14. FDIC-Administered Insurance Funds

Entries in this section relate specifically to the structure, status, and future condition of the two bank insurance funds administered by the Federal Deposit Insurance Corporation. Entries also discuss the merits of maintaining separate insurance funds for thrifts and commercial banks, and the effects of the industry's continuing consolidation on the exposure of the insurance funds.

American Bankers Association. 1991. Banking Industry and FDIC Bank Insurance Fund Conditions. Report.

> This report finds that if the Bank Insurance Fund (BIF) is recapitalized with increases in deposit insurance premium rates, the BIF's funding problem will not be solved. The report discusses some of the difficulties in making reasonable estimates of the size of the problem facing the BIF and describes some of the feedback effects that must be considered when a recapitalization program is designed.

Eccles, Jennifer L., and John J. Feid. 1997. Two Deposit Insurance Funds: In the Public Interest? Economics Working Paper 97-5. Office of the Comptroller of the Currency.

> The authors ask whether it is in the public's best interest to maintain two separate deposit insurance funds or whether the Savings Association Insurance Fund (SAIF) and the Bank Insurance Fund (BIF) should merge. They (1) examine the historical reasons for separate funds; (2) review the legislative history of each fund's creation and evolution; (3) ask whether there could be any economic benefit from combining the funds; and (4) develop a mechanism to determine the optimal insurance fund level. The authors conclude that the FDIC could maintain a lower insurance fund reserve level in a combined fund than in either of the separate funds and still support the same amount of coverage, given the level of probability of loss.

Eisenbeis, Robert A. 1995. Regulation: Resolving the BIF/SAIF Problem. *Journal of Retail Banking Services* 17, no. 4:59–63.

> The Shadow Financial Regulatory Committee put forward a new proposal in its Statement No. 124, "Alternatives to Recapitalizing the Savings Association Insurance Fund and Defeasing the FICO [Financing Corporation] Bonds," September 18, 1995. This article sets out the background for the interest in restructuring the deposit insurance funds and describes in detail the Committee's proposal and why it would be potentially more incentive-compatible and potentially less costly to both the industry and the public than the current proposals being debated.

Fidjestol, Asbjorn. 1991. The [Norwegian] Government Bank Insurance Fund. *Norges Bank Economic Bulletin* 62, no. 1:26–29.

> On January 25, 1991, the Norwegian government put forward Bill Number 20 of January 20, 1991, proposing to establish of the Government Bank Insurance Fund,

which was to be governed by separate legislation. In March 1991, the Storting (parliament) adopted a bill providing for the establishment of the Fund, and allocated NOK 5 billion to it. The Fund's board was appointed in March 1991. The purpose of the Fund is to underpin the soundness of the Norwegian banking system and to secure depositors' interests. The background for the government's proposal to establish the Government Bank Insurance Fund is Norwegian banks' deteriorating loss, earnings, and capital position. The loss trend in 1990, as shown in the banks' year-end adjustment, increased the need for active measures. One of the Fund's functions is to grant loans on special terms to the Commercial Banks' Guarantee Fund and the Savings Banks' Guarantee Fund. The authorities are thereby contributing to buttressing the banking system by facilitating the infusion of risk capital.

Gilbert, R. Alton. 1992. The Effects of Legislating Prompt Corrective Action on the Bank Insurance Fund. Federal Reserve Bank of St. Louis *Review* 74, no. 4:3–22.

Under the assumption that losses to the Bank Insurance Fund (BIF) would have been lower if supervisors had acted differently, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) made major changes in the supervision and regulation of depository institutions. Whether the evidence is consistent with that underlying assumption is an issue for consideration. As part of a program for reform of the supervision and regulation of depository institutions, several economists have begun promoting proposals for prompt corrective action (PCA) by supervisors. The evidence does not support the hypothesis that the longer a bank operates with a low capital ratio before failure, the larger the BIF loss. Instead, the evidence suggests that supervisors have been effective in constraining the risk assumed by poorly capitalized banks. These results raise doubts about whether PCA legislation will reduce BIF losses.

Gilbert, R. Alton. 1993. Implications of Annual Examinations for the Bank Insurance Fund. Federal Reserve Bank of St. Louis *Review* 75, no. 1:35–52.

