Statement of America's Community Bankers for the FDIC Roundtable on Deposit Insurance Reform April 25, 2000

My name is William A. Fitzgerald. I am Chairman and CEO of Commercial Federal Bank, FSB, in Omaha, Nebraska. I am also currently Chairman of America's Community Bankers, and am pleased to present the thoughts of ACB at the FDIC's Roundtable on Deposit Insurance Reform. ACB is the national trade group for community banks of all sizes and charter types. Our members pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. ACB is actively engaged with our members and their customers to determine potential changes that could enhance the deposit insurance system.

Today's policy debate will cover a number of highly technical issues in risk measurement, market discipline and the optimal reserve ratio for the FDIC insurance funds. The policy discussion will also cover an issue that would be more apparent to the customers of the nation's banking sector: the possibility of raising the ceiling on the deposit amounts covered by federal deposit insurance.

Without regard to other considerations, virtually all insured depositories would welcome an increase in the basic insurance amount from the $100,000 that has prevailed for two decades. Inflation, though more moderate now than in the 1980s, has already effectively halved the real value of that coverage. Redressing that erosion and indexing the insured amount in the same way that the Internal Revenue Code forestalls bracket creep would be useful at a time when deposit growth has been chronically weak. It would recognize that insurance coverage has not increased and that some customers have reached the insurance ceiling. However, the benefits of increased insurance coverage to the typical bank or consumer must be carefully weighed against the possible costs of higher insurance premiums or required reserve ratios imposed by the FDIC or other added regulatory burdens.

If any increase in deposit coverage requires a change in deposit insurance pricing, the cost/benefit calculation can quickly become extremely intricate. A basic economic question is how much would the total amount of insured deposits increase for the vast majority of insured depositories in response to an increase in insurance coverage. Before jumping on the bandwagon for increased deposit insurance, ACB members would have to know in some detail what the FDIC thinks about premium pricing and the required reserve ratio. ACB members are aware that deposit brokers have already made it relatively easy for high balance consumers to subdivide their deposits to secure virtually unlimited access to federal insurance.

If the switch to higher coverage at a single depository primarily reshuffles deposits via consolidation of essentially the same aggregate insured deposit base, and is accompanied by the imposition of an insurance premium increase, the marginal cost of whatever new funds are attracted into the banking system could be very unattractive. In a very competitive deposit market, the total impact on interest margins and regulatory burden has to be reasonably foreseeable before changes to the level of deposit insurance coverage are made.

In addition to the economic calculation, the FDIC should consider the significant public policy implications of deposit reshuffling. If higher insurance coverage levels encourage consolidation of larger deposit balances in big institutions, the dangers of 'too big to fail' may resurface. Unless it is conceded that the deposit insurance funds are currently overcapitalized and that raising the level of the coverage is a way to provide additional benefits, implicitly in lieu of premium rebates to the banking sector, it is even more difficult to disentangle the topic of the correct level for the insurance limit from the complex policy issues of market discipline and too-big-to-fail.

Debating these issues should not delay a more obvious improvement in the health of the FDIC's funds: the merger of the separate Bank Insurance and Savings Association Insurance Funds. It is clear that a merged fund would be stronger than either fund alone. Merging the funds is an improvement that should be made even as the issue of rebates continues to be debated.

ACB strongly supports the restoration of rebate authority for the FDIC. It appears clear that the reserve ratio will continue to increase for the foreseeable future under the current statute. The debate that is beginning on the optimum setting of the designated reserve ratio (DRR) is useful, as is the debate on capping reserve ratios at some level to prevent the possibility of excessive growth. There seems to be no reason for the FDIC to select a higher DDR value than the 1.25 percent level statutorily prescribed at present. The ACB has previously testified that a cap of 1.4 or 1.5 percent seems appropriate.

The FDIC has noted the potential for dilution of the reserve ratio if one or more of the newly authorized Financial Services Holding Companies seeks to have customers convert uninsured deposits or other investments in significant amounts to insured deposits. ACB understands this concern, but would not support any special entry fee that might chill the formation of ***de novo*** institutions.

Finally, ACB supports further exploration of the concept of market signals to help set deposit insurance premiums for certain institutions. The Congress has encouraged such experiments. This could perhaps best be tested by coordination with the subordinated debt issuances required from the very largest financial services holding companies. These entities are the most intensively tracked by the capital markets and are also those most likely to gain from any perception of 'too-big-to-fail' status. Given the lower risk of and market attention paid to community banks, it is less likely that these tools could substantially add to the examination assessment of these depositories' health.

ACB is pleased to be able to offer its views as ways are sought to make the deposit insurance system even more efficient. ACB will continue to discuss these issues with our members in an effort to develop a more complete position on the complex issue of fair deposit insurance reform.