the SAIF.

Reducing the capital of SAIF-insured institutions will have an immediate impact on their lending capacity. Thus, the aggregate home lending capacity of savings associations could be temporarily reduced. In regions or localities where savings associations are responsible for most of the mortgage lending, the impact of the special premium will clearly be felt. Nevertheless, the impact of the special premium should be temporary. In the long run, home lending will benefit from placing SAIF-insured institutions on a level playing field with other federally-insured institutions and strengthening the source of funding for the FICO interest payments.

Finally, the Joint Proposal targets each of the key SAIF problems. The SAIF will reach its statutory designated reserve ratio promptly on January 1, 1996. The FICO payment obligation will be spread among all SAIF- and BIF-insured institutions, thereby eradicating the impending premium differential. This will eliminate the single greatest threat to the stability of the deposit insurance system and ensure that there will be no default on FICO obligations.

Most important, the definitiveness of the proposed solution is guaranteed by the proposed merger of the SAIF and the BIF. A merged BIF/SAIF fund will result in a single, stronger, more diversified insurance fund. A merger will eliminate concerns about the SAIF being too small or homogeneous, remove the possibility of premium disparities, and significantly enhance the stability of the federal deposit insurance system.

In the time period prior to a fund merger, the OTS and FDIC support providing the SAIF with access to any unspent RTC funds as a backstop. This contingency fund is not likely to result in the actual expenditure of any government funds.

The OTS believes the time has come to carefully review the future of the thrift charter. Given the urgency of the problems facing the SAIF and FICO and the complexities presented by altering the thrift charter, however, charter issues should be addressed in separate legislation.

TABLE OF CONTENTS

I. INTRODUCTION 1

II. NATURE AND CONSEQUENCES OF THE SAIF's PROBLEMS 2

A. Problem One: the SAIF is undercapitalized and is likely to remain undercapitalized for years to come 2

1. SAIF's undercapitalization and its causes 2

2. The underfunded SAIF's vulnerability to failure of a large institution 4

B. Problem Two: the BIF/SAIF premium disparity is likely to result in a reduction in SAIF's assessment base and an increase in SAIF's resolution expenditures 5

1. Description of the premium disparity 5

2. Consequences of delay in resolving the premium disparity 8

C. Problem Three: there is a significant risk of default on the FICO bonds in the near future 12

1. Description of the FICO obligation 12

2. Consequences of delay in adjusting the FICO funding mechanism 12

III. THE JOINT PROPOSAL 14

A. Overview of the Joint Proposal 14

B. Evaluation of the Joint Proposal 15

1. Is the Joint Proposal as fair as possible? 15

2. How would the Joint Proposal affect SAIF-insured institutions? 17

3. How would the Joint Proposal affect the availability of housing finance? 18

4. Does the Joint Proposal provide a definitive solution to the SAIF problem? 19

IV. SHOULD THE SOLUTION TO THE SAIF AND FICO PROBLEMS ALSO ADDRESS THE FUTURE OF THE THRIFT INDUSTRY 20

V. CONCLUSION 22

I. INTRODUCTION

Good morning Chairwoman Roukema, Congressman Vento and members of the Subcommittee. I appreciate this opportunity to present the views of the Office of Thrift Supervision (OTS) on the proposal of the Treasury Department, the Federal Deposit Insurance Corporation (FDIC) and the OTS to capitalize and stabilize the Savings Association Insurance Fund (the Joint Proposal).

I recognize that having to turn our attention once again to a problem stemming from the thrift crisis of the 1980s is unfortunate. The thrift crisis has resulted in five major pieces of legislation: the Competitive Equality Banking Act of 1987, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, and the Resolution Trust Corporation Completion Act of 1993. These legislative efforts have accomplished much -- the thrift industry is healthy, there have been few thrift failures in the last several years, the supervision of thrifts has been strengthened significantly, and the Resolution Trust Corporation (RTC) will soon wind up its affairs.

Yet, here we are again, six years after the passage of FIRREA, confronting problems in another insurance fund -- the Savings Association Insurance Fund (SAIF). The immediate problem is that the SAIF is only one-quarter of the way toward reaching its statutorily-mandated reserve level of 1.25% of insured deposits. The ongoing diversion of SAIF premiums to cover the annual interest payments on outstanding Financing Corporation (FICO) debt continues to delay capitalization of the SAIF. The SAIF problems will be compounded when the Bank Insurance Fund (BIF) insurance premiums are reduced while SAIF premiums remain high. The resulting premium disparity will create powerful incentives for SAIF-insured institutions to reduce their reliance on SAIF-insured deposits, thereby threatening the viability of the SAIF as well as the servicing of the FICO debt.

These problems are not the result of risky behavior or poor performance by SAIF-insured institutions. Rather, the SAIF problem results from flaws in the mechanism established to fund the SAIF, including the unanticipated shrinkage that has occurred in the SAIF assessment base, the continuing diversion of income from the SAIF to cover non-SAIF obligations, and the absence of Treasury payments authorized by FIRREA. In short, the critical financing assumptions that underlaid FIRREA have not come to pass.

It is important that this last, lingering vestige of the thrift crisis be promptly and definitively resolved. The uncertainties generated by the status quo, as well as the likelihood that any loss of confidence generated by SAIF or FICO problems will spread beyond SAIF-insured institutions, suggest that not addressing these problems this year, runs the risk of an even larger problem in the future.

The Joint Proposal being presented today will definitively address the problems of the SAIF and FICO. The Joint Proposal will immediately and fully capitalize the SAIF with a [illegible] FDIC-insured institutions. SAIF-insured institutions will provide the largest share of the funding. The Joint Proposal also provides for the merger of the SAIF and the BIF.

system printers using supported AS/400 printer transforms.
The IBM Network Station operates without local disk
October 29, 1996.
• IPLA software products announced in Software Announcement 296-416, dated October 29, 1996.

The ability of FDIC-insured institutions to solve the SAIF and FICO problems, however, may dissipate with time. Currently, both banks and thrifts are benefiting from a healthy economy and a relatively low level of problem loans. If we fail to act now, we may miss the best chance to resolve the SAIF and FICO problems with minimal risk to the taxpayer.

In my testimony today, I will provide a brief description of the three major problems faced by the SAIF and why further delay in resolving those problems will be costly. I will then summarize the Joint Proposal and evaluate its fairness, impact, and sufficiency. I will conclude my testimony with a discussion of the future of the thrift industry and issues regarding thrift charter reform. Attached to my testimony are the details of the Joint Proposal.

II. NATURE AND CONSEQUENCES OF THE SAIF's PROBLEMS

A. Problem One: the SAIF is undercapitalized and is likely to remain undercapitalized for years to come

1. SAIF's undercapitalization and its causes

As of March 31, 1995, the SAIF had reserves of $2.2 billion to cover $704 billion in insured deposits. This is equivalent to a reserve ratio of 0.31% -- one-quarter of the 1.25% reserve ratio mandated by statute. There is no reasonable likelihood that, under current conditions, the SAIF will achieve its reserve ratio before the next century. Presently, up to

$793 million per year or almost half of all SAIF assessment income is being diverted to cover interest payments on FICO bonds. Without the FICO draw, the SAIF would capitalize in less than four years. With the FICO draw, however, the SAIF will not capitalize for many years. Under the FDIC's baseline assumptions, the SAIF is not expected to become adequately capitalized until 2002. Under more conservative assumptions, the SAIF is not expected to become adequately capitalized until 2010 or beyond.

These difficulties are due to the use of flawed assumptions in developing the SAIF funding mechanism in FIRREA. The funding mechanism was built on the assumption that the SAIF assessment base would grow by 6% to 7% per year and that supplemental Treasury funding of $8 billion to $11 billion would be provided to the SAIF during the first decade of its existence. Instead, the SAIF assessment base has shrunk by 5% per year since FIRREA, and the SAIF has not received the FIRREA authorized Treasury funding. Chart 1 illustrates the significant difference between the projected size and the actual size of the SAIF assessment base.

