S. HRG. 107–659

PROTECTING RETIREMENT SAVINGS: FEDERAL DEPOSIT INSURANCE COVERAGE FOR RETIREMENT ACCOUNTS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

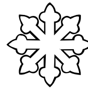
FIRST SESSION

ON

PROTECTING RETIREMENT SAVINGS: FEDERAL DEPOSIT INSURANCE COVERAGE FOR RETIREMENT ACCOUNTS

NOVEMBER 1, 2001

Printed for the use of the Committee on Banking, Housing, and Urban Affairs



U.S. GOVERNMENT PRINTING OFFICE

81–713 PDF WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

PAUL S. SARBANES, Maryland, *Chairman*

CHRISTOPHER J. DODD, Connecticut	PHIL GRAMM, Texas
TIM JOHNSON, South Dakota	RICHARD C. SHELBY, Alabama
JACK REED, Rhode Island	ROBERT F. BENNETT, Utah
CHARLES E. SCHUMER, New York	WAYNE ALLARD, Colorado
EVAN BAYH, Indiana	MICHAEL B. ENZI, Wyoming
ZELL MILLER, Georgia	CHUCK HAGEL, Nebraska
THOMAS R. CARPER, Delaware	RICK SANTORUM, Pennsylvania
DEBBIE STABENOW, Michigan	JIM BUNNING, Kentucky
JON S. CORZINE, New Jersey	MIKE CRAPO, Idaho
DANIEL K. AKAKA, Hawaii	JOHN ENSIGN, Nevada

STEVEN B. HARRIS, *Staff Director and Chief Counsel*
WAYNE A. ABERNATHY, *Republican Staff Director*
MARTIN J. GRUENBERG, *Senior Counsel*
DEAN V. SHAHINIAN, *Counsel*
SARAH DUMONT, *Republican Professional Staff Member*
JOSEPH R. KOLINSKI, *Chief Clerk and Computer Systems Administrator*
GEORGE E. WHITTLE, *Editor*

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

TIM JOHNSON, South Dakota, *Chairman*
ROBERT F. BENNETT, Utah, *Ranking Member*

ZELL MILLER, Georgia	JOHN ENSIGN, Nevada
THOMAS R. CARPER, Delaware	RICHARD C. SHELBY, Alabama
DEBBIE STABENOW, Michigan	WAYNE ALLARD, Colorado
CHRISTOPHER J. DODD, Connecticut	RICK SANTORUM, Pennsylvania
JACK REED, Rhode Island	JIM BUNNING, Kentucky
EVAN BAYH, Indiana	MIKE CRAPO, Idaho
JON S. CORZINE, New Jersey	

NAOMI GENDLER CAMPER, *Staff Director*
MICHAEL NIELSON, *Republican Professional Staff Member*

C O N T E N T S

THURSDAY, NOVEMBER 1, 2001

	Page
Opening statement of Senator Johnson	1
Opening statements, comments, or prepared statements of:	
Senator Bennett	3
Senator Miller	4
Senator Allard	4
Senator Stabenow	4
Prepared statement	25
Senator Carper	21

WITNESSES

L. William Seidman, Chief Commentator, CNBC–TV, and Former Chairman, Federal Deposit Insurance Corporation and Resolution Trust Corporation	5
Prepared statement	25
Response to a written question of Senator Miller	40
Howell E. Jackson, Finn M.W. Caspersen and Household International Professor of Law and Associate Dean for Research and Special Programs, Harvard Law School	8
Prepared statement	26
Glenn C. Dahlke, President, Dahlke Financial Group	12
Prepared statement	33

Additional Material Supplied for the Record

Prepared statement of America's Community Bankers	37
Letter to Senator Tim Johnson from Fred R. Becker, Jr., President and CEO, National Association of Federal Credit Unions, dated October 29, 2001	41
Letter to Senator Tim Johnson from Daniel A. Mica, President and CEO, Credit Union National Association (CUNA), dated October 29, 2001	42

PROTECTING RETIREMENT SAVINGS: FEDERAL DEPOSIT INSURANCE COVERAGE FOR RETIREMENT ACCOUNTS

THURSDAY, NOVEMBER 1, 2001

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, DC.

The Subcommittee met at 2:32 p.m., in room SD–538 of the Dirksen Senate Office Building, Senator Tim Johnson (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR TIM JOHNSON

Senator JOHNSON. The Subcommittee on Financial Institutions is called to order.

I am pleased to convene the Financial Institutions Subcommittee for this second in a series of hearings to consider comprehensive deposit insurance reform. It is critical that we continue on with the business of America, and I would like to thank my colleagues here in the Senate for their commitment to this work.

Today, we will consider the topic of protecting retirement savings. So many of our retirees have spent their lives saving to make sure that they can remain independent in their later years, especially given some uncertainty about the long-term viability of Social Security. Many have put those savings to work for them in a variety of investments through tax-deferred accounts and have watched their balances mount.

Over the past few months, however, we have been reminded that while equity markets can provide unparalleled opportunities for economic growth, those opportunities do come with volatility. And while many younger investors have enough time to ride out the ups and downs, those of us who are closer to retirement age have to make sure that we have enough savings in secure investments to ensure a comfortable retirement.

Yet while Congress has created significant incentives to encourage Americans to save for their retirement, we have not taken the necessary steps to let our retirees keep their life savings safe in their local communities. We are just waking up to the fact that our current deposit insurance coverage of retirement savings is simply inadequate to support the cost of retirement in the year 2001.

As many of you know, I have been very interested in comprehensive deposit insurance reform and I am convinced that this issue continues to grow in importance. The current deposit insurance re-

form system is dangerously procyclical, and in a softening economy, banks are at real risk of having to absorb severe insurance premiums. Those who resist a comprehensive reform package assume that the funds will never dip below the 1.25 percent range. To those individuals, I would simply point them to the latest FDIC Review Board report, which projects the BIF ratio possibly dipping to 1.23 percent for the first time since 1996.

The Senate Banking Committee, under the able leadership of Chairman Sarbanes, recently looked into the failure of Superior Bank of Illinois, which the FDIC projects will cost somewhere in the $500 million range and could cause fund ratios to dip still further. And we see daily reports of softening loan portfolios among our financial institutions, which provide the lifeblood of our economy.

Deposit insurance provides the rock-solid foundation that keeps our financial system healthy by giving depositors the confidence they need to keep their money in the bank. And those deposits, in turn, fund lending activities that finance our Nation's commerce. We must take great care to ensure that our system remains healthy and make any revisions proactively, so that we do not find ourselves in the position of having to act in a crisis mode.

Today, we will be looking at a very narrow slice of what I hope will be a comprehensive deposit insurance reform package. We are privileged to have a distinguished panel of experts who will help this Subcommittee think through the issues related to deposit insurance coverage of retirement accounts.

We have heard a great deal of discussion about the appropriate level of Federal deposit insurance coverage, and that debate continues. But I was struck at our August 2 hearing by a question that Chairman Sarbanes put to our witness panel. Senator Sarbanes asked how it is we should approach the question of what the "right" level of coverage is?

Senator Sarbanes' question, I believe, can be answered in the context of retirement savings, and judging from the very thoughtful written testimony that we have received from today's witnesses, I am hopeful that we will leave this hearing with some real insight into the matter.

Retirement accounts constitute a small proportion of deposits in FDIC-insured institutions. According to FDIC data, as of June 30, 2001, insured banks and thrifts held $219 billion in retirement accounts, 72.9 percent of which are insured. The remaining $59.3 billion of these retirement account deposits are uninsured, and this Subcommittee should be concerned. The safety of our retirees' savings should be a top priority for this Congress, especially as our citizens live longer and want to remain independent of outside assistance.

