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Chairman Bachus, Congresswoman Waters, and Members of the Subcommittee, I appreciate this opportunity to discuss reform of our Federal deposit insurance system. Too often reform occurs against the backdrop of a crisis. Fortunately, we are not in that position today. The deposit insurance funds and the banking industry are strong. Nonetheless, the flaws in the current deposit insurance system pose an unnecessary risk to the stability of the banking system and so merit a careful and timely review by the Congress.

Let me summarize our positions on the major issues that have been raised in connection with reform proposals:

- We think the Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) should be merged. A merged fund would enable the Federal Deposit Insurance Corporation (FDIC) to operate more efficiently and to realize the benefits of diversification.

- Deposit insurance premiums should be more sensitive to risk. Today, 92 percent of all insured institutions pay no premiums, yet common experience, as well as the markets, tells us that these institutions have widely varying risk characteristics.

- The requirement that the premium for banks in the lowest-risk category be set at zero whenever the insurance fund reserve ratio equals or exceeds 1.25 percent of insured deposits should be eliminated. Furthermore, we believe that to compensate the government for the benefits conferred by deposit insurance on all banks, even the least risky banks, should pay some reasonable minimum insurance premium.

- We strongly support eliminating the current designated reserve ratio of 1.25 percent of insured deposits. Instead, we favor empowering the FDIC to establish a size range for the fund, based on the FDIC's periodic evaluation of the risks borne by the funds and its assessment of potential losses. The FDIC should have the authority to pay rebates when the upper end of the range is exceeded and to impose surcharges when the ratio falls below the lower end of the range.

- We see no compelling case for an increase in deposit insurance coverage. There is no evidence that depositors are demanding increased coverage; nor is there a reliable basis for projecting whether an increase would bring new deposits into the system, or simply result in a disruptive reshuffling of deposits among banks.

There is one further set of issues that should be considered in the context of deposit insurance reform: the use of the insurance fund to support the cost of bank supervision, and the inequitable treatment of national banks in the way the BIF is currently used to pay the costs of supervision of state banks. Under the current system, the FDIC spends approximately $600 million dollars a year to supervise state nonmember banks--that is, to perform for state banks exactly those functions the OCC performs for national banks. None of these costs are passed on to state banks in the form of direct assessments. By contrast, the OCC charges national banks for the full cost of their supervision.

This disparity is compounded by the fact that more than half of the funds spent by the FDIC for Federal supervision of state nonmember banks are attributable directly to the accumulated contributions of national banks to the insurance fund. Thus, the earnings of a fund that has been built up by ***all*** banks finance the supervisory costs of only a portion of the banking industry. In other words, for every dollar the FDIC spends on the supervision of state banks, national banks, by our estimates, effectively contribute about 55 cents.

A key principle at the heart of deposit insurance reform is that the premiums paid by individual institutions should be closely related to the expected costs they impose on the funds. The objective is to identify and eliminate subsidies in the current system that, among other things, result in healthy, well-managed banks bearing the costs and risks presented by less well-managed, riskier banks. Similarly, bank supervision should not be based on a system of subsidies--such as those embedded in the current deposit insurance system--that results in national banks paying a substantial portion of the FDIC's cost of supervising state banks. Because one of the main purposes of bank supervision is to protect the insurance fund, ensuring that supervision is funded in a fair and equitable manner is inextricably related to the subject of deposit insurance reform.

Attached to my written testimony is a paper that discusses the disparity in funding supervision in greater detail and proposes a remedy. We believe it would make sense to extend the existing arrangement to cover the costs of both state and national bank supervision from the FDIC fund, just as the fund today is used to cover the FDIC's cost of supervision. In other words, instead of funding supervision through direct assessments on banks, we propose that it be funded by payments to supervisors from the insurance fund, to which all banks contribute. This would ensure that all supervisors have access to the resources needed to deal with stresses in the system, and could eliminate the perverse situation we have today in which our resources can be significantly depleted at the very time when the heaviest supervisory demands may be placed on us.