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Statement of the Shadow Financial Regulatory Committee

on

Accounting for Taxpayers' Stake in
the FDIC's Bank Insurance Fund

December 16, 1991

Accountability for FDIC performance in managing the Bank Insurance Fund (BIF) has to begin with accurate information on the value of BIF's net reserve position. The FDIC should not be subject to less stringent financial reporting and disclosure requirements than the institutions it regulates. For insured deposit institutions, the FDIC Improvement Act of 1991 requires that all assets and liabilities, including contingent assets and liabilities, be taken into account in preparing financial statements. It also requires that methods be developed to let financial statements disclose the estimated fair market value of assets and liabilities, "to the extent feasible and practicable."

The Shadow Financial Regulatory Committee applauds these itemization and valuation principles and urges that they be used as well to measure the condition of the BIF itself. The principal contingent obligation of the BIF is the anticipated losses to which it is exposed by the operations of the institutions it insures. The fair market value of this obligation can be identified as the charges that the FDIC would have to incur in reinsurance markets to shift its insurance obligations to another credible party.

Currently, the FDIC books at year-end a contingent liability for its exposure to losses only in institutions whose insolvency it expects to resolve

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during the subsequent calendar year. Moreover, even with respect to this limited universe, procedures for valuing BIF's expected losses have not been tied explicitly to a market-value standard.

Using the figures now published by the FDIC, the FDIC Improvement Act of 1991 perpetuates the accounting fiction that the BIF is financed entirely out of past and future assessments paid by insured banks. Projections that the fund will experience net outflows over the next few years are presumed to be counterbalanced by the hope that the FDIC can adjust its schedule of assessment rates to generate a stream of net premium income sufficient over the next 15 years to offset the near-term outflows. Relying on this unrealistic presumption, the legislation treats the fund as if it were temporarily short of liquidity, but not economically insolvent. Presuming the fund's solvency, the law authorizes the FDIC to borrow funds to cover the cash-flow shortages it will encounter in the next few years.

Using current assessment rates, earlier this Fall the Office of Management and Budget (OMB) projected substantial net BIF outlays for the years 1991 through 1996 (in billions): \$15.9, 9.7, 8.0, 6.9, 0.9, and 0.6, respectively. Discounted to present value at current interest rates, these projections establish a negative net worth for the Bank Insurance Fund. It is virtually impossible that net premium income can be driven high enough to offset the discounted present value of net outlays of the magnitude that OMB projects.

Those who maintain that BIF is economically solvent fail to recognize that banks will respond to high assessments in ways that will prevent the FDIC from realizing much of a margin of premiums over cost. Beyond an income-maximizing level, higher assessment rates entail reductions, not increases, in BIF's net premium income. Any increase in "user charges" invokes a circumventing response. High assessment rates increase incentives for banks to reduce the base of assessable deposits and to increase the riskiness of the smaller deposit base left to be covered by BIF. Gross revenues that can be projected from given assessment schedules are inherently limited by the opportunity costs for banks to reproduce benefits of the BIF's insurance services in other ways: such as by expanding their recourse to liabilities secured by strong assets.

Although authorities are unwilling to admit it, the bulk of the so-called \$30 billion recapitalization of BIF under the new banking legislation is now being underwritten by the general taxpayer and not by insured banks.