I had a chance to visit yesterday with FDIC Chairman Don Powell, who has earned his very distinguished reputation. He told me he strongly supports the recommendations the FDIC issued earlier this year with respect to comprehensive deposit insurance reform. And directly related to today's discussion, Mr. Powell urged me yesterday to consider raising deposit insurance coverage of retirement accounts to $250,000. My understanding is that such an increase would have a relatively small impact on the ratio of a

combined insurance fund, in the neighborhood of two to three basis points.

I am sure the Banking Committee will have the occasion to hear directly from Mr. Powell on this topic. But today, we turn our attention to our distinguished witnesses, and I would like to take just a moment to introduce them.

It is a great privilege to introduce Bill Seidman, who is so well known he probably doesn't need much introduction. Mr. Seidman is perhaps best known for his Chairmanship of the FDIC from 1985 to 1991, as well as his Chairmanship of the Resolution Trust Corporation. He has seen our financial system through some of its darkest hours, and he brings an important historical perspective to this discussion. Mr. Seidman has also found time to participate very successfully in the private sector, and we have all appreciated him in his current role as Chief Commentator on CNBC–TV.

Mr. Seidman, welcome.

Mr. SEIDMAN. Thank you.

Senator JOHNSON. Our next witness is Mr. Howell E. Jackson, who is the Finn M.W. Caspersen and Household International Professor of Law at Harvard Law School. Professor Jackson has expertise in the areas of regulation of financial institutions, securities regulation, investment companies, and pensions and Social Security.

Professor Jackson received his bachelor's degree from Brown University, followed by a JD and an MBA, both from Harvard. He joined the faculty of Harvard Law School in 1989, and just last week was appointed Associate Dean for Research at the Law School. It is an honor to welcome him before the Subcommittee.

Finally, I would like to introduce Mr. Glenn Dahlke, President of the Dahlke Financial Group of Glastonbury, Connecticut, a family-owned sales and asset management company.

Mr. Dahlke began his career in 1977 as a representative of the Connecticut General Life Insurance Company in New Britain. In 1990, he went into partnership with his father, Gerald Dahlke, also a Connecticut General representative. Together they formed an independent sales and asset management company in Glastonbury that became the Dahlke Financial Group. Mr. Dahlke represents a critical sector of our Nation's economy, the family-owned business. It is a privilege to have him before the Subcommittee today.

I now turn to our very distinguished Ranking Member, Senator Bennett, for any opening comment that he may wish to make.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you very much, Mr. Chairman.

I do not have a great deal to add to your comments. I appreciate the witnesses and appreciate your holding this kind of a hearing. It is not as glamourous or sexy as some of the things that we do, but, in the long run, it may be more important than some of the things that have a higher profile.

The financial services industry and the underlying economy have both changed dramatically since the last time Congress addressed the deposit insurance system. Fortunately, we are in a position where we are not talking about trying to save the system. There have been hearings on that subject in the past.

We have seen the system get healthy enough that, over the past several years, highly-rated institutions that were assessed very high premiums in the 1990's to help recapitalize the insurance funds have not been required to pay any premiums at all over the last several years.

We are talking about examining the system to see whether it needs just a technical fix, all the way to a complete restructuring. A hearing of this kind that is more informational and less adversarial is a very logical thing to do in that kind of an atmosphere.

I congratulate you for pursuing your interest in this and for putting together the kind of panel that we have before us today.

Thank you.

Senator JOHNSON. Thank you, Senator Bennett.

Senator Miller.

COMMENT OF SENATOR ZELL MILLER

Senator MILLER. I do not have an opening statement. I am looking forward to hearing from the witnesses.

Senator JOHNSON. Senator Allard.

COMMENTS OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, just a brief comment. I want to thank you for holding this hearing on deposit insurance for retirement accounts.

I am a cosponsor of legislation to increase deposit insurance on accounts and I am therefore very interested in this topic. Unfortunately, I won't be able to stay here during the entire testimony because I have a Conference Committee I would like to attend, but I will stay as long as I can.

The $100,000 per account level was set in place in the early 1980's and has not been increased since that time. I think we should take a look at a variety of approaches on this issue. These include an increase in the level of deposit insurance, indexing the level, so that it at least keeps up with the level of inflation or simply increasing the level of insurance on retirement accounts.

This last option is the topic of today's hearing and I look forward to hearing from our witnesses.

Senator JOHNSON. Thank you.

Senator Stabenow.

COMMENTS OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman. I want to thank you first for your leadership on this very important issue and welcome all of our panelists that are with us today. I think this topic is extremely important and I will submit my opening comments in their entirety, Mr. Chairman, if that is permissible.

But I would just indicate that I agree that we need to reform the Federal deposit insurance coverage for retirement accounts. There is ample evidence that the current system does not promote adequate savings for retirement. And indeed, there are structural barriers that unnecessarily complicate and impede effective planning for retirement.

When the deposit insurance coverage for retirement accounts was last raised, as everyone has indicated, about 23 years ago, $100,000

went a little bit farther than it does today. No one today could credibly contend that such an amount would be sufficient to provide for the long-term needs of retirees. It is past time for us to review this coverage level.

And so, I want to thank the Chairman again and I look forward to working with you and I believe that we can come to a consensus and move this important policy issue forward.

Thank you.

Senator JOHNSON. Well, thank you, Senator.

Without objection, the written testimony from the three witnesses, along with written submissions from America's Community Bankers and the National Association of Federal Credit Unions, will be included in the record.

Welcome to the panelists. Because we have focused on three panelists who are among the leading experts in the Nation on this issue and have simply the one panel, I think we can take the luxury of affording each of them a little more time than is sometimes the case.

The Chair would suggest a 10 minute period of time to either read or summarize your statement would be available to each of you. And then, at the conclusion of the discussion from all three of the panelists, we will open it to the Committee for any discussion and questions that would follow.

Welcome, Mr. Seidman, and why don't you begin.

STATEMENT OF L. WILLIAM SEIDMAN CHIEF COMMENTATOR, CNBC–TV, AND FORMER CHAIRMAN FEDERAL DEPOSIT INSURANCE CORPORATION AND RESOLUTION TRUST CORPORATION

Mr. SEIDMAN. Thank you, Mr. Chairman, and Members of the Subcommittee. It is nice to be back here after all these years. It is always a real privilege to testify.

I have here an editorial on this subject that I wrote for *Bank Director* magazine, of which I am the publisher. So, I have that as a written statement.

The essence of my view is that I believe that deposit insurance coverage has been reduced during the last 20 years by inflation and it clearly ought to at least keep up with inflation.

We have just seen another demonstration in recent tragedies and strain that the system has been under that deposit insurance prevented the kind of runs on banks and so forth that sometimes take place when there is potential for panic. I think we have once again seen the value of deposit insurance.

As far as increasing the amount is concerned, as I say, it ought to at least keep up with inflation, if not more than that, and that goes a fortiori for retirement accounts, which have a special benefit to those who use them.

I would like to start by saying that when this kind of thing was suggested, there were immediate arguments by some of our leaders that any kind of increase was a very bad idea, including the Chairman of the FED, the then-Chairman of the Senate Banking Committee, and others.

As I read their arguments, one was, it seemed, that there was a potential for great increased cost to the Government by increasing the amount of insured accounts.

First, I would like to point out that deposit insurance for banks has never cost the taxpayer a penny. The deposit insurance fund of the bank has been totally, since 1933, funded by the banks and taxpayers have never been asked to pay any amount of money.

Now, you all know that we had large losses back in the 1980's on deposit insurance. That was in the S&L industry. The losses there, I think we cannot go into the total analysis, but resulted from all kinds of mistakes, bad regulation, and other things, which I will be happy to talk about if you would like. But a well-administered bank insurance fund handled over a thousand bank failures and the taxpayer did not have to pay a penny.