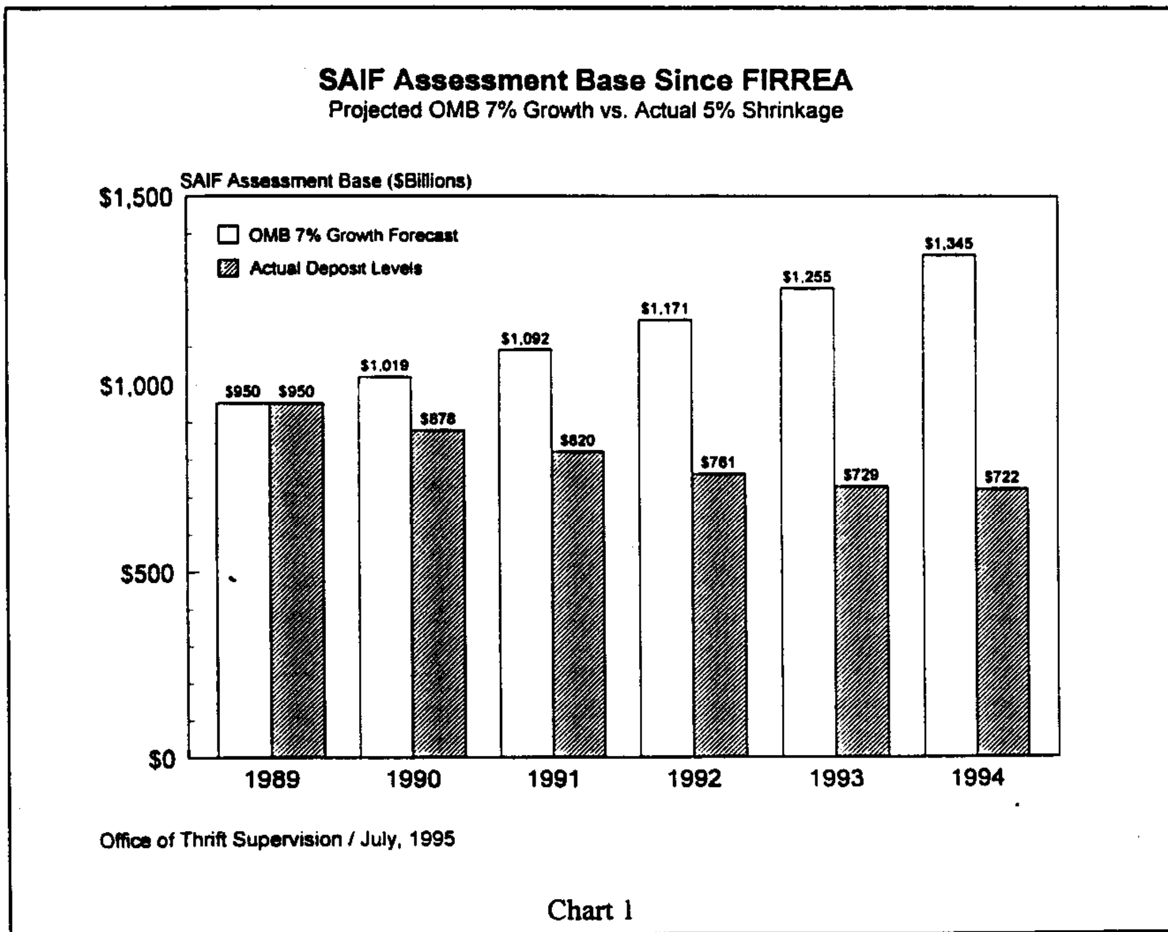

Chart 1

Since FIRREA, SAIF-insured institutions have paid deposit insurance premiums at the same or higher rates than the rates applicable to BIF-insured institutions. Under the FIRREA funding mechanism, however, about three-quarters of all SAIF premiums paid since FIRREA have been diverted from the SAIF to pay interest on FICO bonds and to cover other non-SAIF expenditures, as illustrated in Chart 2. Thus, even though SAIF-insured institutions have paid historically unprecedented premiums for the past six years, the SAIF remains critically underfunded.

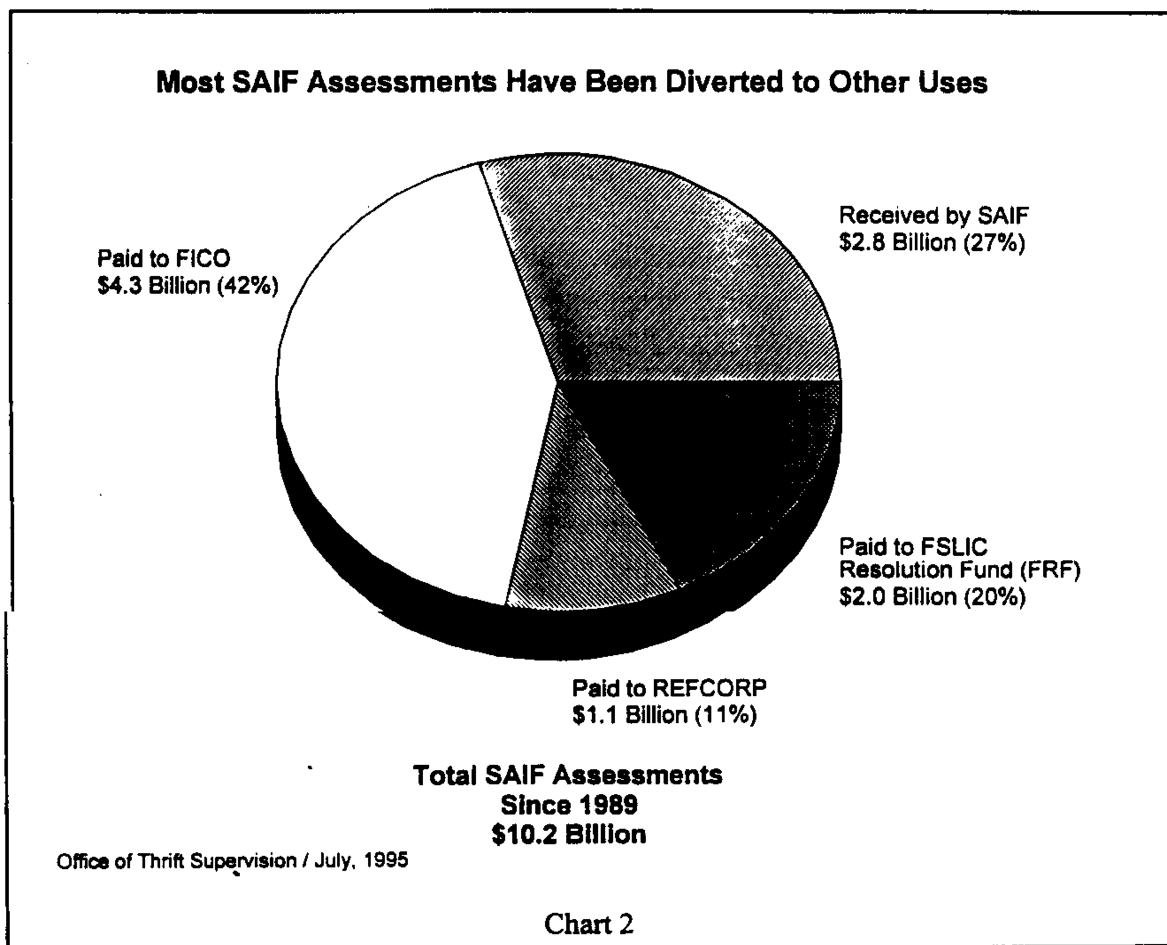

Chart 2

2. The underfunded SAIF's vulnerability to failure of a large institution

On July 1, 1995, responsibility for resolving failed SAIF-insured institutions transferred from the RTC to the SAIF. Under the FDIC's estimate of the average cost of resolving a failed

institution (15 percent of failed institution assets), the failure of SAIF-insured institutions with assets of $15 billion or more would exhaust the SAIF's current reserves.

