

**STATEMENT OF ELLEN SEIDMAN
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ON MERGER OF THE FEDERAL DEPOSIT INSURANCE FUNDS
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON BANKING AND FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES**

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I. Overview

The Office of Thrift Supervision (OTS) welcomes this opportunity to submit a statement for the record concerning the merger of the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). The facts clearly indicate that it is in the best interests of the federal deposit insurance system, as well as all insured institutions, to merge the funds.

While recent events have increased the imperative for merging the funds, events have simultaneously decreased the case—if one ever existed—for conditioning fund merger on charter or agency merger. Fund merger makes sense because both funds have lost their charter-related identity and now insure large amounts of deposits of institutions with all types of charters—federal and state; commercial bank, savings bank and savings association—regulated by all four federal bank regulators. As to merger of the charters and agencies, Congress just passed comprehensive legislation that (i) neither merged the bank and thrift charters, nor eliminated the dual banking system; (ii) added the equivalent of a new charter—the financial holding company structure; (iii) made no changes in agency jurisdiction over banks and thrifts; and (iv) perhaps most importantly, made insurance and securities firms and regulators an intimate part of the banking scene.

It is entirely possible that some time in the future the United States will decide to follow the British model, which combines all financial regulators (including those who regulate securities and insurance) in one agency while separating the central bank from bank supervisory responsibilities. Or, perhaps, a different model will prove appropriate. But three months after passage of a complex and far-reaching bill that restructures large parts of the financial services industry, the impact of which is still unknown, does not appear to be the time to start down that road.

II. The Case for Fund Merger

For the last several years, Chairmen of the Federal Deposit Insurance Corporation (FDIC), as well as the Treasury and Directors of the OTS, have called for merging the federal deposit insurance funds. We support this proposal for the following reasons:

- Both funds insure a single product—deposits—which are held by institutions with a wide variety of business strategies and different state and federal charter types;
- Each fund has become more concentrated, as mergers have increased the size of the largest institutions insured by each fund;
- The proliferation of cross-fund acquisitions has resulted in a significant number of institutions that are members of one fund holding deposits insured by the other fund; and
- Continuing to maintain two separate funds results in needless duplication of administrative expenses incurred by both funds.

Several recent developments make the case for fund merger even more compelling:

- The SAIF now insures deposits of institutions of all charter types, with OTS-regulated institutions accounting for only 54 percent of SAIF deposits; the SAIF is no longer peculiarly the deposit insurance fund of savings institutions.¹ Conversely, about a third of the deposits of savings institutions are insured by the BIF, including 16 percent of the deposits of OTS-regulated institutions.
- In contrast to earlier periods, each fund is now similarly concentrated, with the largest BIF member accounting for about 8.66 percent of BIF deposits and the largest SAIF member holding 9.81 percent of SAIF deposits. In addition, the five largest BIF institutions account for 21.97 percent of BIF deposits and the five largest SAIF members hold 22.13 percent of SAIF deposits. And the SAIF is now large enough that a merger would deconcentrate the combined fund substantially.

¹ All data, unless otherwise noted, are from September 30, 1999. SAIF data include the SAIF Special Reserve, which was set aside within the SAIF as of January 1, 1999, and merged back as of November 12, 1999. Preliminary, year-end 1999 data do not indicate significantly different ratios.

- The BIF has recently experienced losses while the SAIF continues to grow; merging the funds will strengthen the combined fund.

III. Charter Identity is No Longer a Characteristic of the Funds

No longer does the BIF insure commercial banks holding only BIF-insured deposits, nor does the SAIF insure savings associations holding only SAIF-insured deposits. Instead, the BIF insures deposits held by both BIF and SAIF member institutions, as does the SAIF. Although there was some cross-over when the funds were established in 1989—with FDIC-insured state savings banks represented in both funds—over the last ten years the funds have lost their unique identity with a particular charter type largely due to the proliferation of so-called Oakar, reverse-Oakar and Sasser transactions.² As the funds have lost charter type identity, with numerous institutions now holding both BIF- and SAIF-insured deposits, the reason for maintaining separate funds has diminished. The failure of an institution holding both BIF- and SAIF-insured deposits impacts both funds, regardless of the institution's fund membership. Thus, the funds are already significantly co-dependent.