I think, while there is always the potential when you guarantee something that you will have to pay, we have now an almost 70 year history that says that this fund can be self-supporting if it is properly administered.

A second thing that was raised was that this would be another distortion of the free market, would create moral hazard, and therefore, was undesirable. My response to that is that almost everything the Congress does distorts the free market. That is their purpose, which is to make the free market work better by providing the kind of distortions which allows it to operate.

And I have always said the difference between a regulated market and a nonregulated market is like the difference between a prize fight and a barroom brawl. In a prize fight, you have competition, but it is under rules, and even though you can slug the guy, you cannot pick up the chair and you cannot hit the referee and so forth. In a barroom brawl, you can do whatever you want and the whole place gets destroyed.

So the free market is wonderful. I am one of its strongest supporters. But if you look at what the Congress does, it is continually trying to adjust things to make the free market work better.

I must say that Chairman Greenspan runs probably the biggest intrusion in the free market in the financial area in the operation of the Federal Reserve System.

I simply take that argument and say, that cannot be the real question. The question is whether this intrusion in the free market will benefit the system or not. And the argument that it, per se, is wrong because it is a further intrusion in the market I do not think is going to carry the day.

So, we get to the question of is it good for the system to increase deposit insurance, at least keep it even with inflation and especially provide for retirement accounts? And I think it is good on several grounds.

First, having a sound banking system and one that is supported by deposit insurance is probably the single biggest base that we could have for a sound economy. And one only needs to go to Japan where I have been working for the last few years to see how true that is. They have a banking system which is in real trouble. They have no real deposit insurance, and they have, as a result of that and other things, a very sick economy.

So, I think a soundly-based banking system, and one of the things you have to have in a soundly-based banking system is some protection against losses and particularly by those people who have no real way to judge the financial strength of a bank.

For the average citizen, judging the financial strength of a bank is probably beyond any training that he or she has. Maybe in the biggest banks, they can look at the rating system and get ratings from big agencies. But for our community banks, even the regulators have some trouble knowing when banks are in trouble, as we have seen many times over history. I think that the idea that the citizen will regulate the system through judging the strength of banks is one that is not supported by the real facts. Therefore, you have to rely upon regulation rather than the consumer to regulate the system. And that is, of course, what we have done.

I would also point out that for the small depositor, and in today's world, $100,000 is certainly not a big depositor, the ability to get a Government-guaranteed deposit, this is about the only way that they could do it. They could go out and buy Government bonds. That is more difficult. It is not as liquid. They cannot use it for other things. So for the small depositor, let's just say the average citizen, it is a great benefit to their personal finances.

It is also of great benefit to small banks. Deposit insurance was not put in for the benefit of small banks. It is very clear it was for depositors. But it has become, in my view, essential for the survival of small banks, community banks as they are called, because the very large banks, no matter what you say and whatever legislation we have, have always been too big to fail as far as depositors are concerned.

They can fail, and they do fail, but all depositors have been covered in every major bank failure that we have had in the United States and that any of the developed countries has had anywhere in the world.

The day that the regulator is born who will see one of these major banks about to fail and announce that he is going to clip all depositors, I do not think the regulator is yet born that will be willing to do that when he has to face the issue.

Too big to fail is out there. That gives the big banks a tremendous advantage over small banks because small banks not only have failed, but also we have in many, many cases had to penalize the depositors for their over $100,000. I think that it is almost, you might say, essential for small banks to have deposit insurance, to have it at least keep up with the present levels for their safety and soundness. And I would put to you that small banks are a very essential part of this Government's economic system. They decentralize the decisionmaking, and I think they are very important to maintain. So, I come to the conclusion that it is important to increase deposit insurance, at least with inflation, and to have some special provisions beyond that for retirement accounts.

Thank you.

Senator JOHNSON. Thank you, Mr. Seidman.

Professor Jackson, welcome, and why don't you proceed with your testimony.

STATEMENT OF HOWELL E. JACKSON
FINN M.W. CASPERSEN AND HOUSEHOLD INTERNATIONAL PROFESSOR OF LAW AND ASSOCIATE DEAN FOR RESEARCH AND SPECIAL PROGRAMS
HARVARD LAW SCHOOL

Mr. JACKSON. Thank you.

Chairman Johnson, Ranking Member Bennett, Members of the Subcommittee, I am pleased to be here with my copanelists to continue the discussion of reforming deposit insurance that began, I would say, more than a year ago with the FDIC staff's release of their quite excellent Options Paper.

I thought I would begin my comments by saying a few words about deposit insurance in general, and then turn to the particular topic of today's hearing, which is retirement accounts. As Bill Seidman indicated, there are really three reasons why we have Federal deposit insurance.

First, is that there is a certain group of depositors who need to have a certain amount of assurance that there is a risk-free investment vehicle that they can take advantage of. This is a paternalistic consideration, I think it is a valid one, and it is one that has justified deposit insurance in the United States and many other countries. Without deposit insurance, individuals would have to make this inquiry that Mr. Seidman referred to, trying to distinguish between banks and would often make mistakes in deciding where to make their investments. So that is one valid purpose.

Second, another traditional purpose of deposit insurance is to prevent macroeconomic consequences, such as runs or other irrational behavior in times of financial panic. That has been a justification and I think it is a valid one.

Third, I think is regarding issues of political economy, a desire to have a certain kind of financial services sector, including a large number of smaller institutions that might, in the absence of deposit insurance, not be able to compete. So three different considerations. All have been mentioned so far this afternoon.

The debate over expanding deposit insurance at this point, as I understand it, is largely proceeding under the assumption that it is the first and third of these considerations that have changed.

There are not arguments about macroeconomic considerations and I think evidence of the last month shows that we did not experience runs on banks when the events of September 11 occurred. In fact, there was probably money flowing into the depository institutions as opposed to out of the institutions.

What we really have now is a set of arguments about the need for insurance being increased to protect individuals, and I think in a lot of the testimony you have heard before, arguments that small banks need to have higher levels of coverage in order to compete effectively in the current marketplace.

Now in terms of these general arguments, I guess I would say that one should be cautious about expanding deposit insurance in general for a variety of reasons. It is a costly program. There are potentially moral hazard problems. I think it is possible to make a case for expanding coverage and I think, actually retirement savings is a good example of a case for that. But I think the burden should be on the proponents to increasing the levels. In terms of

the political arguments, I think there are also valid arguments and they have been made effectively in a number of forums.

It is not entirely clear to me that we need to freeze the structure of the financial services sector the way it was in 1980, for example. So the mere fact that deposits have declined in relative proportion in the financial services industry is not compelling evidence in my mind that we need to increase the level of insurance.

But, still, I think, the concerns of the small bankers are a valid consideration and one that I think should be factored into this Subcommittee's analysis.

In terms of the underlying ultimate question of the appropriate level of insurance coverage, this is a hard question and a difficult question and one that has been taken up earlier.

I do not have much to add to that, except to say that I think near reference to levels in 1980 or 1970 or 1933 is not particularly helpful. It is better to have a normative baseline of some sort.

The IMF has recently done a study which I cite in my written testimony, that suggests two times GDP per capita is one benchmark. That would suggest a level of $70,000, $75,000 in the United States today. We are at or above that level right now. And if one looks comparatively around the world, most countries are either below or just at that level. Very few countries are ahead of where we are in the United States.

That does not mean that we do not want to have higher coverage in the United States. There may be reasons about our political economy that argue for higher coverage. But it would give me pause to have a general increase much above the current levels, or at least I think the burden would be very much on proponents.

Now today's hearing is about retirement savings. And I think if there is an area that justifies potentially increasing coverage, it is the area of retirement savings.

There have been changes in the United States. The demographics have changed. Life expectancy has changed, length of time in retirement has changed. There is clearly a demand for retirement savings or a need for retirement savings.

