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Administrative Office
c/o Professor George Kaufman
Loyola University of Chicago
820 North Michigan Avenue
Chicago, Illinois 60611
TEL (312) 915-7075
FAX (312) 915-6118

Statement No. 125

For information contact:

Robert A. Eisenbeis
919-962-3203

Paul M. Horvitz
713-743-4765

Statement of the Shadow Financial Regulatory Committee

on

Alternatives to Recapitalizing the Savings Association Insurance Fund and Defeasing the FICO Bonds

September 18, 1995

Current Administration proposals to resolve the funding problems of the Savings Association Insurance Fund (SAIF) involve a two phase plan. Phase One involves a one-time assessment of about 85 basis points on deposits of SAIF insured institutions and spreading Financing Corporation (FICO) bond payments across institutions insured by both the Bank Insurance Fund (BIF) and SAIF. Phase Two would involve merging the BIF and SAIF funds sometime in the future and creating a unified bank and thrift charter. Agreement on the program seems to be in difficulty because of doubts about the deliverability of Phase Two which effectively compensates BIF-insured institutions for bearing part of the cost of servicing the FICO bond payments.

Shadow Financial Regulatory Committee Statement No. 123 offered an alternative way of dealing with the SAIF funding problem. The Committee proposed that the critical level of institutional capital be raised that triggers the least-cost resolution provisions of FDICIA and that the FDICIA mandated 1.25 percentage reserve ratio be abandoned for SAIF.

The Committee suggests that this proposal could be modified and extended in ways that would reallocate the commitments already tentatively agreed to by banks and thrifts in a way that strengthens the Prompt Corrective Action (PCA) provisions instituted by the FDICIA. First, raise from 2 percent to 4 percent the critical capital level at which the least-cost

resolution requirements of FDICIA would be invoked. This makes it unnecessary to recapitalize the SAIF to the mandated 1.25 percent level of insured deposits before the BIF and SAIF can be merged. The increase in the critical capital level expands the resources available to the insurance fund to draw upon should an institution experience financial difficulties. It does this by substituting available deposit institution capital for SAIF insurance funds. The Committee would also extend this two percentage point increase in the critical level of capital trigger to well-capitalized institutions insured by BIF. This would reduce to near zero the needed premiums for well-capitalized banks, since they would be protected more effectively by their own capital.

Second, keep the proposed 85 basis point one-time charge on SAIF-insured institutions, but reallocate its estimated $6 billion of proceeds to defease the estimated $8.4 billion present value cost of servicing FICO bonds. This would leave approximately $2.4 billion in present value of FICO bond interest payments. That amount could be financed by adding less than one basis point to the premiums levied on insured institutions.

Finally, to assure that the intended resources are available to protect the taxpayer, change the method of measuring capital for purposes of the PCA provisions of FDICIA from reliance upon book values to market value measures of net worth . Many assets are already valued at market, or can easily be expressed in market values. As discussed in Statement No. 41, easily valued assets should be revalued regularly as the first step in moving to market value reporting for purposes of calculating capital.

Properly implemented, the proposal would provide a win-win opportunity for everyone. It would strengthen the supervisory process, resolve the FICO bond burden, enhance taxpayer protection, spread the costs of clearing up the funding needs of the SAIF, and improve regulatory agency accountability and supervision. It would also reduce the financing burdens to be born by banks and make it possible to address the issue of combining thrift and bank charters in the future. While the Committee has not reviewed in detail what a unified charter might involve in terms of permissible activities, it seems clear that any proposal to retain an artificially high commitment to housing finance is inappropriate.