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Statement of the Shadow Financial Regulatory Committee

on the

OMB and CBO Statements Calling for More Informative Accounting and Budgeting for Deposit Insurance

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The Shadow Financial Regulatory Committee has frequently noted that losses incurred by the defunct FSLIC, as well as losses still accumulating at the FDIC's Bank Insurance Fund (BIF), have been aggravated by delays in measuring and recognizing the effects of prospective losses at insured institutions. Such delays are inherent in the cash-based accounting procedures traditionally used to measure deposit-insurance revenues and expenditures. The result is a perennial understatement of the FDIC's liabilities. Because taxpayers, Congress, and the rest of the Administration are not apprised in timely fashion of developing problems, pressures for appropriate public policy responses are forestalled.

Traditionally, the FDIC did not establish reserves for deposit insurance losses until an insured institution was taken over by the government. Its delay in recognizing liabilities for losses from future bank failures has been a point of continuing controversy between the FDIC and its official auditor, the General Accounting Office (GAO). This issue has become increasingly important as the FDIC has become more willing to grant forbearance to insolvent and undercapitalized banks.

In principle, whenever it is possible to identify specific banks that will require future FDIC expenditures, reserves should be established to cover losses. Until recently the FDIC rejected this approach, arguing that these expenditures should be treated as unrecorded "contingent liabilities." As a result of GAO insistence, the FDIC has partially adjusted its procedures. The effect of this for yearend 1990 is to increase its allowance for expected 1991 failures by $4.3 billion, which cut its reported fund balance in half.

However, the FDIC's financial statements still will not reflect expected losses from identifiable insurance cases that are not scheduled to be handled until after 1991. In principle, reserves for these losses should be established as soon as such cases are identified.

Further, additional failures are bound to occur that will not have been specifically anticipated. The BIF should include a provision for losses from such failures to the extent that they exceed anticipated net revenue. As a minimum, reserves should be established on a probabilistic basis for losses apt to occur in the following year. There is now no effort to reserve for such expected losses.

To remedy long-standing measurement weaknesses, the Omnibus Budget Reconciliation Act of 1990 required the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) separately to study alternatives for improving accounting and budgeting for federal deposit insurance. Both reports call for computing and publicizing estimates of the economic costs of deposit insurance on an accrual basis. The reports also indicate that accrual and cash-based information may be combined usefully to produce improved measures of the government's financial position. Using an accrual approach, OMB estimates the BIF's yearend 1990 net reserves to lie in the vicinity of negative $40 billion, a figure far more worrisome than FDIC's +$4 billion estimate.

OMB goes further than CBO to illustrate the feasibility of the procedure and to establish a timetable for change. OMB recommends that, beginning in 1993, the FDIC's estimates of accrued liabilities be incorporated into the federal budget in some way. To enhance the reliability of accrual estimates, OMB envisions collecting helpful information on the scheduled maturity of assets and liabilities from commercial banks, parallel to that already collected from insured S&Ls.

The Committee applauds the OMB initiative. The accounting reforms it suggests are long overdue. The public has been badly served by official use of flawed accounting schemes. Cosmetic accounting procedures continue to make it hard for legislators, the press, and other citizens to evaluate and appreciate the full magnitude and true nature of the deposit insurance mess.