And if one accepts the premise that the Government has a role in creating a safe vehicle for certain individuals who want a risk-free investment vehicle, then I think expanding deposit insurance in this area can be supported as a theoretical matter and as an equitable matter. So, in general, I think the idea of a higher level for retirement savings is appropriate.

The difficulty, of course, is figuring out what that level would be. And in my written testimony, I tried to take a stab at how I would set it. I started with a similar assumption that it should somehow be tied to GDP per-capita or household income, that we should be thinking in terms of replacement rates for income, which is how financial planners think.

The usual rule of thumb is that one should have 70 to 80 percent of preretirement income as your base in retirement. So if one takes the median income, household income in the United States, that is about $42,000 today. That is the middle. Half are beneath, half are above that. I think it would be plausible to think about that as the person to protect. Individuals who are wealthier than that, have more income than that, will have retirement savings needs, but

I think we should be focused on the bottom end of the spectrum, people who are not sophisticated, in all likelihood, and need our assistance.

I worked through the calculations of what you might reasonably expect such a person to require for retirement savings and if you factor in Social Security coverage under existing levels, or more or less existing levels, it works out that someone at the median income would need about $250,000 of retirement savings on the eve of retirement to fund their retirement at the sort of target level of 80 percent.

Now there is a lot of heroic assumptions that I have made in coming up with that number. But it gives you a rough cut of what a plausible level would be, if you accept my assumptions that we should be shooting not for Bill Gates. We are not trying to insure his retirement savings, or people at the 95 percentile. But if we take the middle-income person, this is a reasonable amount of retirement savings and you might think in terms of setting the coverage level at that amount.

It is 2½ times the $100,000 level. Coincidentally, I did not do this. This overlaps with what Chairman Powell suggested a few days ago. And it also is the same ratio we saw in the 1970's when we had special coverage higher levels for retirement savings. So there is a precedent for this that you could see historically and I think it could be justified empirically.

Having sort of thrown out this $250,000 level, I think there is a couple of points that I should make aside from the fact that it is based on some debatable assumptions. The main point to make is that this is an aspirational level which the vast majority of Americans currently do not reach.

If you look at the information about the savings, the financial assets of most Americans, it is not close to $250,000 in retirement savings. In fact, the median net worth in 1995, according to census data, was something like $110,000 total net worth. And most of that net worth was in household equity, home equity, not in savings accounts or any other kind of financial asset. So there is a gap between the reality of where Americans are with their retirement savings today, especially if you are talking about the median and lower income individuals in this aspirational level of $250,000. Now that is not to say that we shouldn't set it at $250,000, and my testimony suggests that I think this is plausible. But it is well above where most people are, and I think that that should factor into the analysis.

In my testimony, there are a number of other points that I mention, technical points. Just let me quickly run through them today.

We have been talking generally about retirement savings. It is not clear what that concept means. The term that we use, a lot of the discussion has been IRA's and Keogh plans. But that is a special subset of retirement savings. There are many other kinds of plans, employer-based plans, like 401(k) plans. There are more assets in these other plans.

It is not clear to me that if you are trying to make a risk-free vehicle, you wouldn't want to use a broader category of retirement savings than just IRA's and Keogh's. In fact, when you begin to think about what the real retirement savings of many individuals

is, it is not the tax-preferred vehicles like IRA's and Keogh's. It is home equity and other sources of wealth.

It creates a little bit of a dilemma if you think of a retired couple that has most of their wealth in a house, they sell their house at 65, they put the proceeds in a bank account to fund their retirement in a nursing home or in a smaller apartment.

Are we going to say that those people who did not take advantage of tax-preferred savings are not going to have a higher limit for their bank account. But a wealthy person who will have a roll-over IRA is going to get the higher level. I do not have a solution to this problem, but I think we need to think a little bit more about the definition of what a retirement savings account is, rather than just picking up the old IRA and Keogh definition.

In my testimony, I make two other points. One is controversial, so maybe I should say it out loud so it doesn't slip by. If you look at the testimony of the banking industry, they are very interested in getting retirement savings accounts. And one of the things that they say about these accounts is they are stable accounts. They do not move around. They are very good funding sources.

If you think of the reason why we want to expand coverage for retirement savings, it is because certain borrowers are not sophisticated. They do not shop around. They cannot evaluate things.

This group of people are potentially subject to exploitation and a banker could be tempted to lower the interest rate paid to these IRA accounts and elderly individuals may not move their money.

And so, I think one of the things the Subcommittee should think about is if you are going to give a benefit to the banking industry in the form of a higher retirement savings level for these kinds of accounts, to wonder whether there should not be some obligation on the banking industry's part to pay at least some minimum rate of interest.

I would not propose rate regulation, but tieing the rate of interest to inflation-adjusted bonds or some market rate, is something that I think you should consider. Otherwise, there is a possibility that some of these banks trying to improve the bottom line, could give below-market rates, and I think that would be unfortunate and certainly not help the goal of retirement savings.

Finally, I think that one of the advantages of setting a higher goal for retirement savings is the message it will send to American citizens about the need to save for retirement.

As the Chairman mentioned in his opening comments, there is inadequate retirement savings today. Social Security may not cover that need as it has in the past. And it is very important to send a message that more retirement savings is necessary.

And this notion of $250,000, which is six times final income, is an important target for Americans to begin to think about. And one might think of including an educational component in this legislation, as well as coverage increases.

Thank you very much.

Senator JOHNSON. Thank you, Professor.

Mr. Dahlke.

STATEMENT OF GLENN C. DAHLKE PRESIDENT, DAHLKE FINANCIAL GROUP

Mr. DAHLKE. Chairman Johnson, Ranking Member Bennett, and Members of the Subcommittee, I too would like to thank you for inviting me here to testify.

Mr. Chairman, it is my strong recommendation that Congress should substantially increase the value of Federal deposit insurance for retirement accounts.

You have heard today, and I will be somewhat repetitious here, in saying that, obviously, the cost of retirement has skyrocketed since the last time limits have been set.

But also, I would like to talk a little bit today about a system that has been created for some elderly Americans who want to remain self-sufficient in their later years and how the limitations to some extent has forced them through some complicated and some potentially costly hoops just to protect these savings. This afternoon, I want to make four points.

First, and again, this is going to be somewhat repetitious, $100,000 in retirement savings is simply insufficient to support most retired individuals, especially when we look now at the increased life expectancy that we enjoy and overwhelming medical costs, including the cost of convalescent care.

Second, it is rational for retirees with low-risk tolerance, and those who need a predictable income stream to invest savings in excess of $100,000, I think primarily, or even perhaps exclusively, in insured deposits.

Third, many retirees who invest in insured deposits are ill-equipped to cope with the Federal distribution requirements—these are the required distributions past age 70½—that can become more complicated in figuring what your minimum distribution might be when the accounts would be spread across many different institutions.

And finally, I believe it is inappropriate to require retirees to choose between the safety of their life savings and banking with someone who perhaps they have had a relationship with for many years and who they have learned to trust over those years.

Over the years, Congress has created important tax incentives to encourage people to set aside money for retirement, recognizing the benefits to our society of individual self-sufficiency.

I applaud Congress for recently increasing the amount that Americans may save through tax-deferred programs such as the IRA's, the ongoing increases in 401(k)'s, et cetera, which recognizes, obviously, that the costs of retirement are going up.

However, even without these higher contributions, if we look at what used to be called the rank-and-file individual who has put 20 or 30 years into a single company, has taken advantage perhaps of their 401(k), the company match, the profit-sharing plan, and has put money away in a disciplined manner, you can easily amass over $100,000 in retirement savings.