This paper investigates whether there is a relationship between the frequency of bank examinations and losses to the Bank Insurance Fund (BIF). The author studies whether banks reduce their asset growth and dividends after supervisors classify them as problem banks. If so, BIF losses as a percentages of total assets at failed banks that were examined frequently should be less than BIF losses as a percentage of total assets at failed banks that were examined infrequently. The author concludes that the requirement of annual examinations will reduce losses of BIF.

Isaac, William M., and James A. Marino. 1989. The Bank Insurance Fund: Its Future Prospects. Report. The Secura Group.

This report reviews the works of R. Dan Brumbaugh Jr., Andrew S. Carron, and Robert E. Litan on the topic of the Bank Insurance Fund (BIF). These three authors conclude that the BIF is not viable; however, Marino and Isaac disagree. Marino and Isaac conduct a comprehensive analysis of the condition of the

banking industry and the resources of the BIF and conclude that the BIF is not under-funded.

Kane, Edward J. 1991. Timely Accounting and Budgeting for Deposit-Insurance Losses. Cato Institute *Regulation* 14, no. 4:29–32.

The author believes that the deposit insurance debate is confused by the misleading accounting system federal authorities have used to measure each fund's income, expenditures, liabilities, and net reserves. He suggests that elected and appointed officials be more accountable for deposit-insurance losses as they accrue.

Konstas, Panos. 1992. The Bank Insurance Fund: Trends, Initiatives, and the Road Ahead. *FDIC Banking Review* 5, no. 2:15–23.

The article discusses the changes to the financial condition of the Bank Insurance Fund (BIF) and the measures taken to restore the BIF to financial viability. The author recommends that a "moving-average" approach to assessment policy be implemented after the BIF reserve reaches its target ratio of 1.25 percent of insured deposits.

Lateef, Noel V., and Raymond S. Sczudlo. 1995. Federal Deposit Insurance Funds: The Impending Rate Disparity between Banks and Thrifts. *Banking Law Journal* 112, no. 4:353–83.

The authors examine the deposit-insurance rate disparity between members of the Bank Insurance Fund and members of the Savings Association Insurance Fund, and predict another S&L debacle unless the two funds are merged.

Marino, James A. 1990. A Preliminary Inquiry into the Financial Exposure of the Bank Insurance Fund. Report. The Secura Group.

This paper examines the need for further premium increases by providing a general view of the potential exposure facing the Bank Insurance Fund (BIF). The author estimates the number of institutions with a high failure potential among the approximately 13,000 commercial banks and 480 savings banks insured by the BIF. By isolating potential failure candidates, one can arrive at general conclusions regarding the BIF's potential exposure. Because the paper is interested primarily in failure prediction, it does not pretend to provide a balanced account of the condition of the banking industry.

Oshinsky, Robert. 1999a. Effects of Bank Consolidation on the Bank Insurance Fund. Working Paper 99-3. Federal Deposit Insurance Corporation.

During the 1990s, mergers of large banks changed the industry dramatically, with the concentration among the 100 largest banking organizations increasing from 54.6 percent as of year-end 1990 to 72.6 percent as of mid-1999. Using a Monte Carlo model under various levels of industry concentration, the author examines changes in the Bank Insurance Fund's (BIF's) ability to remain solvent. To better

examine the effects of consolidation, the author simulated the top 100 banking organizations individually, whereas other banks were simulated in the aggregate. The results show that, on the basis of historical loss and failure rates, the consolidation that took place between 1990 and 1997 increased the risk of BIF insolvency by approximately 50 percent, and that megamergers that took place or were announced during the 18 months between year-end 1997 and midyear 1999 further increased the risk of insolvency. Moreover, unlike the BIF of 1990, the solvency of the BIF of 1999 is inseparably tied to the health of the largest banking organizations.

Oshinsky, Robert. 1999b. Merging the BIF and the SAIF: Would a Merger Improve the Funds' Viability? Working Paper 99-4. Federal Deposit Insurance Corporation.