The vast majority of thrifts supervised by the OTS have recovered from the financial weaknesses of the 1980s. The number of institutions on the OTS problem thrift list has fallen steadily over the last 5 years. Today, problem thrifts hold assets totaling $32 billion. We do not expect the majority of these problem institutions to fail. This assumes, however, that there is no economic downturn in the markets where these thrifts operate. A weakness in a particular real estate market where thrifts and other SAIF-insured institutions are concentrated, or unexpected problems at one or two large institutions could result in failure that exhausts the SAIF's reserves. Such an event could weaken public confidence in the financial strength of the federal deposit insurance funds, and might require taxpayer funding to meet the FDIC's obligations.

The current vulnerability of an underfunded SAIF to sudden insolvency is accentuated by the disproportionate concentration of its members in a single region (California) and the concentration of thrift assets in a single type of asset (home loans). Individually, home loans are less risky than commercial loans, but the required concentration of SAIF-insured thrift institutions in home mortgage loans, however, makes the SAIF particularly vulnerable to a downturn in residential real estate markets. In addition, the SAIF has a number of institutions that are quite large in relation to the SAIF.

Moreover, given the current drain on SAIF income caused by payments on FICO bonds, capitalizing the SAIF will be a painstakingly slow process. For example, in 1996, the first full year after the SAIF assumes responsibility for resolving failed institutions, SAIF reserves are projected by the FDIC to grow by only $700 million. At this rate, the SAIF will remain vulnerable to sudden insolvency for many years to come.

B. Problem Two: the BIF/SAIF premium disparity is likely to result in a reduction in SAIF's assessment base and an increase in SAIF's resolution expenditures

1. Description of the premium disparity

In contrast to the SAIF, BIF premium dollars go directly into the BIF. As a result, the BIF is expected to reach the statutorily-mandated 1.25% reserve ratio in 1995. The FDIC board

has proposed to lower the average BIF premium from 23.5 basis points to 4.5 basis points once the FDIC can verify that the BIF has reached this reserve ratio. Because the SAIF remains under 1.25%, the FDIC board has proposed to leave SAIF premiums at their current average level of 24 basis points.

If the FDIC board's proposals are adopted, which is likely, SAIF premiums paid by healthy SAIF members will be six times greater than the BIF premiums paid by healthy BIF-members. The significance of this premium disparity becomes even more apparent when related to the income of banks and thrifts. As Chart 3 illustrates, such a premium disparity is significant. If the proposed BIF premium schedule had been in effect during 1994, BIF premiums would have been roughly equivalent to 2.3% of all 1994 bank net income. By contrast, SAIF premiums were equivalent to approximately 32% of all 1994 thrift net income. This is a material difference.

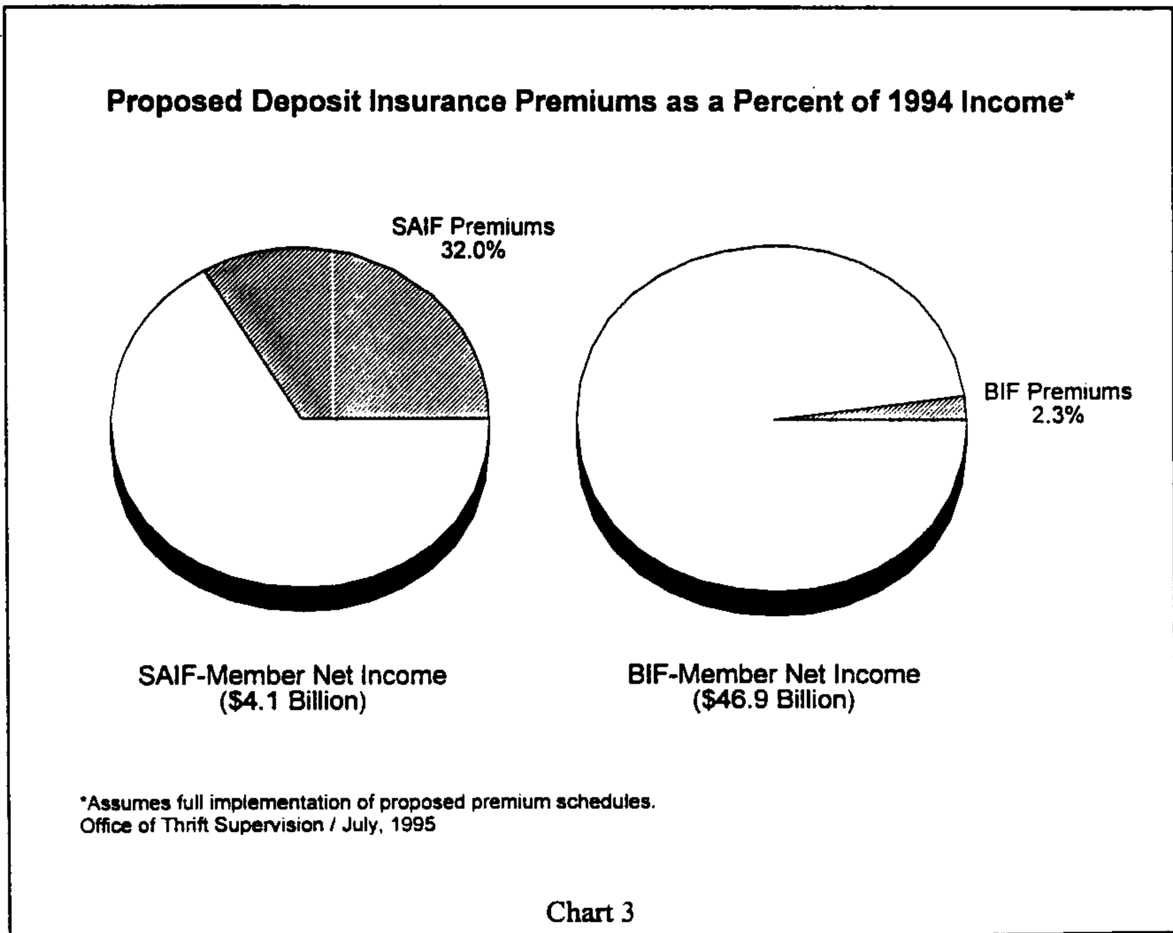

Chart 3

Moreover, such a disparity could last well into the next century. For example, Chart 4 illustrates what happens to SAIF premiums under the FDIC's baseline assumption that the SAIF assessment base will decline by 2% per year and that assets in failed SAIF-insured institutions will average 1/5 of 1% (22 basis points) of industry assets.

