GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-261516

May 31, 1995

The Honorable John J. LaFalce
House of Representatives

Dear Mr. LaFalce:

This letter responds to your April 13, 1995, request for certain information on the designated ratio of reserves to insured deposits established for the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). Specifically, you asked whether, in our recent study of the potential premium rate disparity between institutions insured by BIF and SAIF[1] or in other work, we had analyzed the adequacy of the designated reserve ratio or had otherwise officially expressed views on the reserve ratio.

The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 created BIF and SAIF and designated the Federal Deposit Insurance Corporation (FDIC) as administrator of the two Funds. FIRREA designated a minimum ratio of reserves to insured deposits of 1.25 percent or a higher percentage determined by FDIC's Board of Directors, not to exceed 1.5 percent, for BIF and SAIF. FIRREA also provided for specific premium rates to build each Fund's reserves up to the designated reserve ratio. The Omnibus Budget Reconciliation Act of 1990 removed the 1.5 percent reserve ratio upper limit. FDIC may increase the designated reserve ratio for any year it determines that circumstances exist raising a significant risk of substantial future losses to either BIF or SAIF.

In our recent study of the premium rate disparity between BIF and SAIF, we did not analyze or otherwise assess the adequacy of the designated reserve ratio as a level of reserves sufficient to withstand the pressure of substantial financial institution failures in the future. Our study focused on the

[1]Deposit Insurance Funds: Analysis of Insurance Premium Disparity Between Banks and Thrifts (GAO/AIMD-95-84, March 3, 1995).

impact a significant premium rate disparity would have on the banking and thrift industries, the ability of SAIF to achieve the designated reserve ratio, and the thrift industry's annual Financing Corporation bond interest obligation. Similarly, we have not analyzed the adequacy of the reserve ratio in other work.

We have expressed views on the designated reserve ratio with respect to BIF in past reports and testimonies. For example, in our report on the results of our audit of BIF's 1989 financial statements,[2] we questioned whether the 1.25 percent reserve ratio was sufficient considering the risks and exposure facing BIF at that time. In our report, we recommended that the Secretary of the Treasury, as part of Treasury's FIRREA-mandated study of deposit insurance reform, determine (1) the reasonableness of the minimum and maximum reserve ratios established by FIRREA and (2) a reserve ratio target that would protect taxpayers in the event of a recession. We reiterated this recommendation in a September 1990 hearing on BIF's financial condition before the Senate Banking Committee.[3] In that hearing, we noted that we had identified no existing study which offered conclusions as to the reasonableness of the designated minimum and maximum reserve ratios established by FIRREA.

Treasury's FIRREA-mandated study, issued in February 1991,[4] stated that there was no scientific method of determining the appropriate level of BIF reserves, either in terms of an absolute amount or in relation to some measure of exposure, such as insured deposits. The study noted that the Fund's reserves must be sufficient to cover its losses and meet its funding needs but that, beyond this, the issue of the adequacy of the reserves is dependent on the contingencies the Fund faces and the public perception of its ability to protect depositors under different economic conditions.

---

[2]Bank Insurance Fund: Additional Reserves and Reforms Needed to Strengthen the Fund (GAO/AFMD-90-100, September 11, 1990).

[3]Additional Reserves and Reforms are Needed to Strengthen the Bank Insurance Fund (GAO/T-AFMD-90-28, September 11, 1990).

[4]Modernizing the Financial System: Recommendations for Safer, More Competitive Banks, United States Department of the Treasury, February 11, 1991.

Although the amount of reserves the insurance funds should maintain is a matter of judgment, the Congress has set time frames for achieving the 1.25 percent designated reserve ratio. The FDIC Improvement Act (FDICIA) of 1991 prescribed time frames for achieving the designated reserve ratio for BIF and SAIF. FDICIA required FDIC to establish a recapitalization schedule for BIF to achieve the designated reserve ratio not later than 15 years after implementation of the schedule, which occurred in September 1992.

Regarding SAIF, FDICIA required FDIC to set premium rates sufficient to achieve the designated reserve ratio according to a 15-year schedule after January 1, 1998. The Resolution Trust Corporation Act of 1993 authorized FDIC to extend the date specified in the schedule to a later date that it determines will, over time, maximize the amount of insurance premiums received by SAIF, net of insurance losses incurred. FDICIA required FDIC to set premium rates at levels appropriate for each Fund to maintain the designated reserve ratio after the Funds achieve the ratio.

It is also important to note that FDICIA provided a framework that should help reduce the risk of significant losses to the insurance funds. The accounting, corporate governance, and regulatory reforms contained in FDICIA were designed to correct systemic weaknesses in the deposit insurance system that contributed to the depletion of BIF's reserves in 1991. The act's early warning reforms and early regulatory intervention requirements should minimize the risk that losses will deplete the insurance funds' reserves if such reserves are maintained at the designated reserve ratio.

We hope this information will be of assistance to you. Please call me at (202) 512-9406 if you or your staff have any questions.

Sincerely yours,

Robert W. Gramling

Robert W. Gramling
Director, Corporate Financial
Audits

(917558)

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (301) 258-4097 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Mail
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested