

into its balancing process a review of variables particular to the financial services industry such as interest and exchange rate volatility and nonbank competition as well as projections for the economy in general.

The proposal reviewed the propriety of including under this factor consideration of the competitive disparity arising from the differential in assessments for members of the BIF and SAIF. The Board is adopting without change the interpretation of "other factors" which was set forth in the proposal.

The proposal discussed the interplay of the "other factors" provision with section 7(b)(2)(B), which requires the Board to set semiannual assessments for members of each fund "independently" from semiannual assessments for members of the other insurance fund. Read together, these provisions do not specifically prohibit Board consideration of the impact of BIF rates on SAIF members as long as the rates are set independently. However, the proposal indicated the potential conflict with section 7(b)(2)(A)(i) which requires the Board to set rates to maintain the BIF reserve ratio. If the Board were to take into consideration the impact on the SAIF when it set BIF rates (*i.e.*, setting BIF rates higher than otherwise necessary to minimize the disparity between BIF and SAIF rates), and, as a result, the reserve ratio continued to increase in excess of the DRR, it might be considered a violation of the statute.

Although a total of 591 commenters indicated that the Board should not take into account the impact on the SAIF and its members when setting the rates for BIF members, few of those comments provided any legal analysis. Those that did, (including the ABA, ABA State Association Division, IBAA, Citicorp, New York Clearing House, the California Bankers Association, GreenPoint Bank and Bank of Boston) concurred with the analysis set forth in the proposal. A number of these commenters indicated that "other" factors should be interpreted only to encompass factors that relate to the condition of the BIF.

By contrast, the Savings Association Insurance Fund Industry Advisory Committee (SAIFIAC) indicated that the FDIC "has an equal duty and responsibility to each Fund * * * [which] dictates that any proposal to lower BIF rates must be coupled formally with both a regulatory determination that the SAIF PROBLEM MUST BE DEALT WITH, and a proposal for a solution." (Emphasis in original.) SAIFIAC further indicated its belief that the proposal declined to take into

account the impact on SAIF because that impact could not be quantified.

The Board continues to believe that setting BIF rates higher than otherwise would be warranted would likely cause an increase in the BIF reserve ratio above in the DRR in violation of the statute. Accordingly, the Board is adopting the interpretation of "other factors" as proposed.

3. Conclusions

The principal conclusion of the foregoing analysis is that the exercise of the FDIC's insurance responsibilities require it to look beyond the immediate period in pricing risk. A pure pay-as-you-go pricing system can expose the banking industry to unduly high and volatile insurance assessments that can adversely affect the soundness of the banking system and the BIF. Moreover, the FDIC's experience with bank failures makes it clear that a meaningful evaluation of the risk associated with even highly rated and well-capitalized institutions must look beyond a six-month period. Accordingly, the Board will undertake to look beyond the immediate period in determining the revenue needs of the BIF.

The second principal conclusion is that the Board's duty to maintain the DRR as a target requires it to take account of the substantial variability of a number of factors influencing the revenue needs of the fund. Insured deposits display enough variability to cause the BIF reserve ratio to fluctuate considerably relative to the DRR. Insurance losses are extremely difficult to predict, and the FDIC's policy of establishing loss reserves for failures expected to occur as much as 18 months in the future magnifies the problem of prediction. This is because the prediction of the BIF's income in the second half of 1995 necessarily must allow for the possibility of changes in the reserve for future failures that may not occur until year-end, for failures anticipated to occur through mid-1997.

In light of the imprecision inherent in the measurement of banking risk—whether through examination ratings, capital measures or models used to project bank failures—the Board does not intend to specify a time period over which the FDIC will attempt to estimate its expenses for the purpose of setting assessment rates. Instead, rate-setting will be undertaken as an evolving process in which historical analysis tempered by informed judgment about current conditions, including the investment income deriving from the balance in the BIF, is revisited on a semiannual basis.

The historical analysis presented above suggests that an effective average assessment rate in the range of 4.5 to 13 basis points would be expected to meet the revenue needs of the fund over the very long term. The factors outlined above have convinced the Board that the lower end of the assessment range is reflective of the risks currently facing the BIF and, moreover, takes adequate account of the variability in insured deposits, losses, and additions to the reserve for future failures that may affect the adequacy of the BIF relative to the DRR over the second half of 1995. The Board is, accordingly, adopting the 4 to 31 basis point rate matrix as originally proposed.

In adopting the 4 to 31 basis point rate schedule, the Board emphasizes its expectation that the rate-setting process going forward will evolve continuously. For example, even assuming no change in the FDIC's risk exposure to potential bank failures, the attempt to balance revenues and costs over a longer horizon is consistent with semiannual adjustments to reflect changes in the fund balance. Increases in the BIF balance, due either to shocks or to favorable industry conditions that persist beyond the period that could be expected, would increase investment income and make it less likely that the fund would fall short of the DRR over any given future horizon, other things equal. In response to this, and depending upon other relevant factors, the Board may deem it appropriate in subsequent semiannual periods to reduce assessments below the level that previously had been expected to be necessary to meet the revenue needs of the funds.

V. Application and Adjustment of New Assessment Schedule

The Board is adopting the proposal to apply the new assessment rate schedule in the semiannual period during which the DRR is achieved, with refunds of any overpayments from the first day of the month following the month in which the DRR is achieved. Under the final rule, overpayments will be refunded with interest at a rate that corresponds to the rate of interest earned by the FDIC on the overpayments.

In addition, the Board is adopting, with two clarifications, the proposed process for modifying the new assessment rate schedule by means of an adjustment factor of 5 basis points, as necessary to maintain the reserve ratio at 1.25 percent without the necessity of engaging in separate notice-and-comment rulemaking proceedings for each adjustment.