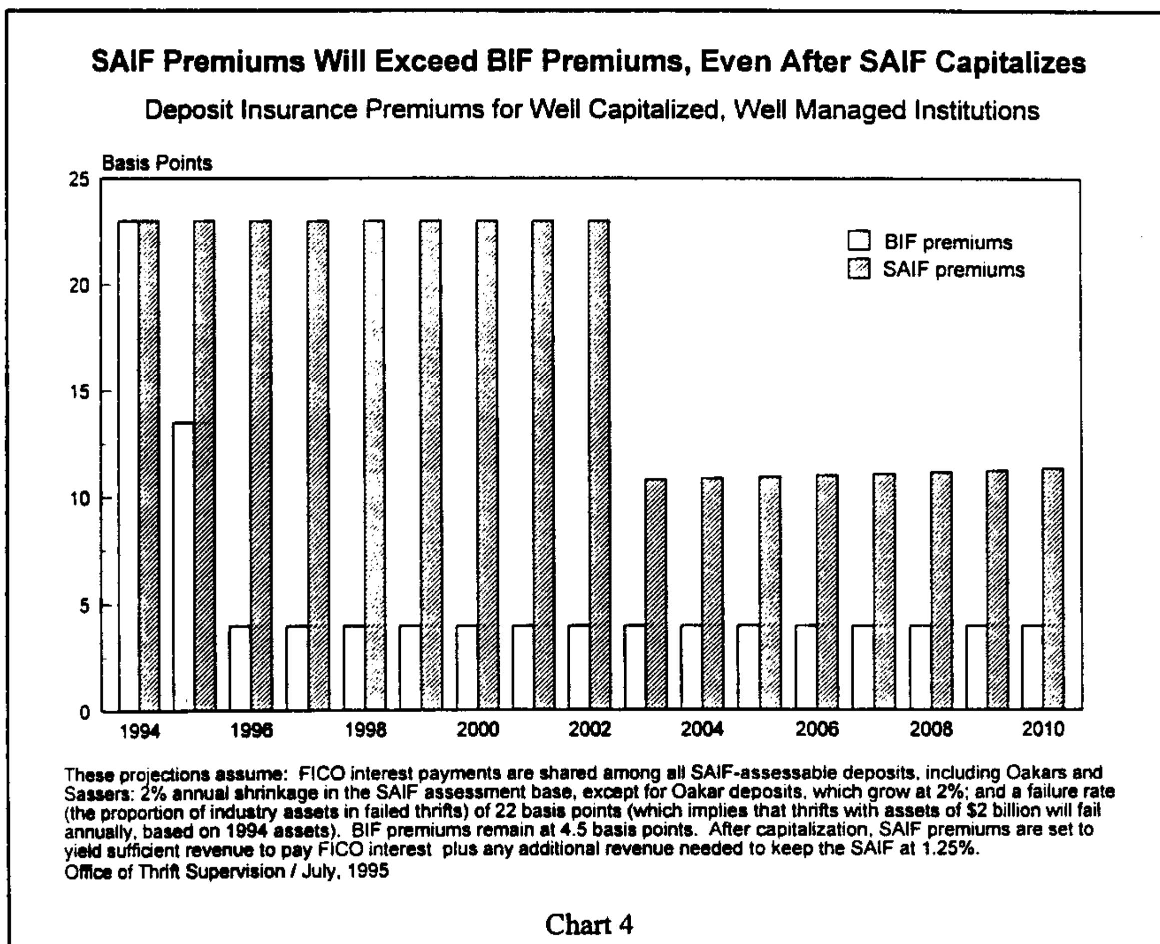

Chart 4

Under this scenario, even *after* SAIF reaches the required 1.25% reserve ratio in the year 2002, SAIF premiums remain almost three times higher than comparable BIF premiums for an additional 17 years due to diversion of SAIF assessments to pay interest on FICO bonds, as mandated by FIRREA.

2. Consequences of delay in resolving the premium disparity

The premium disparity is likely to have a significant adverse impact on SAIF-insured institutions and on the SAIF. The longer this disparity is allowed to continue, the greater the potential for lasting, systemic harm to SAIF members and to the SAIF. The principal potential adverse consequences are as follows.

- **First, the premium disparity will place pressure on management of SAIF-insured institutions to reduce their exposure to SAIF premiums, thereby reducing SAIF income.**

In recent years, there has been a noticeable shift by institutions away from SAIF-insured deposits into repurchase agreements and Federal Home Loan Bank advances, neither of which is assessed an insurance premium. These alternative funding sources carry the risk of additional losses to the SAIF since these liabilities are fully collateralized and have priority over SAIF's claims in the event of a failure. In addition, as institutions shift their funding away from core deposits to more market-based liabilities, they may become more vulnerable to interest rate risk.

To avoid the loss of core deposits, many institutions are exploring ways to substitute lower-cost BIF-insured deposits for SAIF-insured deposits. Several of the largest savings associations -- holding well in excess of 10% of SAIF's assessable deposits -- have already announced that they intend to apply to establish de novo banks insured by the BIF to conduct their deposit-taking activities. While it has been suggested that the government should set up roadblocks to this and other efforts by institutions to avoid high SAIF premiums, the introduction of a material disparity between BIF and SAIF insurance premiums will provide continuous market pressure on SAIF-insured institutions to minimize their SAIF assessment base. The government's previous lack of success in blocking market forces (e.g., the failure of Regulation Q, which sought to limit interest rates earned by consumers on their savings) should make us all hesitant to pursue a similar strategy vis-a-vis deposit insurance premiums.

We cannot stop the customers of SAIF-insured institutions from voluntarily transferring their deposits to BIF-insured institutions in search of higher returns. If a BIF member located near a SAIF member is able to offer a higher rate of return on deposits due to the premium disparity, it is inevitable that customers of the SAIF member will migrate to the BIF member.

From the perspective of the SAIF, it matters not whether the deposits are lost to a BIF affiliate of a SAIF-insured institution or an unaffiliated BIF-insured competitor. Either way, the SAIF income base declines.

- **Second, the premium disparity may make it difficult for SAIF members to attract and retain capital, further increasing the SAIF's resolution costs.**

An industry that generates about 60 basis points in income -- the average return in the thrift industry over the past several years -- will clearly be adversely affected by a 19 basis point surcharge against its earnings. The eventual effect of such a tax could be a reduction in the franchise value of SAIF-insured institutions, making it even more difficult to recapitalize troubled institutions.

The effect of an extended period of high insurance premiums on the thrift industry's ability to raise capital was a concern during the FIRREA debate in the Congress. Former Federal Reserve Board Chairman Paul Volcker warned that:

> I would think that a larger question with respect to thrifts arises from the fact that that premium is already pretty high, and how long does one contemplate keeping that premium in force? How does that affect the ability of the industry, generally, to raise capital and be a viable competitor over time? To what degree does it discourage potential buyers or to what degree does it discourage current owners from operating in that industry because of the size of the cost burden extended indefinitely over a period of time? (Problems of the Federal Savings and Loan Insurance Corporation (FSLIC), Hearings before the Committee on Banking, Housing, and Urban Affairs, United States Senate, Part I of IV, 101st Cong., 1st Sess., at 264 (1989).)

Reducing the competitive viability of thrift institutions may make it more likely that the government will have to resolve problem institutions, and may place even more financial strain on the SAIF.

- **Third, the premium disparity may increase the risk profiles of SAIF members, thereby increasing SAIF resolution costs.**

Because of the highly competitive nature of the financial markets. it is likely that a substantial portion of any BIF member's cost savings resulting from lower premiums will be passed on to its customers. If BIF members increase their deposit rates and services and/or reduce loan rates and fees to attract customers, SAIF members will be forced either to match these rates and reduce profit margins, or to lose deposits and loan business. Some SAIF-insured institutions could respond to the squeeze on earnings by pursuing higher yielding and potentially riskier lending and investment activities. While the regulatory agencies will seek to prevent unsafe and unsound practices, the pressure on SAIF-insured institutions to increase their revenue will be great.

- **Fourth, the premium disparity could adversely affect the U.S. housing market.**

Savings associations continue to play an important role in housing finance. Savings associations were directly responsible for 1 in 6 of all residential mortgage loans originated during 1994. Although hard data are not available, savings associations also may have originated at least as many mortgage loans through their mortgage banking subsidiaries as they originated directly. As of December 31, 1994, savings associations and their subsidiaries held in portfolio $459 billion in residential mortgage loans and mortgage-backed securities or about 16.2% of all outstanding residential mortgage loans and mortgage-backed securities.

In certain key markets, thrifts are leaders in meeting the housing finance needs of minorities and low-income families. Thrifts are also leaders in originating and holding adjustable-rate mortgages -- important mortgage vehicles that often make housing affordable for first-time home buyers (especially when long-term interest rates are high). Almost half of all mortgage loans held by thrifts are loans that are not easily securitized for the secondary market.

As a National Association of Home Builders (NAHB) representative noted at an FDIC public hearing on the SAIF in March:

> As portfolio lenders, thrifts also have been innovative in offering new mortgage products and play a critical role in providing the adjustable-rate mortgages that were so important in cushioning home buyers from rising rates last year.

The NAHB representative went on to say that the emergence of a BIF/SAIF premium disparity will "detrimentally affect the cost and availability of housing credit."

Home lending is the principal business of savings associations. Currently, approximately 70% of all savings association assets are residential mortgage loans and mortgage-backed securities. To the extent the premium disparity weakens savings associations, it will also weaken their ability to support housing.

