Oral Statement

Of

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Senate Committee on Banking, Housing and Urban Affairs

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Chairman Sarbanes and Members of the Committee, our position on the major issues in deposit insurance reform is essentially the same as those expressed by Chairman Greenspan and Secretary Fisher, and I will not burden the Committee with repetition on those points. My written statement elaborates on these issues.

I would like to use this time to focus on an issue that is of major consequence to the OCC -- the need to reform the way bank supervision is funded. This issue is of direct relevance to deposit insurance reform for a number of reasons:

First, it relates to the way the deposit insurance funds are used to absorb the costs of supervising insured banks that are not members of the Federal Reserve System. The question of deposit insurance reform necessarily involves consideration of how large the funds should be, and that question compels consideration of how the funds are and might be used in the future.

Second, some of the proposals for deposit insurance reform have held out the prospect that there might be rebates made from the fund when it exceeds a certain size, or credits against future premium liabilities given under some circumstances for banks that have paid into the funds in times past. We believe that any consideration of rebates or credits must take into account the long-standing inequity that national banks have suffered by reason of the present use of the funds to finance the costs of state bank supervision by the FDIC.

While all insured banks, both state and national, have in years past paid premiums into the funds, and are obligated to pay premiums in the future sufficient to maintain the insurance funds at the designated reserve ratio, state banks receive a special benefit from the funds that is not afforded national banks. Each year the funds -- which are about $42 billion in size -- are tapped to pay the FDIC's costs of supervising state banks that are not members of the Federal Reserve System. I should add that State banks that <u>are</u> Fed members receive supervision from the Federal Reserve, and the Fed's costs of providing such supervision are charged against the System's earnings -- which last year were about $32 billion.

In 2001, the FDIC and the Fed together spent over $900 million on state bank supervision, yet none of these costs were passed on to the banks they supervise. To be sure, state banks do pay modest direct assessments to their state supervisors, but the supervision provided by the states is a relatively small component of the overall cost of supervision of state banks. Thus, in 2001, we estimate that state banks in the aggregate paid only $237 million in state assessments, or about 22% of their total cost of supervision.

In stark contrast, national banks pay 100% of the costs of their supervision -- in direct assessments that must be levied by the OCC. In 2001, those payments totaled more than over $400 million.

As a result of the decisions by the Fed and the FDIC to absorb their costs of supervising state banks, there is a continuing incentive for national banks to convert to state charters to realize the lower costs that are thus made available. Indeed, state supervisors aggressively proselytize for such conversions, heavily exploiting fee disparity as a major part of their sales pitch to national banks.

The unfairness of this disparity is underscored by two facts: First, the supervisory functions performed by the Fed and the FDIC for state banks are exactly the same as those performed by the OCC for national banks. There is virtually no function we perform for national banks that is not replicated for state banks at our sister agencies. Second, because national banks account for about 55% of the amount presently in the bank insurance fund, they are in practical effect picking up more than half of the FDIC's costs of supervising state banks

Ending this anomaly is not just a matter of fairness to national banks. It is a necessary component of allocating the costs and benefits of deposit insurance in an equitable and efficient manner among insured banks -- and we respectfully submit that this issue should be considered in the context of any legislation that would bear on the determination of how large the fund should be and how rebates and credits are calculated.

One approach to the resolution of this problem that we have formulated is to use the earnings on the FDIC's insurance funds to cover the costs of both state and national bank supervision. Today, with combined reserves of BIF and SAIF at about $42 billion, the interest income earned by the funds of $2.5 billion per year exceeds by a large margin the combined supervisory costs of the FDIC, OCC, OTS, and all fifty state supervisory agencies -- and, of course, the $525 million that the FDIC spends on state bank supervision is already a charge against the funds.

Under our proposal, which is spelled out in more detail in an OCC white paper, a nondiscretionary formula would be devised that would operate automatically to provide the various supervisory agencies (both federal and state) with a baseline amount reflecting their current levels of expenditures on supervision. The allocations would be adjusted each year under the formula to reflect changes in the composition and risk profile of the banks. In the event the earning on the funds were insufficient to cover the allocations called for by the formula, the various agencies would have to resort to their assessment authority to make up any shortfall --

but we calculate that it would take a very significant reduction in the size of the funds to reach this point.

An arrangement such as this would not only remedy the inequity to national banks that exists today, but would add new vitality to the dual banking system by creating a regulatory environment in which banks choose their charters on the basis of the quality of supervision and the suitability of the charter for their business objectives, rather than on the basis of a disparity in supervisory assessment attributable solely to the fact that the preponderance of the costs of supervising state banks are absorbed by the federal agencies responsible for the major portion of that supervision.

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