The facts regarding the current distribution of charter types represented in the SAIF are compelling. As of September 30, 1999, OTS-regulated thrifts accounted for only 54 percent of SAIF-insured deposits, meaning that 46 percent—almost half—of all SAIF-insured deposits are in institutions regulated by the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB) or the FDIC. The distribution of these institutions is as follows:

- OCC-regulated national banks accounted for 22 percent of SAIF-insured deposits;
- FDIC-regulated state-chartered savings banks accounted for 8 percent of SAIF-insured deposits; and

² An Oakar transaction—named after Representative Mary Rose Oakar, the sponsor of the amendment adopted in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)—involves the acquisition of SAIF-insured deposits, either by merger or branch purchase, by a bank subsidiary of a bank holding company. A reverse-Oakar transaction involves the acquisition of BIF-insured deposits, either by merger or branch purchase, by a thrift subsidiary of a thrift holding company. A Sasser transaction—named after Senator James Sasser, the sponsor of the FIRREA amendment—involves a charter flip by a SAIF-insured savings association to a SAIF-insured commercial bank. Each of these transactions requires the acquired deposits to remain in their original fund regardless of the fund membership of the acquiror.

- FDIC- and FRB-regulated state-chartered commercial banks accounted for 16 percent of SAIF-insured deposits.

In the aggregate, commercial banks accounted for 38 percent of SAIF deposits,³ and state-chartered institutions not regulated by the OTS accounted for 24 percent of SAIF-insured deposits.⁴

On September 30, 1999, savings institutions held 31 percent of deposits insured by the BIF, with 16 percent of BIF-insured deposits held by OTS-regulated thrift institutions. On yet another dimension, 42 OTS-regulated savings associations are members of the BIF and 108 commercial banks are members of the SAIF.⁵

Fund merger is appropriate at this time because each fund now insures the deposits of institutions of various charter types. Fund merger has nothing to do with whether the charters within each fund are converging. That is a separate question with a different answer. The banking and thrift industries, unlike the funds, are not converging. The link between these two issues suggested by some does not exist.

In fact, the business of thrifts is still quite different than that of commercial banks. The most telling statistic is the most straightforward—as of September 30, 1999, thrifts⁶ had 70.8 percent of their assets in residential loans. By contrast, commercial banks had only 23.4 percent of their assets in residential loans. Of these amounts, thrifts held 47.3 percent of their total assets in single family mortgage loans—a substantially higher percentage than the 14.3 percent held by commercial banks.

³ Commercial banks that hold SAIF-insured deposits include national banks and state-chartered commercial banks.

⁴ State-chartered institutions not regulated by the OTS that hold SAIF-insured deposits include FDIC-regulated state-chartered savings banks and FDIC- and FRB-regulated state-chartered commercial banks.

⁵ Fund membership is largely the result of the assignment of institutions to one fund or the other pursuant to a provision of FIRREA, section 7(l) of the Federal Deposit Insurance Act (FDIA). The provision generally provided that depository institutions the deposits of which were insured by the FDIC immediately preceding the time the funds were established (including certain FDIC-insured federal savings banks) would be BIF members and savings associations were designated SAIF members. This assignment mechanism remains in place, with newly chartered thrifts (except certain federal savings banks) assigned SAIF membership and de novo banks assigned BIF membership. As a result of the substantial merger and acquisition activity that has occurred since FIRREA, many institutions now hold deposits insured by both funds.

⁶ This includes FDIC-insured state savings banks, about 60 percent of which are insured by the BIF.

Thrifts, with only about one-fifth the assets of commercial banks, originate about the same amount of single family loans. Thus, every dollar of thrift capital supports five times as many dollars of home mortgages as each dollar of commercial bank capital. Conversely, commercial banks focus much more on commercial lending activities. As of September 30, 1999, commercial banks had 17.2 percent of their assets in commercial loans, compared to thrifts' 2.2 percent of assets in commercial loans. This difference holds for thrifts of all sizes, even the smallest institutions.

Because of the mortgage lending focus of thrifts, OTS oversight and supervision places a far greater emphasis than that of the other federal banking agencies on interest rate risk management. We also focus on the liquidity and pipeline risk faced by lenders that originate any asset in quantity for sale to a secondary market—a common practice with many mortgage lenders. Of course, like our fellow regulators, we also pay attention to credit and operational risks, and to legal and reputation risks. But collateralized home mortgage lending is simply less risky from a credit perspective than commercial or consumer lending—witness thrifts' net charge-offs of 16 basis points for the first three quarters of 1999 compared to 58 basis points for commercial banks.⁷

Again, the facts demonstrating the interdependence and cross-ownership of the BIF and SAIF clearly make the case for fund merger. Charter merger is simply irrelevant to the issue.

IV. Fund Merger Will Significantly Decrease Fund Concentrations

A major risk for any insurer is concentration, *i.e.*, the possibility that one event or one insured entity will cause a massive and disproportionate loss. An example with which this Committee is intimately familiar is disaster insurance. Whereas automobile and homeowners' insurance is relatively readily available to most people, flood insurance is sponsored by the federal government and meaningful earthquake insurance is expensive and hard to obtain.

