June 1995
(Combines June 1 and June 15 issues*)

ECONOMIC COMMENTARY
Federal Reserve Bank of Cleveland

SAIF Policy Options

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The ability of the thrift industry to capitalize the Savings Association Insurance Fund (SAIF) is becoming increasingly uncertain. By the end of the year, SAIF-insured thrifts may face deposit insurance premiums six times greater than those assessed on banks insured by the Bank Insurance Fund (BIF). In fashioning a solution for the SAIF problem, fundamental questions about the policy objectives for savings associations should be at the forefront of policymakers' discussions.

As part of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989, Congress mandated a minimum coverage ratio of $1.25 of insurance reserves per $100 of insured deposits for the Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF).[1] The Federal Deposit Insurance Corporation (FDIC), which administers both funds, estimates that the BIF's ratio will reach the mandated 125-basis-point coverage ratio by midyear and that as a result, banks and other BIF-insured depositories are likely to see their average deposit insurance assessment fall from 24 cents per $100 of domestic deposits to 4 cents by the close of 1995.[2]

On the other hand, the SAIF ended 1994 far short of the estimated $8.6 billion it would need to meet the minimum coverage ratio mandated in FIRREA. This means that SAIF-insured thrifts will continue to be assessed premiums averaging 24.5 cents per dollar of domestic deposits —six times that of BIF-insured institutions. This premium differential places SAIF-insured thrifts at a competitive disadvantage to BIF-insured banks and thrifts in deposit markets. It may also have a negative impact on the quantity of deposits held by SAIF-insured depositories, thereby compromising the ability of the thrift industry to capitalize the SAIF.

In dealing with the problem, Congress faces several policy choices: taking no action, having taxpayers fund SAIF's capitalization, merging the two FDIC insurance funds, and employing various intermediate strategies.[3] While much of the policy debate on the impending BIF/SAIF premium differential has focused on important issues such as fairness, the competitive impact on thrifts, and the consequent ramifications for the SAIF, a larger issue looms: What is the public policy objective served by savings associations?[4] Only after policymakers answer this question can they weigh the options for dealing with the SAIF.

An additional concern surrounds the Financing Corporation (FICO) bonds authorized by the Competitive Equality Banking Act of 1987 to partially recapitalize the now-defunct Federal Savings and Loan Insurance Corporation Fund, which the SAIF was set up to replace. This FICO obligation has impaired the ability of thrifts to capitalize the SAIF. In addition, the increasing probability that the SAIF may soon be unable to meet its obligation to make FICO interest payments could result in a SAIF funding solution that is expedient, but inconsistent with public policy objectives.

We contend that the option for dealing with the SAIF problem should be chosen based on policy objectives for savings associations. To pursue a legislative solution for the SAIF without appraising the role of thrifts is putting the cart before the horse. Some alternatives, such as no legislative action, are likely to foster a decline in the savings and loan industry. Others, such as a taxpayer-funded capitalization of the SAIF, may help to preserve a role for specially chartered housing finance lenders. We also discuss how policy choices for dealing with the FICO problem should be driven by the same principles applied to the SAIF problem.

■ What about Thrifts?

As we argued in a previous *Economic Commentary,* with the increased integration of financial markets and the consequent competition across industry lines, there appears to be little justification for maintaining separate regulatory structures and deposit insurance funds for banks and thrifts.[5] Despite being restricted by the qualified thrift lender test (65 percent of assets must be held in mortgages or mortgage bank securities), savings institutions are no longer the predominant holder of home mortgages (classified as one- to four-family mortgages in table 1). Moreover, the mortgage holdings of thrifts as a share of total mortgage debt has been declining for more than a decade (see figure 1).

* The *Economic Commentary* series will contain 20 issues starting this year. The sequence will remain semimonthly EXCEPT during June, July, November, and December, when we will publish a single issue for the month.

