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Statement of the Shadow Financial Regulatory Committee

on

Funding of the BIF and Depository Insurance Reform Proposals in H.R. 2094

May 20, 1991

The Subcommittee on Financial Institutions of the House Banking, Finance and Urban Affairs Committee has recently reported out H.R. 2094. This bill addresses a subset of the issues raised by the Treasury's recent legislative proposal, namely the funding of the Bank Insurance Fund (BIF) and the introduction of an early regulatory intervention and closure structure to deal with troubled banks. H.R. 2094 is scheduled to be considered by the full Banking Committee in June.

The Shadow Financial Regulatory Committee believes that the other issues raised in the Administration's bill (H.R. 1505) must also be addressed if we are to have a sound and efficient financial system. These include deposit insurance premiums and coverage, expanded geographic and product powers and reorganization of the regulatory structure. However, the most urgent needs are refunding the BIF and meaningful deposit insurance and supervisory reforms. As explained in our Statement No. 41 (February 13, 1989), this requires structured early regulatory intervention and mandatory recapitalization of failing institutions.

The BIF's need for funds is critical, and the amounts required may even be greater than currently believed by agency officials. If this is true, then any deficiencies will ultimately be born by the taxpayer.

H.R. 2094 does not answer the question of who in the final analysis will bear the BIF's losses. If BIF's resources are exhausted, there are only two sources of additional capital to cover losses in insolvent institutions: levies on solvent institutions or on taxpayers. Given that the banking industry bears a considerable responsibility for the existing problems, the Committee feels that it is entirely appropriate that a large portion of the burden of recapitalizing the BIF be borne by the private sector. The extent of this burden will have to be determined by the Congress. In the interim, however, BIF financing should come directly from the Treasury, as H.R. 2904 provides, to minimize costs and to acknowledge them candidly, without any resort to deceptive devices such as borrowing from the Federal Reserve.

The Committee also strongly endorses the supervisory reforms contained in H.R. 2094. Requiring early structured regulatory intervention or mandatory closure for banks that fall below predefined capital ratios is fundamental to correcting existing perverse regulatory incentives and to protecting taxpayers against escalating burdens on the deposit insurance fund.

The Committee reiterates its opposition to any weakening of mandatory regulatory actions that would allow regulators to exempt certain under-capitalized institutions from required sanctions because they believe that those institutions might be too big or too special to impose losses on uninsured claimants. Prompt action under the intervention and closure provisions should eliminate both the threat of runs on individual institutions and systemic risk. Providing exceptions for large institutions from the costs of regulatory sanctions only increases the threat of taxpayer bailouts and eliminates market discipline for these institutions.

The Committee also endorses the proposal contained in H.R. 2094 to constrain the FDIC to use the "least costly" method to resolve each failed bank

and to document its calculation. We urge that this documentation be made publicly available. This proposal, together with the additional provision that prohibits the FDIC from protecting uninsured depositors and creditors from sharing the losses of a failed institution, will provide adequate protection for taxpayers.

Finally, the Shadow Financial Regulatory Committee believes that the Federal Reserve's ability to provide liquidity to undercapitalized institutions should be restricted. Unrestricted, such lending can put taxpayers at greater risk by delaying regulatory intervention to resolve the problems of troubled institutions. The Federal Reserve should be permitted to make loans only on an uncollateralized basis to institutions that have fallen below the critical capital standard.