**Written Statement of**
**Thomas J. Sheehan, President**
**Independent Community Bankers of America**
**Federal Deposit Insurance Corporation**
**Roundtable on Deposit Insurance Reform**
**April 25, 2000**

The Independent Community Bankers of America is pleased to participate in the FDIC's Roundtable on Deposit Insurance Reform. The issues raised for discussion during the Roundtable are timely and important. The ICBA commends Chairman Donna Tanoue and the FDIC for undertaking this review of our nation's deposit insurance system. A well-functioning federal deposit insurance system is critical to maintaining stability and depositor confidence in the banking and financial system.

**Coverage Levels**

Community bankers strongly support increasing the deposit insurance limit to $200,000 and indexing it for future inflation to adequately preserve the value of its protection for depositors going forward. An increase is long overdue. Deposit insurance levels have not been increased in 20 years, the longest period in history without an increase. Following the "financial modernization" accomplished in the Gramm-Leach-Bliley Act, it is now time to modernize the deposit insurance system.

The general level of income, prices and wealth in our nation has been on a steady increase for decades. Yet, today's deposit insurance limit is economically inadequate. Inflation has eroded the value of deposit insurance nearly in half since it was last increased in 1980. In fact, it is worth less today, in constant dollars, than it was in 1974 when it was raised to $40,000. If it were indexed for inflation since 1980, the coverage amount would be $197,000. Looked at another way, in 1935, when federal deposit insurance was established, the coverage level was ten times per capita annual income. Today, it is only four times per capita income.

Raising coverage levels may not substantially elevate the risks to the FDIC funds. As Chairman Tanoue has noted, this is because depositors already have the ability to structure their accounts to achieve far greater coverage (although the ultimate effect will depend on depositor behavior).

Deposit insurance is vital to both depositor confidence in the banking system, and community banks' ability to attract core deposits which are used to support community lending. Community banks are losing deposits to mutual funds, brokerage accounts, the equities markets and "too-big-to-fail" banks. And we do not have ready access to the capital markets for alternative funding. Easier access to the Federal Home Loan Bank System will help. But alternative funding sources at competitive prices for community banks other than deposits are scarce.

Large banks have an inherent funding and deposit gathering advantage over community banks because of their "too-big-to-fail" status. Just the perception that "too-big-to-fail" banks have governmental protection not available to other banks gives them "an advantage in attracting depositors, other customers and investors," as Kansas City Federal Reserve Bank president Tom Hoenig has said.

And the consolidation of the banking and financial industries that will continue in the wake of Gramm-Leach-Bliley will result in greater numbers of "too-big-to-fail" banks and financial firms. "The growing scale and complexity of our largest banking organizations…raises as never before the potential for systemic risk from a significant disruption in, let alone failure of, one of these institutions," Federal Reserve Governor Larry Meyer has observed.

Thus, deposit insurance is more critical than ever to the vitality and competitiveness of community banks. Core deposits are the primary source of funds for community lending. A dwindling core deposit base in turn hurts the whole community.

**Municipal Deposits**

Community bankers support 100 percent deposit insurance protection for municipal deposits. These are taxpayer funds that should not be put at risk. Many states require institutions to collateralize municipal deposits. This makes it harder for community banks to compete for these deposits. Many loaned-up community banks do not have the available securities to use for collateral. Those that do must tie up assets in lower yielding securities which affects their profitability and ability to compete. Collateralizing municipal deposits take valuable resources away from other community development and lending activities. Full deposit insurance coverage of municipal deposits would free up the investment securities used as collateral, enable community banks to offer a more competitive rate of interest to attract municipal deposits, and enable local governmental units to keep deposits in their communities.

Both the BIF and SAIF currently have reserves well in excess of the required statutory minimum level of 1.25 percent of estimated insured deposits. Both continue to grow, due to low levels of bank and thrift failures and the interest earned on the reserves of nearly $40 billion. Because of the strength and the growth of the deposit insurance funds, we believe that insurance levels can be increased without impairing the full capitalization of the funds.

**Deposit Insurance Premium/Pricing Structure**

Recent events have highlighted some anomalies in the deposit insurance premium system. The prime example is Merrill Lynch's plan to move large sums of money (some estimate up to $100 billion) in Cash Management Accounts from uninsured money market funds into insured deposits in its two subsidiary banks. This results in new deposits insured by the FDIC without any premiums having been paid. Significant increases in the insured deposit base could impair the reserve ratio of the BIF/SAIF, with the result that **all** banks and thrifts have to pay increased premiums, not just those with rapid new deposit growth. Similarly, de novo banks have deposit insurance coverage, but have never paid premiums. An equitable remedy for these situations is worth exploring.

Community bankers generally support a risk-based premium system. Some observers have criticized the current risk-based premium system, however, since the vast majority of banks and thrifts (over 90 percent) currently pay no FDIC premiums since their current very healthy condition places them in the highest-rated premium category.

Further distinctions among banks based on the risks they pose to the federal deposit insurance system, it is argued, could address this situation. However, if the distinctions become too fine, adequately defining these categories so that they reflect real differences in risk profiles among banks, achieve consistent treatment across the industry, and keep subjectivity to a minimum, becomes a real challenge. The costs of implementing very fine distinctions between risk categories must be weighed against the benefits that would be achieved.

Moreover, finer distinctions in risk categories among banks should not be used as an excuse to collect more premiums from the industry, particularly when the BIF and SAIF have reserves well in excess of the statutory minimum.

**Maintaining the Funds: Rebates, Current Designated Reserve Ratio**

Community bankers would welcome a rebate of excess reserves in the BIF and SAIF. However, many feel that increasing levels of deposit insurance coverage would be more beneficial to the long-term stability of their institutions—and their long-term ability to meet the credit needs of their communities—than a rebate of excess reserves. Thus, instituting a system for rebating reserves to the industry should not come before adjustments in the coverage level are made.

Safeguards are currently in place to reduce the risk to the BIF/SAIF posed by bank failures, including depositor preference, prompt corrective action, and least cost resolution procedures in FDICIA that were designed to reduce the loss rates in the fund. In addition, the FDIC has the authority to increase the designated reserve ratio for a particular year when faced with a significant risk of substantial losses, and can levy emergency special assessments. At the same time, the impact of industry consolidation on the risk to the funds should be carefully monitored and addressed as appropriate. But until there is clear evidence that the risk to the funds requires a higher reserve requirement, the current designated reserve ratio should be maintained.