As of the third quarter of 1994, banks held nearly $123 billion more in home mortgage loans, and almost $394 billion more in total mortgages, than did savings institutions. But mortgage holdings by banks and thrifts measure only one aspect of the increased competition in mortgage markets. Primary home mortgages held by secondary-market mortgage pools totaled $1,053 billion at the end of 1994:IIIQ. These pools include the Government National Mortgage Association (Ginnie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae), the Farmers Home Administration (FmHA), and private mortgage pools. Advances in communications and information technology have increased the ability of markets to bundle up mortgages and issue securities against them. This market innovation has essentially made the thrift mortgage specialization obsolete.

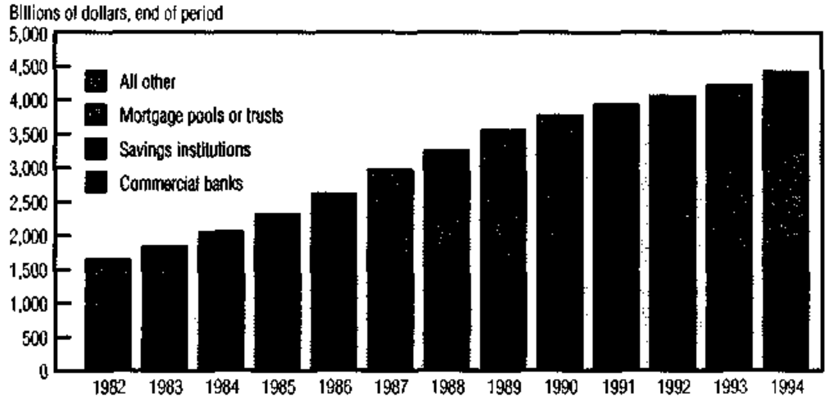
However, there may still be social benefits associated with charter-related distinctions among depository institutions, especially in the area of housing finance. Hence, Congress needs to reassess the public policy objectives associated with a separately chartered housing finance industry. Is the maintenance of the thrift charter necessary to carry out those objectives? And do the expected social benefits arising from this industry justify the level of subsidies that may be needed to make it viable? While the answers to these questions are beyond the scope of this article, they are crucial for crafting a consistent policy for the SAIF.

TABLE 1 BANK AND SAVINGS ASSOCIATION MORTGAGE HOLDINGS, 1994:IIIQ (Millions of dollars)

Type of Mortgage Loan	Banks	Savings Associations
One- to four-family	590,244	466,414
Multifamily	38,130	65,611
Commercial	320,568	55,058
Farm	22,408	292
Total	**981,350**	**587,375**

SOURCE: Mortgage holdings at the end of 1994:IIIQ as reported in *Federal Reserve Bulletin*, April 1995, Table 1.54, "Mortgage Debt Outstanding," p. A38.

FIGURE 1 MORTGAGE DEBT OUTSTANDING, 1982–94



SOURCE: Board of Governors of the Federal Reserve System.

■ SAIF Policy Options

Three distinct policy options exist for dealing with SAIF's capitalization: 1) take no action now and deal with any future problems when they become imminent; 2) merge the SAIF into the BIF; and 3) capitalize the SAIF.[6] We discuss these options in the context of underlying policy objectives for thrifts.

Wait and See

If a separately chartered housing finance provider is no longer necessary to meet policy objectives, it may be attractive to choose the wait-and-see course. Congressional action would be reserved for dealing with a default on the FICO bonds or with the impending financial collapse of the SAIF. The deposit insurance premium differential between SAIF- and BIF-insured depositories would remain until either the SAIF reached its minimum funding level or one of the aforementioned crises occurred.

Taking no action to reduce the BIF/SAIF differential will accelerate the shrinkage of the thrift industry through two channels. First, BIF-insured institutions will be able to compete deposits away from SAIF members, causing the SAIF-insured part of the industry to shrink. Second, some innovative SAIF-insured thrifts have already found a way around the current moratorium on switching insurance funds. A number of institutions, including two of the largest California thrifts, have announced plans to convert their deposits into BIF-insured bank deposits. They propose to do this by acquiring a bank charter and encouraging depositors to switch their accounts from their SAIF-insured subsidiary to their BIF-insured bank. Without pending legislation to close this loophole, the bulk of well-capitalized SAIF members can be expected to follow.