Up in Hartford, we have United Technologies, which was one of the first companies to get involved in 401(k)'s. And it is not unusual now to see several hundreds of thousands of dollars coming out of their 401(k) plan.

Now in a lot of cases, what is being rolled over? And I think Professor Jackson said it. This is not coming from IRA money. This is coming from qualified plans that people have taken out of their qualified plans at retirement.

But this is a major source of income other than Social Security, and what we are seeing here is it becoming a major asset of theirs, even a greater asset than their residence. And $100,000 is just barely sufficient to cover basic living needs.

For example, if we take a 72-year-old widow, a woman who is in the time period where she must now be taking required minimum distributions, she has $100,000 in an interest-bearing IRA account. Plus $10,000 of Social Security. Well, if you look at the IRA earning her minimum distribution of the 5 to 6 percent range, she is living at an income of $15,000 a year.

This is not a lavish lifestyle. And she also is not in a position where she can afford to take a lot of risk. She cannot replenish this money, and she cannot take on the financial shock she might get if she needs a new roof or she has some kind of uninsured medical procedure. So she needs to save this money.

I think this is a crucial point because there has been some argument that $100,000 is a lot of money. Well, $100,000 simply is not a well-off person at all. I think, on the contrary, Congress should insure that those workers who have saved in a disciplined and responsible manner for their retirement have a completely secure investment option. Now there is a lot of options here. But they should have a secure investment option for an amount adequate to support themselves. I think that is fair and I think, frankly, that is good public policy.

First, it is rational for retirees who have a low-risk tolerance and need a predictable income stream to invest savings in excess of $100,000, primarily or, again, exclusively, in insured instruments such as certificates of deposit. I do not think Congress should create disincentives for this investment strategy.

Insured deposits are appropriate investments for retirees who may be able to live comfortably off their interest on their savings, but cannot afford to lose any of the principal. There is also the point here of retirees who prefer these kinds of instruments because they provide a predictable fixed income.

When we look at how IRA's are distributed and the method you use, which, for somebody over 70½, is to take the balance of their IRA accumulations on December 31 of the preceding year, apply a divisor for it, and that now determines the required minimum distribution.

If we are sitting in front of a client and they want predictable income, we have to then predict what these balances are going to be from year to year. The only predictable instrument that you can really use pretty much are certificates of deposit. It is not going to happen with stock. We have seen what has happened with stock balances and IRA's over the last few years.

And even with Treasuries and any other interest-sensitive vehicle, that will affect the December 31 balance, which will affect the issue of predictable income. So I think that is a crucial point here.

Finally, a lot of retirees prefer to keep their money with people they know and trust, especially in small towns. I live in Con-

necticut, which is supposed to be a populated town, but I live in a town of 2,500 people and we do not have any banks. We have a car dealership. We have a marina. We have a grange. But we do not have any banks.

Personal relationships can develop between bankers and their clients and this may be hard to believe for people that live in an urban environment. These local relationships remain an important feature of the community banking system that we have heard about today.

Higher coverage levels for retirement accounts would significantly reduce the risk that a retiree with over $100,000 in insured deposits would become subject to the 50 percent penalty for undistribution of IRA savings. Again, the way you make distribution from an IRA account, you do not have to take it from IRA from IRA. You must take the distribution from the aggregate among all the retirement accounts.

People with CD's tend to take the money from the CD with the lowest-paying interest. So people who are in CD's tend to play the shell game of where their money's coming from.

Well, with someone with, say, $250,000 of IRA savings who want to be insured, being forced now to three different institutions have to make this calculation and have three times the chance of screwing up the calculation. And if they screw up the calculation, that is fine. The IRS says, you owe me 50 percent of what you did not take for your minimum distribution. And these are for people who haven't managed money in their life, and just trying to hold on to what they have.

The risk is enhanced, obviously, as I said, when this individual has to spread between institutions, and this is what the $100,000 is doing. It is forcing them to spread their $100,000 to different institutions. And again, there is the talk of, well, you go to a bank that is $5,000—we are talking about IRA's. That does not exist. You cannot have joint accounts, et cetera. It is limited to the $100,000.

I have gone over the point that the retirees are, again, forced to choose between the insured deposits and banking with someone that they have had the relationship.

We in the financial community drill into our clients the sanctity of diversification of their investments. But we do not like them to get diversification of financial advice. We prefer that they get that at one place, hopefully, our own office. Again, moving the people to different banks again forces them to different advice.

I think that Chairman Greenspan has wisely noted that deposit insurance coverage limit is designed to accomplish exactly this objective of spreading money across banks to reduce the Government's risk at any institutional failure.

But in the retirement context of real people with real money, it is my strong belief that this is really a bad trade-off. The benefits from maintaining an adequate level of insurance retirement savings pale in comparison to the potential costs to retirees, like the under-distribution, forced to maintain multiple accounts.

For these reasons, Mr. Chairman, I strongly urge Congress to increase coverage levels that have not been touched in I guess over

two decades, and to take measures to ensure these limits keep pace with the true costs of retirement.

And I thank you for the opportunity to present my views to the Subcommittee.

Senator JOHNSON. Thank you, Mr. Dahlke.

I will lead off with questions. And I direct this in particular to Professor Jackson, I believe.

Bank holding companies which permit a single corporate family to maintain multiple bank charters appear to me to be at a significant marketing advantage in offering clients more than $100,000 in deposit insurance coverage, especially with respect to retirement accounts.

As Mr. Dahlke has pointed out in his testimony, higher coverage that could be structured within a single institution with respect to general deposits is not possible with retirement accounts, or is not advisable, because of restrictions in the tax code.

According to the information provided by the Federal Reserve Board, 21 bank holding companies have 10 or more bank and thrift subsidiaries, 106 have five or more bank and thrift subsidiaries. And so two questions occur to me in particular.

First, other than bank holding companies, is there any other structure that would allow a bank to offer any given individual more than $100,000 in retirement account coverage?

Professor Jackson.

Mr. JACKSON. The coverage is limited to $100,000. There are a variety of different ways that other accounts, joint accounts, can be offered to increase the effect of coverage for individuals at a particular institution, and the FDIC has documented the rules there. They are quite complicated.

I have heard from some bankers that occasionally, they will send deposits down the road to a sister bank or something, but it is not nearly as effective as a bank holding company with multiple sister banks to whom the deposits can be farmed out sort of at will. I think you are absolutely right, that this does put the single bank unit at a disadvantage with respect to the holding companies.

Senator JOHNSON. Let me ask Mr. Dahlke and Mr. Seidman, when we talk about retirement savings, there are clearly different combinations of what could fall under that definition for purposes of a different retirement amount coverage.

Today, we have been talking about IRA's and Keogh accounts in which the FDIC maintains data. But Professor Jackson has suggested that we should perhaps include more in the retirement account category.

I wonder if you would share any thoughts that you might have about the appropriate scope of retirement savings that Congress should consider for this higher deposit insurance coverage if we go down that road.

Mr. Seidman.

Mr. SEIDMAN. Well, first, I think this discussion highlights the problems you get into when you try to take a particular kind of account and have that account have additional coverage. If I had my choice, I would rather have $200,000 across the board and let that handle at least a good part of the retirement account privilege and it would make life a lot simpler.

I think the last time I looked at the figures, about 80 percent of the uninsured deposits were by depositors who were over 65 years of age. This amount is very much concentrated in that group.

So, I would like to have the broadest definition you could find. Let's just say, to start an argument, that anybody who is over 65, his account is a retirement account, and given whatever amount we decide upon.

I would like to just make a comment on the idea that we ought to use the median as a way to judge what the size could be. That seems to me a little bit like telling a nonswimmer to go across a lake that has an average depth of 2 feet. But it is 10 feet deep in the middle.

We have a lot of people in this group that really need more coverage. And I do not think we ought to be tailoring it for just the median person.