Before concluding my discussion of the premium disparity, I want to be very clear about what I am, and am not, saying. I am not saying that the premium disparity is likely to cause large numbers of thrift failures over the next few years. While some might argue that the thrift industry may collapse under the weight of the premium disparity, I do not share their point of view. Clearly, the thrift industry and home lending will be adversely affected by the disparity, but the likelihood that the disparity will cause significant numbers of thrift institution failures is remote.

My concern is that the SAIF funding mechanism -- rather than the thrift industry -- may collapse under the weight of the premium disparity. The premium disparity sets up a type of pincer movement of competing forces that will converge on the SAIF from opposite directions. On the one hand, the disparity will create powerful incentives for SAIF-insured institutions and their customers to seek to shift deposits from the SAIF to the BIF, thereby reducing the SAIF assessment base. On the other hand, the disparity is likely to result in a modest increase in the cost of thrift failures over time (due to decreased profitability and/or the pursuit of higher-yielding investments) and make it more difficult to find private investors willing to invest in failing thrifts. Thus, SAIF resolution costs may increase at a time the SAIF's income base is declining. To stabilize the SAIF, the premium disparity must be resolved.

C. Problem Three: there is a significant risk of default on the FICO bonds in the near future

1. Description of the FICO obligation

As already noted, interest on FICO bonds, which totals $793 million annually, is paid out of draws that FICO is authorized to make against a portion of the SAIF premium income stream. Under current law, these draws can only be made against that portion of the SAIF income stream attributable to SAIF-member savings associations. SAIF assessments paid by SAIF-insured banks are not subject to the FICO draw.

In the most recent assessment year (1994), premiums assessed against savings associations totaled $1.2 billion. Thus, the FICO draw consumed 67% of all savings association SAIF assessments. Earlier I said that the SAIF assessment base has shrunk by an average of 5% per year since FIRREA. But that figure is computed on the **entire** SAIF assessment base, which includes many banks. The savings association portion of the SAIF assessment base has been declining even more rapidly than the SAIF assessment base as a whole. The average annual shrinkage of savings association SAIF deposits since enactment of FIRREA has been 10.7%.

2. Consequences of delay in adjusting the FICO funding mechanism

Recently, the board of directors of FICO issued a press release stating that, "if the downward [SAIF] deposit trend continues, FICO will have insufficient funds to meet the interest payments on [FICO bonds] through maturity . . . unless Congress enacts further legislation providing new or additional funding sources." Indeed, as Chart 5 illustrates, if the SAIF's savings association assessment base continues to decline at its average annual post-FIRREA rate, FICO will default on its interest payments as early as 1998. The impending BIF/SAIF premium disparity, discussed above, may actually accelerate this trend.

Although FICO bonds are not backed by the full-faith and credit of the United States, a default on the FICO bonds could have serious public policy ramifications due to the effect that a default would have on the obligations of other government sponsored enterprises (GSEs). Currently, FICO bonds are considered high-grade investments based largely on FICO's status as a GSE. Unless action is taken, however, FICO bonds are in danger of being downgraded, with a potential adverse impact on all GSE obligations.

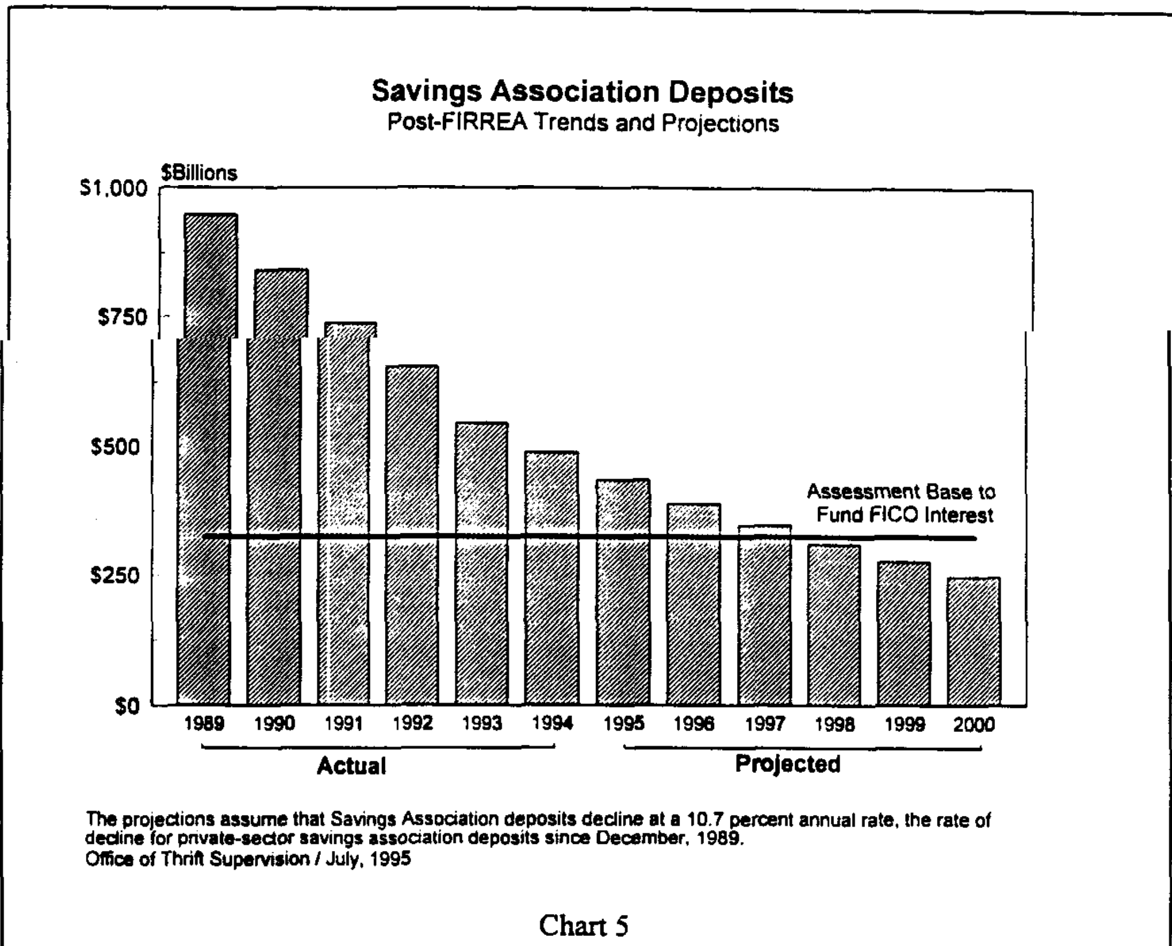

Chart 5

For all of the foregoing reasons, it is important that the problems of the SAIF be promptly resolved. As I noted at the outset, several years of sustained profitability for thrifts and banks have opened a window of opportunity to solve the SAIF problems with non-government resources. If we fail to act now, we may miss the best chance to resolve the SAIF problem with minimal risk to the taxpayer.

III. THE JOINT PROPOSAL

A. Overview of the Joint Proposal

The details of the Joint Proposal are set forth in the attachment to this testimony. I will provide a brief overview of the main elements of the Joint Proposal, and then turn to an evaluation of its merits.

First, institutions holding SAIF-insured deposits would be required to pay a special premium in an amount sufficient to capitalize the SAIF fully as of January 1, 1996. Although the exact amount of the special premium cannot be predicted precisely, we anticipate that the premium may need to raise as much as $6.6 billion. This is equivalent to about 85 to 90 basis points of the SAIF assessment base. Once the SAIF is fully capitalized, it is expected that the SAIF premium schedule would initially be set at a level that is equivalent to that of the BIF premium schedule. If over time, losses to the SAIF exceed those incurred by the BIF, then SAIF premiums may have to be raised above BIF premiums to the extent required to maintain the 1.25% required reserve ratio. If BIF losses turn out to be higher than those incurred by the SAIF, and if, as a result, BIF premiums need to be raised in order to maintain the BIF at 1.25%, then the SAIF premiums will also be raised. The intent is to ensure that BIF-insured institutions, which under the proposal would be required to share responsibility for the FICO obligation, do not end up paying higher insurance premiums than SAIF-insured institutions.

