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Statement of the Shadow Financial Regulatory Committee

on

Proposed Changes in the FDIC's Risk-Related Premium System

March 1, 1993

In December 1992, the Federal Deposit Insurance Corporation (FDIC) requested comments on proposals to amend the transitional risk-related system of deposit insurance premiums put in place last year. The request raised five specific questions concerning premium structure:

1. whether and how to establish a new category of "minimal-risk institutions" that would be charged less than the current minimum of 23 cents per $100 of deposits;

2. whether and how to widen the 8-cent spread between the highest and lowest premiums in the system;

3. whether and how to expand the number of risk categories beyond the nine in the current system;

4. whether and how the insurance premiums charged by private reinsurers in a reinsurance demonstration project should affect the FDIC's risk category assignments; and

5. whether and how to increase premiums assessed against lowest-rated institutions that fail to improve their condition promptly.

The Shadow Financial Regulatory Committee believes that each of these actions should be taken. The only question is how.

In principle, the FDIC's risk-measurement and pricing decisions should emulate those of a well-managed private deposit-insurance corporation operating in a competitive market. To evaluate any risk assessment procedure requires developing and disclosing an information system that measures the loss exposure that is imposed on the Bank Insurance Fund by each risk class it insures. Absent such a system, any premium schedule inevitably will be arbitrary, with some institutions paying more than they should for the risks they pose to the insurer, while others will pay less.

The object of risk-related premiums must be to reinforce and to refine the risk-control incentives established by the tripwire system of capital discipline under the Federal Deposit Insurance Corporation Improvement Act of 1991. In practice, this means the insurer should seek to earn a zero net return on the business of each risk class. The FDIC should aim to remove from deposit insurance premiums both subsidies for weak entities and penalties for the strong. The number of risk categories, premium spreads across categories, and penalties levied on nonresponsive institutions should all adapt to this purpose.

The Committee urges the FDIC to put its pricing and risk-control systems on a cost basis and to disclose its supporting information and analysis.