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Statement of the Shadow Financial Regulatory Committee on Brokered Deposits and Capital Requirements

June 1, 1992

The FDIC has adopted a rule governing permissible acceptance of brokered deposits by depository institutions, as required under Section 301 of the Federal Deposit Insurance Corporation Improvement Act of 1991, to take effect on June 16th. Under the rule, an "undercapitalized" bank or thrift would be prohibited from obtaining deposits through brokers and from paying interest on directly solicited deposits exceeding 75 basis points above the interest rate in the market from which the deposits are obtained. A so-called "adequately capitalized" institution would be prohibited from using brokers, except with a waiver from the FDIC, and then would be subject to the same interest rate cap. A so-called "well capitalized" institution could obtain deposits from brokers or directly from customers without limitations.

While the Shadow Financial Regulatory Committee supports the FDIC's rule in concept, we are concerned about two important aspects of its application. First, the threshold "zone" ratios defining capital strength are set substantially too low. A bank or thrift would be considered "well capitalized" if its total capital is 10% or more of its risk-adjusted assets and its Tier 1 capital (leverage ratio) is 5% of its total on-balance-sheet assets. Recent experience has indicated that these ratios are too low to absorb the kinds of shocks that have affected the industry. Moreover, interest-rate risk and concentration-of-default risk (both of which contributed greatly to the massive insolvency of much of the savings and loan industry) are not incorporated in the risk calculation. Furthermore, because capital is measured on an historical cost basis, which often overstates current market prices, even some "well capitalized" depositories may not be adequately positioned to absorb losses of significant magnitude.

Second, there seems to be little reason to distinguish between brokered and non-brokered deposits. The intent of the FDIC's rules is to prevent less-than-well-capitalized depositories from paying too much for deposits, regardless of their sources. Thus, the rule could be simplified by requiring that the proposed interest rate ceilings for inadequately capitalized and undercapitalized institutions be applied to all of their deposits, whether or not they are brokered or non-brokered. We believe that ceilings should not be applied to well capitalized depositories, provided capital is properly defined, since there is less danger that their deposits would not be supported by adequate capital.

Finally, although some object to higher capital requirements as being too costly to banks, the Committee believes that this concern is groundless. Most bank competitors not covered by the federal safety net operate profitably with much higher capital ratios than banks.

It is the Committee's policy that members abstain from participation on policy statements in which they have a direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, Richard C. Aspinwall abstained from voting on this statement.