The FDIC board would be authorized under the Joint Proposal to exempt specific institutions from the special premium in instances where the board determines that payment of the special premium would increase risk to the SAIF. Exempted institutions would be required to continue paying insurance premiums as set under the current SAIF premium schedule through 1999. Such exempted institutions would have the option of paying a pro-rated portion of the special premium during the subsequent four year period in order to drop down to the lower premium schedule.

Second, responsibility for FICO interest payments would be spread among all FDIC-insured institutions on a pro rata basis in accordance with their level of assessable deposits. We estimate that each SAIF-insured institution and each BIF-insured institution will end up paying initially an amount equivalent to 2.5 basis points of their deposits. This amount is expected to decrease over time as the combined insured deposits of banks and thrifts grow.

Third, the BIF and the SAIF would be merged into one federal deposit insurance fund as soon as practicable.

In addition, the OTS and the FDIC support making unspent RTC funds available as a backstop to the SAIF until the BIF and the SAIF are merged. These unspent RTC funds would be available only to cover any catastrophic and unexpected SAIF losses. For these purposes, SAIF losses will be deemed catastrophic only if they exceed $500 million in any fiscal year. During the time period that the backstop would remain in place, the FDIC has projected annual SAIF losses of $270 million and the Congressional Budget Office (CBO) has projected annual SAIF losses of $450 million.

B. Evaluation of the Joint Proposal

There is no painless solution to the SAIF's problems. Unfortunately, the mechanism established under FIRREA to fund SAIF and pay interest on the FICO obligations is not working. As a result, a revised funding mechanism is required that expands the revenue sources. I believe it is in everyone's interest to put the thrift crisis behind us once and for all. I further believe that the interagency process produced a fair and balanced solution.

In assessing the merits of the Joint Proposal, I believe we should consider four key questions.

1. Is the Joint Proposal as fair as possible?

It is unlikely that any solution to the SAIF/FICO problem can be developed that will be viewed as "fair" by all those required to contribute to the solution. The Joint Proposal seeks to achieve a workable long-term solution that is comprised of a reasonably fair distribution of the costs of such a solution.

The Joint Proposal places the greatest onus on surviving SAIF-insured institutions. I recognize that the vast majority of surviving SAIF-insured institutions were always operated responsibly and did not cause the thrift crisis. They are well-capitalized, strictly regulated, invest billions in housing credit, have superior community reinvestment records, and provide vital financial services to the public. I understand their concern regarding the additional financial burden imposed on them under the Joint Proposal. But the funding to capitalize the SAIF has to

come from somewhere, and institutions holding SAIF-insured deposits appear to be the best and most logical choice among the unfortunate choices available.

I anticipate that SAIF-insured institutions may also question the fairness of the provision that, prior to the merger of the SAIF and the BIF, the SAIF assessment schedule may not be lower than the BIF assessment schedule and that the SAIF (unlike the BIF) will be prohibited from rebating premiums collected in excess of the 1.25% reserve ratio. These provisions are designed to ensure that SAIF-insured institutions do not end up paying lower premiums than BIF-insured institutions once BIF members take on a pro rata share of the FICO obligation. It would be difficult to ask BIF-insured institutions to assume pro rata responsibility for FICO, while simultaneously setting SAIF premiums below BIF premiums.

Moreover, if losses at the SAIF are relatively low and over-capitalization of the SAIF occurs, this will provide further protection to the fund against large thrift losses. It could also provide reassurance to BIF-insured institutions that a merger of the SAIF and the BIF is less likely to result in increased bank premiums to cover future thrift losses.

The Joint Proposal also calls upon BIF-insured institutions to contribute to the resolution of the problem. BIF-insured institutions, along with SAIF-insured institutions, would assume pro rata responsibility for the FICO obligation. Because the SAIF is so much smaller than the BIF, the FICO obligation, which represents a huge liability for SAIF-insured institutions, is significantly reduced when spread over all FDIC-insured institutions. The annual FICO burden amounts to 11 basis points of the current SAIF assessment base, but only 2.5 basis points of the combined BIF and SAIF assessment base.

BIF-insured banks can be expected to protest that they should not be required to share any responsibility for FICO. The resolution of the thrift crisis, however, was important to all institutions holding federally-insured deposits. If the government had not provided funding through FICO and other sources to pay the depositors of failed thrifts, public confidence in federal deposit insurance would have been shaken and the entire deposit insurance system on which banks depend might have been threatened. Moreover, banks benefitted from the government's actions to place weak thrifts into receivership. Weak thrifts frequently paid exorbitant prices for deposits that effectively drove up the cost of funds for all institutions, including banks.

In addition to all FDIC-insured institutions contributing to the solution, the OTS recommends that the Federal Government put unused RTC funds aside to serve as a backstop for extraordinary, unanticipated losses to the SAIF until the BIF and SAIF are merged. (The recommendation for an RTC backstop is that of the OTS and not that of the Administration.) While under current law RTC funds may presently be used by the FDIC to support the SAIF through 1997, the terms that must be met before these funds are utilized are quite restrictive. These terms would have to be modified.

I recognize the difficulties posed by such a recommendation. My concern is that the high level of problem assets in OTS-supervised thrifts leaves even a fully capitalized SAIF vulnerable to large losses. A drop in housing prices in an area of the country with a large thrift presence could put renewed pressure on the SAIF and result in another round of high SAIF premiums. OTS does not expect such an event to occur. An RTC backstop, however, would provide greater assurance that there would be no recurrence of a SAIF funding problem. The backstop would only be used in the event of unanticipated, catastrophic SAIF losses that exceed the estimates of the OTS, FDIC, and CBO. Ultimately, if there are unexpected major losses in the thrift industry, taxpayer exposure would occur with or without a built-in backstop. Preserving the integrity of the deposit insurance system is an important national objective that benefits all Americans.

2. How would the Joint Proposal affect SAIF-insured institutions?

The OTS has carefully reviewed the impact of an 85-90 basis point special premium on the thrift industry. The burden will be substantial. Surviving thrifts have worked extremely hard over the past five years to build their capital. An 85 basis point premium would instantly reduce industry capital by a full 7.8%. Reduced capital means reduced lending and reduced earnings.

Based on 1994 earnings, an 85 basis point special premium on an after-tax basis would be equivalent to three-quarters of a year's income for thrift institutions. For a typical $500 million thrift with $355 million in insured deposits, the special premium would total $3 million. This same thrift, on average, reported 1994 income of $2.8 million.

Over 99% of all OTS-supervised thrifts have capital levels that meet or exceed the FDICIA definition of adequate capital. Most of these institutions have sufficient capital to

absorb an 85 basis point special premium without a change in their regulatory capital status. Over 90% of OTS-supervised SAIF-insured institutions are profitable and can generate earnings to rebuild their capital levels.

A small number of institutions, however, with lower capital levels, may be seriously impaired by an 85 basis point special premium. Some may have their capital levels fall below what is considered adequate. I believe it would be counterproductive to the goal of stabilizing the SAIF to effectively expose the insurance fund to even greater losses as a consequence of the imposition of the special premium. The Joint Proposal, therefore, permits the FDIC board to exempt weak institutions from the special premium if an exemption would reduce risk to the SAIF.

Thus, we do not anticipate any additional failures of SAIF-insured institutions as a direct and immediate consequence of the special premium. It is, of course, more difficult to predict what the indirect consequences of the special premium will be. It is entirely possible that the special premium, when combined with a variety of other factors (such as a downward turn in the economy or unexpected loan losses at an institution), may ultimately contribute to serious problems at some institutions.

The status quo, however, also poses risks to SAIF-insured institutions. The competitive disadvantage resulting from a significant premium disparity may also cause financial weakness. In my view, therefore, the costs imposed by the Joint Proposal are worthwhile in order to shore up the prospects for the long-term viability of the SAIF and FICO, as well as SAIF-insured institutions and their customers. I see no realistic alternative. If we continue to delay capitalizing the SAIF and resolving the FICO problem, I fear a weak SAIF and a possible FICO default, as SAIF-insured institutions reduce their reliance on SAIF-insured deposits.