It seems to me that we ought to be covering at least, let's say, 75 percent of the population, would be a better way to look at it, than the median group.

Senator JOHNSON. Mr. Dahlke, any thoughts about the scope of retirement account coverage?

Mr. DAHLKE. I think we have to distinguish between individual accounts—the IRA's, the traditional Roth, what have you—and money that is held within qualified plans with companies, the 401(k)'s, profit-sharings.

But you start to get a little complicated, and I do not have an answer for this, but many of these companies have so-called pool accounts, where all the employees may be pooled into, let's say, a stable value account as they might be called. You might have thousands of employees into this one account.

Well, what do you do with the coverage there, as opposed to the company that has self-directed accounts and every employee has their own stable value account?

I think if you are going to talk about raising this for IRA's or individual plans, you have to build a bridge over to the profit-sharing, 401(k) sector as well.

Senator JOHNSON. Thank you.

Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman. Thank you to the panelists. This has been very helpful, and I do not have a whole lot of really penetrating questions. I am just going to go over your testimony with great interest.

Do I catch the flavor that there should be a difference between the deposit limits on a checking account that is held by somebody who happens to have that much money, but is 35 years old and moving around, and somebody who is clearly using this as a retirement vehicle? Are you saying that there should be two tiers of deposit insurance?

Mr. JACKSON. I think that is the weight of what I am saying. There may be some disagreement on the panel on this issue.

Senator BENNETT. I picked that up, and so I wanted to focus on that for just a minute because I had not heard that suggestion before.

Mr. SEIDMAN. Well, having been an administrator of some of these things, I am against complications. And every time you get

into that kind of tiering and so forth, it is remarkable how much it costs to make it work and how many problems you get into. I wouldn't think that we would try to distinguish between checking accounts and CD's or any other kind of deposit.

Mr. JACKSON. My reaction is this. It is a little bit different. I certainly understand the point and I think complexity is a problem. But I think the most powerful argument for increasing the coverage, if you look at the discussions, it focuses in on retirement savings. That is the really good case in point of why $100,000 is not enough. My view is, if that is the reason that $100,000 is lagging, deal with that and do not increase every corporate checking account, every commercial balance up to $200,000.

You are bringing a whole lot up. And again, my assumption is coverage should not increase without a strong case. I think the case is here for retirement, but not for everything else.

Senator BENNETT. Okay. Now go back and reverse the question. What does it cost you if you increase it for all these other things? Is there increased risk? Increased exposure?

Mr. SEIDMAN. Well, I can tell you that we went back and studied what it would have cost us if we had covered $200,000 instead of $100,000.

Senator BENNETT. Yes.

Mr. SEIDMAN. And the increased cost was minimal, very minimal, almost nothing.

Senator BENNETT. What about risk?

Mr. SEIDMAN. What about what, sir?

Senator BENNETT. Risk. Could you afford it, afford the increased exposure?

Mr. SEIDMAN. The cost in resolution, we took a bank that had failed and had $100,000——

Senator BENNETT. I see. That is factored in.

Mr. SEIDMAN. Yes, we factored that in.

Senator BENNETT. In your analysis.

Mr. SEIDMAN. As I remember it, and I am sure that the FDIC can dig this study out, but it was something in the neighborhood of 7 or 8 percent. Not doubled by any manner of means because when you handle these banks, by and large, you are trying to get all the deposits covered by selling them off and that is what happened in most of the cases. As a matter of fact, the increased cost was very small.

Senator BENNETT. All of the members of my family, including me, are now in the category that you are talking about. And I have been very interested to see one of my sisters who never struck me growing up as being that sophisticated an investor, now handling her money and watching the stock market with a great deal of sophistication, all of which she has learned since she has retired, or while preparing for retirement.

Having your retirement entirely in an interest-bearing bank account strikes me as the most unsophisticated kind of retirement savings. Do we have any kind of studies as to what percentage of the retirees go that particular route, or how many of them are like my sister, who will sit down with me for the first time in our lives over dinner and talk about how her high-tech stocks are doing, as opposed to some of the basic manufacturing, and using words like

diversification that she never used in her life until she turned 60. As I say, she is very sophisticated. Nobody taught her. She is entirely self-taught.

Mr. SEIDMAN. That is due to the good work of CNBC, Senator. [Laughter.]

Senator BENNETT. I went over to her house for dinner one night expecting to have a polite, pleasant chat. She and her husband both started to get nervous around 8 p.m., and I could tell that she had something on her mind. She finally said, would you mind if we watched television? That is very unusual when we are getting together with family. And I said, no, I would be happy to. I was expecting their favorite sitcom or the basketball game. No, they watched Louis Ruckeyser for half an hour with great concentration.

I am sorry for that little bit of family history, but I raise the question—what percentage of the retirees have their nest egg entirely in an interest-bearing bank account, for whom this kind of protection would be important?

Mr. JACKSON. Well, that is a good question. And I think one of the things that more study needs to be done on is this distribution of actual financial assets.

The figure about IRA and Keogh assets at $218 billion is in banks, the total amount of IRA's and Keogh's is 10 times that. So roughly 10 percent, in that category, is in banks.

In general, if you look at 401(k) plans—I should probably defer to my colleague here—but the mutual fund sector has been, I think, the most successful in attracting those. Of course, the insurance companies have also been successful.

So, I think if you look broadly, particularly at the wealthier, you will see them distributed outside of the depository institution sector to a large degree.

Mr. DAHLKE. Yes, I would agree that the investment at risk, it takes a larger part, certainly, of the retirement plan scenario. But I also think that people should have the right to pick their own poison here, no matter what the percentages. And how big your bag of gold is, is a perception that only you can answer.

People who generally have low-risk tolerances need to be protected against more sophisticated investors that put all their money in pets.com and e-toys, who now have no money in their retirement plans.

Senator BENNETT. I do not know how sophisticated those investors were.

Mr. DAHLKE. I guess I am trying to turn the word sophisticated on its head.

Senator BENNETT. Yes. Okay.

Thank you, Mr. Chairman.

Senator JOHNSON. Thank you, Senator.

Senator Miller.

Senator MILLER. With Mr. Seidman's experience on and around Capitol Hill, and also the analogy you used and the difference between prize-fighting and barroom brawling, I am tempted to ask you to elaborate on your observations of what happens around here. But I won't. I want to ask you something else.

Mr. Seidman and Mr. Dahlke, I would like you to respond to something that Professor Jackson had in his testimony, in which

he raised various points about which tax-favored vehicles to cover, expanding the definition of retirement savings, and potential abuses with the retirement savings account.

Mr. Jackson you gave us quite a bit to think about.

I did not hear you say this specifically, but on the last page of your testimony, you say: "Compelling theoretical arguments support the expansion of the FDIC insurance coverage for retirement savings. However, the task of structuring an appropriate extension—that is, an extension likely to reach low- and middle-income savers—is not trivial. And it is possible that the practical problems of implementing such a regime will prove so substantial as to derail the entire effort."

What do you think about that, Mr. Seidman and Mr. Dahlke?

Mr. SEIDMAN. Well, I think that is, Senator, what I was referring to when I said I prefer not to go the route of trying to specify accounts. And if I had my choice, I would much rather see the system go to $200,000, and let that substantially take care of the retirement program.

And I think, as the Professor has pointed out, it will be a big technical problem to try to define retirement account, administer retirement account.

Do not forget, when we go in to take over a bank, we have to do all of this right away because we have to get it some place else. So the more complicated it becomes, the more difficult it is to resolve the bank in a hurry. And to resolve the bank, you have to know what the insured amounts are.

So, I have a lot of sympathy for the thought that it will be complicated, and that is why, if I could have a definition of anybody 65 or over, or something like that, it would be a lot easier and more practical and might do 90 percent of the job.