During the 1990s, the differences between BIF-insured and SAIF-insured institutions declined. Because of mergers, over one-third of the deposits insured by the Savings Association Insurance Fund (SAIF) had come to be held by Bank Insurance Fund (BIF)-member institutions. Using a Monte Carlo model under various levels of industry concentration, the author examines the SAIF's ability to remain solvent. He shows that industry consolidation has served to reduce the vulnerability of the SAIF, as several large BIF-member institutions have increased their SAIF-insured holdings. Nonetheless, the SAIF continues to be somewhat more vulnerable to insolvency risk than the BIF. The paper also examines a possible merger of the BIF and the SAIF. The results show that a larger, combined insurance fund would be less risky than either the BIF or the SAIF separately. In other words, both the BIF and the SAIF would benefit from a merger of the funds. In addition, the results show that the probability of either fund's becoming insolvent is significantly higher that the probability of a merged fund's becoming insolvent.

Savings Association Insurance Fund Industry Advisory Committee (SAIFIAC). 1990. Report of the SAIFIAC. Report. SAIFIAC.

This report was submitted to the House Committee on Banking, Finance and Urban Affairs and the Senate Committee on Banking, Housing, and Urban Affairs. The advisory committee urged Congress to take action to prevent further losses to the insurance funds, finding that the SAIF would have inadequate funds to perform its role as insurer. The committee recommended that funds designated for the SAIF not be counted as available to cover Resolution Trust Corporation (RTC) losses and that the $32 billion designated in FIRREA as contributions to the SAIF be preserved. The committee commented on insurance premium parity, regulatory independence, retroactive passive loss restrictions, QTL test, and purchased-mortgage servicing rights. The committee was established by FIRREA to make recommendations to the FDIC. The summary is from the June 1990 semiannual report of the SAIFIAC.

Savings Association Insurance Fund Industry Advisory Committee (SAIFIAC). 1994. Report of the SAIFIAC. Report. SAIFIAC.

While Congress was considering various proposals for consolidation of federal bank regulatory agencies, the Savings Association Insurance Fund Industry Advisory Committee was considering the status of the insurance funds, particularly the viability of the Savings Association Insurance Fund. The advisory committee recommended that a merger of the BIF and the SAIF take place as soon as possible.

U.S. General Accounting Office (GAO). 1993–1995. Deposit Insurance Funds: Compliance with Obligation and Repayment Requirements. GAO.

The Federal Deposit Insurance Corporation Improvement Act of 1991 required the GAO to report quarterly on the condition of the BIF and the SAIF and their ability to pay their obligations. The GAO also assesses whether the funds' total collections from the management and disposition of assets acquired from failed banks would be enough to repay their existing working capital borrowings. The GAO discontinued the reports once the banking crises subsided and the funds were deemed to be financially sound.

U.S. General Accounting Office (GAO). 1994a. *Federal Deposit Insurance Corporation: Management Letter as of December 31, 1992.* GAO/AIMD-94-30ML.

Pursuant to a legislative requirement, the GAO reviewed the Federal Deposit Insurance Corporation's (FDIC's) accounting procedures and internal controls for corporate, consolidated office, and asset pool operations. The GAO found several problems with the FDIC's accounting procedures and internal controls, and these are itemized in the report.

U.S. General Accounting Office (GAO). 1994b. *Federal Deposit Insurance.* GAO/GGD-95-47R.

Pursuant to a congressional request, the GAO reviewed whether (1) the transfer of money from federal deposit insurance funds into mutual funds would significantly affect the assessment income of the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF); and (2) Federal Deposit Insurance Corporation (FDIC) projections for the BIF and the SAIF consider this movement of money. The GAO noted that (1) the transfer of savings from deposits has reduced the assessment bases of the BIF and the SAIF; (2) slow rates of growth in the assessment bases contribute to the shortening of timetables for recapitalizing the BIF and the SAIF; (3) the slow rates of growth in the assessment bases would reduce the level of deposits that the BIF and the SAIF are projected to insure, but it would not reduce the funds' projected reserves by the same proportion; (4) the FDIC has not explicitly taken into account the effect of mutual funds on deposits; and (5) the willingness of consumers to move funds between deposits and mutual funds introduces a source of volatility into deposit growth projections and insurance fund reserve ratio calculations.