When the insurance funds were established in 1989, the largest commercial bank held only 4.03 percent of all commercial bank deposits and the largest OTS-regulated thrift had only 2.86 percent of all thrift deposits. With the mergers and acquisitions of the 1990s, today's large depository institutions are not only significantly larger than their predecessors in absolute size, they also hold a far

⁷ For 1999, charge-offs for OTS-regulated savings institutions were even lower, at 14 basis points, annualized through September 30, 1999.

larger percentage of a very slow-growing base of insured deposits. The result is that each of the insurance funds is subject to growing concentration risk.⁸

Currently, the concentration of deposits in the two funds is similar. As of September 30, 1999, Bank of America, the largest BIF-insured institution, accounted for 8.66 percent of BIF-insured deposits, while Washington Mutual (WAMU), the largest SAIF-insured institution, held 9.81 percent of SAIF-insured deposits. The five largest BIF-insured institutions hold 21.97 percent of BIF-insured deposits; and the five largest SAIF-insured institutions hold 21.13 percent of SAIF-insured deposits.⁹ Two institutions—Bank of America and First Union, neither of which currently has a thrift in its corporate family—are among the top five deposit-holders in each fund.

If this sort of concentration had existed prior to the recapitalization of the SAIF in 1996, merger of the two funds would have had relatively little impact, since the SAIF was quite small compared to the BIF. At the end of 1994, the SAIF balance was less than 9 percent of the BIF balance; at September 30, 1999, SAIF's balance was almost 35 percent of BIF's. As a result, a fund merger today will meaningfully reduce the concentration of the combined fund. Had the funds been merged as of September 30, 1999, Bank of America would have accounted for only 6.51 percent of the combined deposits, and WAMU would have held only 2.43 percent of the combined deposits.

This reduction in concentration is valuable to both the BIF and the SAIF. The reduction in the risk exposure to a large failure that would result from a combined fund supports the merger of the funds.

V. Existing SAIF Reserves Will Bolster a Strong, Unified Fund

During the initial years after formation of the SAIF and BIF, SAIF premiums were diverted to make payments to the Resolution Funding Corporation (REFCORP) and the Financing Corporation (FICO) to such an extent that the SAIF barely grew. Although SAIF members were assessed approximately \$11.1 billion from 1989 through 1995, the SAIF fund balance only grew from zero to \$3.4 billion. At the same time, BIF grew from \$13.2 billion to \$25.5 billion, with all BIF assessments going into that fund. From 1994 through 1996, both funds

⁸ It is important not to equate "large" with "risky." For example, OTS's ten designated problem institutions (CAMELS ratings of 4 or 5) have total assets of only \$4 billion, 0.4 percent of total thrift assets.

⁹ Bank of America, First Union, Wells Fargo, Chase and Wachovia are the top five BIF members. Washington Mutual, First Union, Bank of America, CalFed and Citibank hold the most SAIF deposits.

experienced proportionally similar resolution costs; thus, the funds remained at their relative reserve ratio positions.

Since 1996, and particularly in 1999, SAIF experienced a significantly lower percentage of losses. One SAIF-insured institution failed in 1996, none in 1997 or 1998, and one in 1999, which is projected to cost the SAIF a maximum of approximately \$1.3 million.¹⁰ In contrast, there were five failures of BIF institutions in 1996, one in 1997, three in 1998 and five in 1999. The five BIF failures in 1999, three of which were unusually costly in comparison to the asset size of the failed institutions, have caused the BIF to suffer a decline in its reserve ratio at the same time the SAIF reserve ratio is increasing.

In November 1999, FDIC staff advised the FDIC Board that the combination of significantly higher projected losses for BIF and somewhat faster deposit growth meant that on June 30, 2000, the BIF reserve ratio would likely stand at between 1.33 and 1.41, while the SAIF ratio would be between 1.42 and 1.50.

This is not to suggest that there could not be SAIF losses. We at OTS, like our sister bank agencies who regulate the institutions that hold the other 46 percent of SAIF deposits, are doing our best to keep fund losses both small in number and small in size. But losses can happen. Whether they do or do not, however, we are at a point in time when combining SAIF and BIF reserves will create a fund that is more healthy and has a lower risk profile than separate BIF and SAIF funds.

VI. Conclusion

The facts regarding the current composition of the SAIF and BIF, as well as the benefits that would be derived from combined funds, indicate that fund merger is in the best interests of the federal deposit insurance system and all institutions that rely on this system. Over the past several years, the composition of the SAIF and the BIF have changed to such an extent that their names are now misleading. Almost half of the deposits insured by the SAIF, or Savings Association Insurance Fund, are now held by commercial banks and FDIC-regulated savings banks. Similarly, almost one-third of the deposits held by thrift institutions are now insured by the BIF, or Bank Insurance Fund. These facts alone make the case for fund merger; and when the benefits of a combined fund are considered, the case is all the more compelling. For these reasons, OTS supports merger of the federal deposit insurance funds.

¹⁰ For comparison, SAIF earns about \$600 million per year in interest on the fund balance.