Senator MILLER. Mr. Dahlke.

Mr. DAHLKE. I like simple. I think the tax code is pretty clear on what is a qualified retirement account. And I think when you start to get away from that, and you get into nonqualified, deferred compensation, is that defined as a retirement account? They are set up for retirements accounts, but I think now you start to blur the line. I would leave this to the tax code. And if the tax code defines something as a qualified retirement account, the shoe fits.

Senator MILLER. Let me ask you this, Professor Jackson.

In your statement, you suggest that if legislation is adopted to include a higher level of FDIC coverage for retirement savings, that the bill should include an educational component. Would you elaborate on what you are talking about there? Do you mean something like investor education, whereby the individuals would be counseled on how the program works? Or are you talking about something entirely different from that?

Mr. JACKSON. Well, I think that there is a lot of reason to believe that the private retirement savings in the United States is too low right now and individuals are not adequately saving for their retirement.

And we are talking now about coverage levels, $200,000, that are greatly in excess of what most people are saving. There is a case to be made for doing it. But I think the more important thing for enhancing retirement security is not so much topping off the extra

$150,000 that we are talking about, but encouraging people actually to save more.

I think wrapped up with this increase, one could imagine some sort of educational program akin to the tobacco education that the Government sponsored back in the 1960's, to make people aware of the dangers of tobacco.

One could here think about educating individuals about the need to save for retirement, with some specific recommendations about rough levels that are appropriate.

That is how I got to the $250,000 number and I think that is what American savers need to know about. And I think the Government could have a role in doing that.

Following up on one of the other points that has been made earlier, I do not think we should be saying to the American public that they should save for retirement exclusively in FDIC-insured banks. I think that would be not appropriate for many people. I wouldn't put this perhaps with the FDIC as being solely in charge of the message, even though it has been a very effective agency for many things. You would want to make it more broad than that.

I think that is an important thing. And as I mentioned in my testimony, some other countries are taking that as a public charge for their regulators.

Senator MILLER. Can I ask Mr. Seidman one more question? My time is up?

Senator JOHNSON. Time is up, but go ahead.

Senator MILLER. That is all right.

Senator JOHNSON. All right. We will come back around.

Mr. Seidman, perhaps more than just about anybody in the country, you had a front-row seat at the savings and loan crisis. Many opponents of increased deposit insurance coverage expressed concern about increased moral hazard that would be introduced into the system with higher coverage limits. And they point to the S&L crisis as evidence that increased coverage at that time exacerbated the costs of those failures.

My understanding is that brokered deposits were particularly problematic during that time. Yet with an inadequate coverage limit for retirement accounts, it would seem to me that we are leaving some people with little choice but to find alternative depositories if they really want totally secure retirement savings.

So, Mr. Seidman, or anybody on the panel, I would be very interested in hearing your analysis as to how an increased retirement coverage limit, for example, in the range of $250,000, how that relates, if at all, to brokered deposits and increased systemic moral hazard.

Mr. SEIDMAN. Well, first, the concept of brokered deposits as developed back there in those days has been substantially outmoded by the Internet.

Now the whole country is, in effect, a broker and deposits are raised nationally on the Internet. So the limits on what can be raised and the work of the broker is really not much used any more, although some of it still is used.

But the point is that if brokered deposits were a hazard, then the hazard today is much larger because deposits are raised on the Internet. And any bank can go in today and raise any amount of

money they want within what the regulators will let them do, simply by paying an interest rate that is something higher than other banks are going to pay. That raises some very substantial issues in the regulatory world, much more difficult perhaps than the one we are talking about now.

When I was the Chairman, I said that I wanted all the banks reviewed, and all of those that were paying an appreciable amount above, quote, "the market rate," would have a system by which an electrical line would go to the seat of our chief supervisor and give him a jolt, so he would immediately go to those banks and find out how they could be paying these rates.

So just to get back to the basic problem of brokered deposits, it is the problem of the Internet. How you handle that is dependent upon the regulatory system.

Once you guarantee amounts and make them available nationally and internationally, although those are not guaranteed, but once you make them available, then the competition does not regulate. The regulators have to regulate. And therefore, it makes it a more difficult regulatory problem than it has been in the past and one that I am sure the FDIC is going to spend a lot of time looking at, because if they are paying higher interest rates, they have to get a return by taking riskier investments and that involves risking the whole system. That is where regulation comes in.

Senator JOHNSON. I would simply observe that the higher limit, it seems to me, makes it less necessary for people to search out unfamiliar institutions if they can keep their money local. And that is one of the benefits that might come of this.

Senator Miller.

Senator MILLER. I will yield my time to my good friend, Senator Carper, who has just come in, if he has any questions or observations. I have never known him not to have.

[Laughter.]

COMMENTS OF SENATOR THOMAS R. CARPER

Senator CARPER. I want to thank Governor Miller, my old compadre, for yielding. That is very kind.

Mr. Seidman, great to see you.

Mr. SEIDMAN. Nice to see you again, Senator.

Senator CARPER. It is always great. In early life, he and I used to go back and forth. Actually, we had a real good relationship over when I was in the House and you were at the FDIC. It is good to see you, and we welcome each of our witnesses. Have you been over to Japan lately?

Mr. SEIDMAN. Yes, I just came back from there.

Senator CARPER. Have you talked about that already?

Mr. SEIDMAN. Well, I only mentioned it, in saying that it is clear proof of the fact that if the banking system is in trouble, the whole economy is in trouble. In their case, the banking system is in great trouble and their economy is in great trouble. They have not been able to fix the economy until they get the banking system fixed.

Senator CARPER. Just take a minute, if you would. What do they need to do, more specifically? What do they need to do to fix their banking system?

Mr. SEIDMAN. I have been going over there for 10 years. And I guess for 8 of the 10 years, my speech was, if you do just this, this and this, you will fix it. This time, it is so big and so tough, that I had much more difficulty coming up with the kind of statement that says, this is what will fix it, because it is so pervasive now.

Nevertheless, what they have to do, in my opinion, is start somewhere to take the bad loans out of the banking system so that the banks can function as banks. In Japan, the banks do 80 percent of financing. In the United States, they do 20 percent.

So when their banking system is sick, they are really sick. They are going to have to get started by separating these things into good banks and bad banks and trying to put the good banks back into the private sector, or keep them in the private sector, and take the rest. And then the most difficult decision that they have to make is which loans should be restructured and which loans should be simply closed.

This is a decision that we make every day, sort of like the doctor does, only in the financial world, who lives and who dies. And they are substantially unprepared to do that. We had 10,000 people in the Government and 80,000 or 90,000 private-sector people doing that. They essentially do not have any set-up to do that.

So my speech there, and I talked with, I guess, all of the people involved, was this is a huge task for which you are not yet prepared. And you have to do this task in a way that the citizens will support it, which means in public.

You remember how much we did to try to keep everybody informed of everything we did, so we could get the support from you to use more money.

So, they have a tremendous challenge. And when you combine that with the fact that their national debt is now 140 percent of GDP, or something like that, the highest in the civilized world, so they do not have the resources at the government level any longer the way they have had, it is a tremendous problem.

Senator CARPER. Right. Thank you for that candid assessment.

Back to the subject of the hearing. Looking around the world, are there other countries that have really set the standard, maybe one that we ought to be emulating with respect to deposit insurance? Are we the model?

Mr. SEIDMAN. We are the model for the world. We send people all over the world. Every system in the world that I know about is modeled on the U.S. system, more or less. I do not think there are any models out there that we would follow because they have all followed us.

Senator CARPER. I have just come from another hearing and I apologize for missing your testimony. We were dealing with infrastructure, protecting our infrastructure from terrorists one floor down. But if you could each take 30 seconds and tell me, in a nutshell, what should we do, if anything, with respect to our current deposit insurance system as it pertains to retirement accounts?