The net effect of this policy option will not be to eliminate specialized housing lenders from the financial landscape, but rather to effectively obliterate charter-related distinctions among depository institutions. However, this alternative is not a panacea. First, the exodus of SAIF members to the BIF could eventually force the SAIF to default on the FICO bonds and may limit congressional options for dealing with the FICO problem. In addition, a large inflow of SAIF deposits into the BIF could delay BIF's capitalization and the reduction in premiums for BIF members. Thus, some of the cost of the SAIF capitalization would be passed on to current BIF members.

This wait-and-see strategy would also undermine the viability of the SAIF fund. As the SAIF assessment base shrinks, the percentage of SAIF deposits controlled by banking organizations would rise.[7] Furthermore, the remaining SAIF institutions not controlled by banks are likely to be ones that because of size or precarious financial condition are not able to exploit the BIF conversion loophole. The remaining assessment base may be inadequate to offset large losses to the SAIF from future thrift failures. Hence, policymakers may eventually be faced with resolving an underfunded, and possibly insolvent, SAIF. Finally, if this option results in the lion's share of SAIF-insured deposits being controlled by banking organizations, then one must seriously question the rationale for having separate bank and thrift deposit insurance funds.

Merge the Funds

This solution is consistent with a move toward a generic depository institution charter while allowing separate thrift charters and housing-finance-related subsidies if dictated by public policy objectives.[8] In our previous *Economic Commentary,* we argued that "the historic rationale for separate regulatory systems for banks and savings associations no longer seems valid, especially given the intense competition between banks and thrifts."[9] A fund merger would require setting up criteria for SAIF thrifts to join the BIF. Strict admission requirements that allowed only strong, well-capitalized thrifts to switch funds would be needed to minimize the burden on current BIF members associated with the merger. Provisions would also have to be made to recapitalize, sell, or liquidate the remaining SAIF members that could not qualify for BIF insurance. This could ultimately require some taxpayer monies or an additional assessment on BIF members.

Like the wait-and-see alternative, merging the funds would transfer some of the burden of SAIF's undercapitalization to the banks. On the other hand, a merger of the funds would allow for the continuance of special-purpose charters for housing finance lenders (which may facilitate a further blurring of the distinction between banks and thrifts). Therefore, merging the funds may be less desirable than a taxpayer-funded solution if there remains a strong public policy purpose for having a separate and distinct housing finance industry.

Capitalize the SAIF

If a separate regulatory structure and subsidies are required to preserve the traditional role of savings associations, and if the social benefits of doing so justify the costs, then capitalizing the SAIF may be the preferred choice. One option is a savings-association-financed solution, which might impose a one-time surcharge against thrift capital.[10] Alternatively, Congress could choose a surtax on the profits of current SAIF members (or their parent companies or successor firms). Either way, the burden of funding the SAIF would remain with current SAIF institutions, regardless of whether they subsequently exited the fund.

At the other extreme, general taxpayer monies could be used to rescue the SAIF. This solution should be considered only if the benefits of maintaining the SAIF ultimately accrued to society in general, and not just to SAIF-insured depositories. In this case, the cost of the policy should be widely dispersed so that thrift competitors are not asked to bear a disproportionate share of the burden.

■ The FICO Problem

A major stumbling block to a savings association capitalization of the SAIF is the $780 million of FICO interest payments, which currently consume approximately 45 percent of the fund's annual assessment income.[11] Without this drain, the SAIF would be close to reaching the minimum reserve coverage ratio. Neglecting interest that the SAIF might have earned on the FICO payments, adding the five years of FICO assessments back into the SAIF would boost the fund to more than $6.5 billion at the end of 1994, leaving it only about $2 billion short of being fully funded.[12]