3. How would the Joint Proposal affect the availability of housing finance?

The OTS has also considered the impact of an 85 basis point premium on housing finance. Reducing the capital of SAIF-insured thrifts will have an immediate impact on the lending capacity of SAIF-insured institutions. The aggregate home lending capacity of savings associations could be temporarily reduced by the special premium.

As I noted earlier, savings associations currently hold $459 billion in mortgage loans and mortgage backed securities. The special premium will have the effect of initially reducing the home lending capacity of savings associations. Our analysis suggests that portfolio lending by SAIF-insured thrifts may be reduced by as much as 8%. This may not translate into an 8% reduction in home lending nationwide, however, because there are many other participants in the mortgage market besides savings associations. In certain regions or localities, however, where savings associations are dominant in particular segments of the market, the impact of the special premium will clearly be felt.

The impact of the special premium should be temporary. In the long run, home lending will benefit from placing SAIF-insured institutions on a level playing field with other federally-insured institutions and the strengthening of the source of funding for the FICO interest payments.

All things considered, therefore, I believe the Joint Proposal is consistent with a strong mortgage finance system. The alternative -- a long-term premium disparity that throttles the lending capacity of SAIF-insured institutions, weakens the industry and raises the specter of a FICO default -- would be much worse.

4. Does the Joint Proposal provide a definitive solution to the SAIF problem?

The Joint Proposal targets each of the key SAIF problems described at the outset of my testimony. First, because of the special premium, the SAIF will reach its statutory designated reserve ratio promptly on January 1, 1996 -- a full seven years in advance of even the most optimistic projections under the status quo.

Second, because prompt capitalization will be achieved via the special premium and because the FICO payment obligation will be spread evenly among all SAIF- and BIF-insured institutions, the impending BIF/SAIF premium differential will be eradicated. This will eliminate the single greatest threat to the stability of the deposit insurance system. Spreading the FICO obligation will also ensure that there will be no default on FICO obligations. The combined BIF/SAIF premium income stream is many times larger than the annual FICO obligation.

Third, the definitiveness of the proposed solution would be guaranteed by the merger of the SAIF and the BIF. A merged BIF/SAIF fund will result in a single stronger, more diversified insurance fund. In particular, a merger will eliminate any concerns about the SAIF being too small or SAIF-insured institutions being too homogeneous to be sound over the long-term. It also removes the possibility of premium disparities arising with the attendant pressure on institutions to move between the two separate funds. Thus, merger of the SAIF and the BIF will significantly enhance the stability of the federal deposit insurance system.

If such a merger is not immediate, OTS believes SAIF should have access to RTC funds to cover extraordinary, unexpected losses. It is not anticipated that this contingency fund is likely to result in the actual expenditure of any government funds. It is merely intended to serve as a catastrophic backstop to ensure that the SAIF is stable and well capitalized at the time of the SAIF/BIF merger. Given the significant financial contributions that the Joint Proposal calls on thrifts and banks to make to solve the SAIF problem and the need to avoid another round of BIF/SAIF legislation if the unexpected happens over the next few years, an RTC backstop gives both Congress and the regulated industry reasonable assurance that this is the last of the post-FIRREA fallout.

IV. SHOULD THE SOLUTION TO THE SAIF AND FICO PROBLEMS ALSO ADDRESS THE FUTURE OF THE THRIFT INDUSTRY

The immediate challenge facing the thrift industry is the undercapitalized SAIF, the potential for an insurance premium disparity and the rising FICO burden. The Joint Proposal will ensure that SAIF-insured institutions are not placed in an untenable competitive situation of paying rising insurance costs due to a declining SAIF assessment base. The Joint Proposal, which was developed over the last six months by the Administration and the regulatory agencies, focuses on the need to solve the immediate problems facing the SAIF.

Thrift institutions, however, clearly face a more fundamental and longer-term issue arising out of the statutorily-mandated requirement that their lending and investment focus be directed towards residential mortgage credit. Thrift institutions, under the Home Owners' Loan Act, are required to hold a minimum fixed percentage of their assets in "qualifying thrift investments."

Over the last two decades, however, competition in residential mortgage lending has expanded significantly. Many non-thrift competitors such as mortgage bankers and government-sponsored enterprises such as FNMA and FHLMC, which are not subject to many of the regulations and costs faced by depository institutions, have gained market share at the expense of commercial banks and thrift institutions.

In some markets where the competitive pressures are intense, mortgage spreads have narrowed significantly. Commercial banks in those markets have pared back, or in some cases, even closed their residential mortgage lending operations and thrift institutions have reduced their mortgage concentrations within the constraints of the qualified thrift lender test. Some thrift managers have gone farther and indicated their desire to increase their lending flexibility by converting their institutions to commercial banks. Under current law, however, such conversions are quite difficult.

Given these developments, the OTS believes it is appropriate for the federal government to ask whether it should continue its policy of promoting residential housing by requiring (as well as encouraging through tax policy) thrifts to concentrate in residential mortgage lending.

One of our country's great resources is its dynamic and vibrant financial markets. As a consequence of technology, innovation (including securitization of assets), and changing demographics, the role of traditional depository institutions is changing. Market shares shift in response to changing demand for various products. The fact that financial markets are responsive to change is one of the strengths of our system. Ultimately, it is important that our statutes remain consistent with the realities of the market and that we allow market forces to determine the relative roles of the various sectors comprising our financial services system.

We recognize that changing the statutory framework governing the thrift industry raises a host of broad, and in some cases contentious, issues involving not only the thrift industry but also the banking industry and regulatory structure. The intent of any modification to the thrift charter, including the merging of thrift and bank charters or the conversion of thrift institutions to commercial banks, should be to ensure that the present thrift institutions remain strong and viable depository institutions in the future. It is important, therefore, that any change in thrift powers, and any changes in ownership rules governing thrift institutions, not result in weaker institutions with reduced access to capital. It is also important that current customers of healthy thrift institutions not be unintentionally harmed by any statutory changes.

It is our hope that putting the insurance fund and FICO issues behind us will facilitate dealing with these other issues. Given the urgency of these financial problems and the complexities presented by altering the thrift charter, it is our judgment that charter issues should be addressed separately. OTS stands ready to work with the Congress, the Administration, and other interested parties to develop a vision for what our system should look like and how to get there. But we should not delay critically needed SAIF and FICO reforms while charter issues are debated.

V. CONCLUSION

Not so very many years ago, the former Federal Home Loan Bank Board (FHLBB) and the now defunct Federal Savings and Loan Insurance Corporation (FSLIC) were roundly criticized for having failed to come forward promptly to warn Congress of the magnitude of the problems facing the FSLIC insurance fund. The FHLBB and FSLIC were admonished for repeatedly minimizing the seriousness of the thrift crisis, and for advocating stop gap measures, rather than a comprehensive approach.

The thrift crisis taught us many lessons. One of the most important lessons is that failing to recognize the existence of an insurance fund problem, or delay in responding to that problem, only makes matters worse. The thrift crisis also taught us the value of early intervention in minimizing the costs to the government. Prompt corrective action is now a core concept in the regulation of insured depository institutions.

We must apply this same core concept to the SAIF -- delay will only increase the exposure of taxpayers.

ATTACHMENT

RESOLVING THE PROBLEMS OF THE SAVINGS ASSOCIATION INSURANCE FUND

July 27, 1995

BACKGROUND: THE NEED FOR ACTION

SAIF Is in Poor Condition, and Its Prospects Are Bleak.

- ***SAIF is significantly undercapitalized.***

  As of March 31, 1995, SAIF held reserves of $2.2 billion to cover $704 billion in insured deposits -- only 31 cents in reserves per $100 of insured deposits.

- ***SAIF assessments have been -- and continue to be -- diverted to other uses.***

  From SAIF's inception in 1989 through March 1995, $7.4 billion in SAIF assessments were diverted to cover past thrift losses. If those funds had gone into SAIF, the fund would have been fully capitalized last year.