There is an additional issue related to the FICO interest. In 1992, the FDIC issued an interpretation of FIRREA arguing that SAIF deposit insurance assessments on thrift deposits by banks, or those in thrifts that converted to state-chartered commercial or savings banks (which account for roughly 38 percent of all thrift deposits), could not be used to pay interest on the FICO bonds.[13] Although this does not change the impact of FICO on the capitalization problem, it does materially affect the SAIF's ability to service the debt. Debt service will become increasingly difficult if the share of thrift deposits controlled by banking organizations continues to rise or if the SAIF's assessment base shrinks. For example, if the SAIF's assessment base available for FICO interest service declined by $120 billion in insured deposits, at current deposit premium levels, the SAIF could not meet its FICO obligation.[14]

The issue of FICO interest needs to be addressed as part of the solution to the SAIF's capitalization. Options being debated include leaving the FICO responsibility with SAIF-insured institutions, broadening it to include all depository institutions, and using general taxpayer funds.[15] While each merits serious consideration, the ultimate choice should be consistent with the principles underlying the SAIF policy choices.

■ Conclusion

Less than two years after the SAIF began operations, questions have arisen as to its viability and the ability of the thrift industry to capitalize it. The FDIC's recent announcement that the BIF capitalization is nearly complete and that bank deposit insurance premiums will be about one-sixth those charged to SAIF-insured thrifts has upped the ante considerably. Failure to address issues surrounding the SAIF and the FICO bonds could result in the extinction of savings associations.

However, before policymakers deal with the specifics of the SAIF problem, they should address fundamental issues regarding the future role of specially chartered housing finance lenders. The choice of any of the three distinct policy options presented, or of some intermediate solution, should be based on the underlying policy objectives associated with maintaining a separately chartered housing finance lender.

Footnotes

1. FIRREA allows the FDIC Board to set the coverage ratio as high as $1.50 of insurance reserves for every $100 of insured deposits.

2. The FDIC estimates that at the end of 1994, the BIF's reserve coverage ratio was 115 basis points (FDIC Press Release PR-23-95, March 21, 1995). The SAIF ended 1994 with a balance of $1.9 billion, or roughly 28 basis points of reserves per dollar of insured deposits.

3. Recently, U.S. Representative John J. LaFalce (D–NY) introduced 12 bills (HR 1470 through 1481) covering a range of these policy options for resolving the SAIF funding issue.

4. See Ricki Tigert Helfer, FDIC Chairman, "Remarks before the Exchequer Club," March 15, 1995, p. 2.

5. See William P. Osterberg and James B. Thomson, "Making the SAIF Safe for Taxpayers," Federal Reserve Bank of Cleveland, *Economic Commentary*, November 1, 1993.

6. Of course, there are also a number of mixed strategies available that combine elements of two or all three of the above options.

7. The Oakar amendment to FIRREA, which allows banking organizations to acquire healthy thrifts, effectively prevents banks from shifting deposits from the SAIF to the BIF. Therefore, only savings associations not controlled by the banking industry can exit the SAIF.

8. For a thorough discussion of the issues involved in merging the SAIF and BIF, see Osterberg and Thomson (1993), footnote 5.

9. Ibid.

10. Note that the surcharge against capital would be based on the assessable (for deposit insurance) deposit base of each institution. The surcharge could be expensed over two or more years if payment would result in an institution becoming undercapitalized.

11. See Helfer, footnote 4.

12. See FDIC *Annual Reports* 1990–1993, Washington, D.C., and Helfer (ibid.).

13. See FDIC *Annual Report* 1991, Washington, D.C., p. 86.

14. At the time this was written, six SAIF-insured thrifts with $80 billion in deposits were planning to acquire a bank charter and convert their SAIF-insured thrift deposits into BIF-insured bank deposits. See FDIC Press Release PR-20-95, March 15, 1995; and Daniel Kaplan, "Thrifts Seeking Lower Premiums by Buying Banks," *American Banker*, March 24, 1995.

15. It makes little difference if the money allocated to pump up the SAIF is newly appropriated or is left over from funds originally appropriated to the Resolution Trust Corporation for thrift resolutions. Both are taxpayer funds. For a discussion of the Resolution Trust Corporation, see Christopher J. Pike and James B. Thomson, "The RTC and the Escalating Costs of the Thrift Insurance Mess," Federal Reserve Bank of Cleveland, *Economic Commentary*, May 15, 1991.

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