  Payments on bonds issued to prop up a prior deposit insurance fund (FICO bonds) currently consume 45 percent of SAIF assessments -- and that percentage will increase if SAIF deposits continue to shrink.

- ***SAIF's assessment base has declined sharply.***

  SAIF deposits shrank by 23 percent from year-end 1989 through March 1995, or an average of 5 percent annually, rather than growing over 40 percent (as projected at the time of SAIF's creation in 1989).

- ***SAIF is now responsible for resolving failed thrifts.***

  On July 1, 1995, SAIF became responsible for handling thrift failures. Given SAIF's meager reserves, the failure of one or two large thrifts could render SAIF insolvent and put the taxpayer at risk.

Consequences of Inaction: Prospects for SAIF, the FICO Bonds, and the Thrift Industry Will Worsen.

- ***Erosion of the SAIF assessment base would accelerate.***

  The healthiest SAIF members will have strong economic incentives to avoid paying almost 6 times as much as the healthiest BIF members for the same insurance coverage. Because of SAIF's obligation to make payments on the FICO bonds, a large differential between BIF and SAIF premiums would persist until the year 2019 even if SAIF were fully capitalized. Thus institutions would continue to have incentives to shrink their SAIF deposits.

  Healthy institutions have a wide variety of ways in which to shrink their SAIF deposits, despite the current moratorium on converting from BIF to SAIF. For example, they can sell off loans instead of holding them in portfolio. They can replace deposits with nondeposit funding sources. They can also seek to switch deposits from SAIF to BIF by forming or acquiring affiliated BIF-insured banks offering higher interest rates than thrifts.

- ***SAIF's weaknesses could lead to a default on FICO interest payments.***

  If the portion of SAIF's assessment base available for FICO payments declines 10 percent annually, FICO will default on its interest payments in a few years.

- ***Failure to resolve SAIF's problems could weaken the thrift industry, and thus further weaken SAIF.***

  Uncertainties about SAIF -- and high SAIF premiums -- could make it more difficult for SAIF members to attract and retain capital, thus reducing the thrift industry's ability to help solve its problems and respond to any adverse economic changes.

- ***Structural issues make SAIF more vulnerable to economic downturns and financial market instability.***

  SAIF faces increased risks because it insures institutions with similar asset portfolios, and because SAIF-insured deposits are concentrated in large West Coast thrifts.

PROPOSAL

1. Capitalize SAIF Through Assessments on SAIF Deposits

- Require institutions with SAIF-assessable deposits to pay a special assessment in an amount sufficient to capitalize SAIF (i.e., increase the Fund's reserve ratio to 1.25 percent). Base the special assessment on SAIF-assessable deposits held as of March 31, 1995. Make the special assessment due on January 1, 1996.

  The special assessment would probably amount to 85 to 90 basis points. The rate would depend on (1) the extent to which SAIF is undercapitalized at the end of this year; and (2) the total deposits subject to the special assessment (i.e., total SAIF-assessable deposits, minus deposits at weak institutions exempted by the FDIC from the special assessment, as discussed below).

  The risk-based assessment schedule for the newly capitalized SAIF would be similar to the schedule for BIF (the current FDIC Board proposal has rates ranging from 4 to 31 basis points).

  For purposes only of setting risk-based assessments for coverage during the calendar year 1996, the FDIC would calculate a SAIF-insured institution's capital before payment of the special assessment but taking into account other capital fluctuations.

- Permit the FDIC's Board of Directors (acting pursuant to published guidelines) to exempt weak institutions from the special assessment if the Board determines that the exemption would reduce risk to the Fund.

  - Require institutions exempted from the special assessment to continue to pay regular assessments under the current SAIF risk-based assessment schedule, with rates ranging from 23 to 31 basis points, for the next four calendar years (1996-1999).

Thus weak institutions would still, over time, generally pay more than healthy institutions. A healthy institution would pay approximately 101 basis points from 1996 through 1999 (an 85 basis point special assessment, plus a risk based assessment of 4 basis points for each of four years as proposed by the FDIC Board). A weak institution would pay annual assessments of 29-31 basis points (under the current schedule weak institutions pay assessments of 29-31 basis points) for a total of 116-124 basis points (29-31 basis points for each of four years).

- To encourage weak institutions to resolve capital and other deficiencies, give institutions exempted from the special assessment the option -- during the 1996-1999 period -- of paying a pro-rated portion of the special assessment and then paying assessments under the new risk-based schedule for the remainder of the period.

- Require that rates under the risk-based assessment schedule for SAIF be no lower than the rates for comparable institutions under the risk-based assessment schedule for BIF until the Funds are merged.

---

2. Spread FICO Payments Over All FDIC-Insured Institutions

- Effective January 1, 1996, expand the assessment base for payments on FICO bonds to include the entire assessment base of all FDIC-insured institutions -- both BIF members and SAIF members (thus spreading the FICO obligation pro rata over all FDIC-insured institutions).

  As under current law, the cash to pay FICO bond interest would come from assessment payments remitted by insured depository institutions, rather than by withdrawing money from the deposit insurance funds.

  Spreading FICO payments would still allow healthy institutions' BIF premiums to decline dramatically from current rates.

---

3. **Merge the Deposit Insurance Funds**

- Effective as soon as practicable -- preferably no later than the beginning of 1998 -- merge the BIF and SAIF.

A merger of the funds would resolve the long-term weaknesses of SAIF by providing the requisite asset and geographic diversification, which in turn should protect taxpayers from the possibility of another deposit insurance crisis.

We recognize that any discussion of a merger of the funds raises a host of ancillary issues, such as the future of the thrift charter -- and other distinctions between banks and thrifts. The Treasury is developing a comprehensive proposal to deal with these issues.

---

4. **Authorize Rebates of BIF Excess Premiums**

- Authorize the FDIC to rebate assessments paid by BIF members to the extent that BIF reserves exceed the designated reserve ratio.

Rebate authority would not extend to BIF's investment income, which has never been rebated in the FDIC's history.

---

5. **Adjust Rules to Promote Assessment-Rate Stability**

- Direct the FDIC's Board of Directors to maintain a deposit insurance fund's reserve ratio so that it approximates the designated reserve ratio. Give the Board flexibility to reduce the size and frequency of assessment rate changes by permitting the reserve ratio to fluctuate temporarily within a range of not more than 0.1 percentage point above or below the designated reserve ratio. This would provide flexibility to smooth out premium rate fluctuations but would not change the 1.25 percent designated reserve ratio.

The FDIC would seek to maintain the fund at approximately the designated reserve ratio, but could permit it to fluctuate temporarily within a narrow band. This flexibility would in no way impair such other rules as (1) the FDIC's duty to base assessments on risk; or (2) the requirement that SAIF assessments be no lower than BIF assessments. Nor would it authorize rebating BIF's investment income.

- Lower from 23 basis points to 8 basis points the minimum average assessment required under section 7(b)(2)(E) of the Federal Deposit Insurance Act when a deposit insurance fund is undercapitalized or when the FDIC has borrowings outstanding for the fund from the Treasury or the Federal Financing Bank.

FDIC and OTS:

Make Unspent RTC Funds Available as a Backstop for Extraordinary, Unanticipated SAIF Losses Until the BIF and SAIF are Merged

- If SAIF losses were to exceed $500 million in any calendar year during the period beginning on July 1, 1995 (when SAIF takes over the RTC's responsibility for resolving failed institutions), and ending when the Funds are merged, make unspent RTC funds available to cover the amount by which the losses in that year exceed $500 million.

  Thus SAIF would cover the first $500 million in losses during any such year, and unspent RTC funds would cover any additional losses.

  Neither the CBO nor the FDIC currently projects that SAIF losses will reach $500 million in any year. (The FDIC projects losses of $270 million per year; the CBO projects losses of $450 million per year.) Thus unspent RTC funds would serve only as a reinsurance policy against losses more severe than those now anticipated.

  The Treasury does not support use of RTC funds.