Mr. Dahlke, would you just kick it off?

Mr. DAHLKE. I think we should raise it to adjust it for inflation. The cost of insurance, the cost of retirement is much higher than it was when the limits were set. And I think we have created a system for a lot of elderly Americans that makes it more complicated

than it does, forcing them to go to numerous institutions to be fully covered for their retirement savings.

Senator CARPER. So, we ought to adjust the coverage for retirement accounts to $100,000 plus inflation?

Mr. DAHLKE. I do not have a number in mind. I would leave that to my other colleagues to come up with. I would pull it out of a hat.

Senator CARPER. Okay. Good. Thank you.

Professor Jackson.

Mr. JACKSON. Well, I guess I did pull it out of a hat because I did recommend $250,000 as a level for retirement savings.

I think the case is strong for increasing the coverage for retirement savings. I think the case is less strong for other kinds of deposits. So, I would keep the general level where it is today or indexed to two times GDP, which is an international standard, GDP per capita.

So have them both float up, but have the retirement savings be higher. We were talking a little bit earlier about the problem of hot money and the moral hazard of deposit insurance.

I think that is pronounced for general deposit insurance where there is a lot of different kinds of people. But I think the moral hazard problems or what trouble people about expanding deposit insurance, are not strong for retirement savings.

It is implausible to think that a lot of people are going to put their IRA in a bank, which is kind of a cautious thing to do, and then run around the country looking for a hot money investment vehicle. I think the problems of expanded coverage are limited for retirement savings and the case for it is pretty strong. But I think that is the one area of increased coverage that I would support. Others I think are more problematic.

Senator CARPER. Good. Thank you.

Mr. Seidman.

Mr. SEIDMAN. I generally support indexing from the last time that there was an increase.

Senator CARPER. Any idea of what that would take us to?

Mr. SEIDMAN. About $200,000.

Senator CARPER. And would that be just for retirement savings accounts or other accounts as well?

Mr. SEIDMAN. All accounts.

Senator CARPER. Okay.

Mr. SEIDMAN. And I base that, as much as anything else, on the fact that I am a strong advocate of trying to keep a diversified banking system with small banks. We can start a new bank in our country because we have deposit insurance. No other country can do that, unless there is deposit insurance.

I think that is a very important part of the decentralized system that we have. And that allows our economy to get financing with decisions at the local level. I think it has had much to do with the great period of prosperity that we had in the 1990's.

So if for no other reason than to help small banks compete with big banks, I would support the $200,000 figure. And on top of that, I think for our citizens, certainly $200,000 is not an exorbitant amount for people to be supported. It certainly has proven to keep us from suffering from panic and all the rest. And in the banking system, it has never cost the taxpayer a penny.

I think that gets lost in all of this because of the S&L debacle, which was due to a lot of things like outlawing adjustable rate mortgages. We would never have had the S&L thing if adjustable rate mortgages had not been outlawed.

So because there was a big cost there, I do not think it is appropriate to use that in looking at the banking system, where there has been a very good record of the banks paying for insurance. It is really not even a Government subsidy because the banks have paid for every bit of it.

Senator CARPER. Thank you for your perspectives and thanks for being here. And again, Mr. Seidman, it is great to see you again. Thank you.

And thanks, Mr. Chairman.

Senator JOHNSON. I would observe to the gentleman that the retirement account coverage has been at $100,000 since 1978, and $100,000 in general since 1980. So it has been over a generation now since we have dealt with these issues.

And while there is a certain arbitrariness, I suppose, as to how high coverage ought to be increased if it is increased, it would seem to the Chair that if you subscribe to the notion that there ought to be a public policy which provides protection for a certain level of savings, then you necessarily almost have to follow that that level of coverage does periodically need to be adjusted, which is something that we have not done now for 20 years-plus.

I think the discussion from this panel has been very helpful as we go through this.

Senator Miller, anything else?

Senator MILLER. I do not have anything else except, Mr. Chairman, thank you and to thank the members of the panel for a very good hearing.

Senator JOHNSON. Well, let me say, then, thank you to the panel. I think your testimony today has been very, very helpful. I am doubtful that, given all the circumstances the country faces right now, that we get to the floor with FDIC reform legislation this year. But I think you have helped us set the stage for, hopefully, what is a constructive legislative effort, if not this year, at least on into next year.

I believe that there is a certain level of urgency relative to FDIC reform in general. And I think focusing on the retirement issues was a very useful exercise today.

Thank you.

Mr. SEIDMAN. Thank you.

Mr. JACKSON. Thank you.

Mr. DAHLKE. Thank you, Mr. Chairman.

Senator JOHNSON. This hearing is adjourned.

[Whereupon, at 3:55 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR DEBBIE STABENOW

Thank you, Mr. Chairman, for calling today's hearing. I want to commend you for the leadership you have shown on the issue of deposit insurance reform. I know that there are a number of serious policy questions that we will be grappling with as we begin this discussion and I am looking forward to working closely with you.

I believe today's hearing topic is extremely important and I am glad that in the midst of this challenging work environment that all of us are facing, we are moving forward with today's discussion.

Mr. Chairman, I agree that we need to reform Federal deposit insurance coverage for retirement accounts. There is ample evidence that the current system does not promote adequate savings for retirement. Indeed, there are structural barriers that unnecessarily complicate and impede effective planning for retirement. When the deposit insurance coverage for retirement accounts was last raised approximately 23 years ago, $100,000 went a lot further than it does today. No one today could credibly contend that such an amount would be sufficient to provide for the long-term needs of retirees. It is past time for us to review the level of coverage.

Congress has shown wisdom in the past to create incentives for additional savings. Indeed, earlier this Congress, we increased the amount of money that individuals can save through IRA's. The current cap on insurance coverage is at cross-purposes with this recent action.

However, with that said, I want to be sure that we work through this subject carefully. We must be mindful of the impact any change to our deposit insurance would have on the insurance funds. It is also worth asking the question of how changes to insurance coverage may steer money from riskier, yet potentially much more profitable savings instruments. Nonetheless, I think we can proceed in a reasoned, methodical way and I think this is one area of reform where consensus can be reached relatively quickly.

Mr. Chairman, I am looking forward to hearing from our witnesses today and to the ensuing discussion. I hope that as we move forward, we keep a few simple concepts in mind. First, we need to ensure that Government policies consistently encourage savings. Second, we need to remove illogical and artificial barriers that complicate financial planning. Third, we need to keep in mind that the public's savings needs evolve over time. And, fourth, we need to be sensitive to the fact that individuals, in planning for their retirement, have different tolerances for financial risk taking. I think if we keep all of this in mind we can come up with legislation that effectively updates our insurance coverage laws and serves the upcoming generations of retirees.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF L. WILLIAM SEIDMAN

CHIEF COMMENTATOR, CNBC–TV, AND FORMER CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION AND
RESOLUTION TRUST CORPORATION

NOVEMBER 1, 2001

The battle is on—in one corner there is the proverbial David in the person of FDIC Chairman Donna Tanoue, and in the other corner, three giant Goliaths—Senate Banking Committee Chairman Phil Gramm, Treasury Secretary Lawrence Summers, and Federal Reserve Board Chairman Alan Greenspan.

Technically the conflict is over the FDIC's Deposit Insurance Option Paper—published in August—which suggested—some said foolishly—that deposit insurance coverage should be increased from $100,000 to $200,000 per depositor. As the paper pointed out, such an increase would compensate for the last 20 years or so of inflation since the insurance level was set at $100,000. The new ceiling might also help to meet an increasingly difficult problem for community banks—obtaining sufficient deposits to meet growing loan demand. Core deposits as a source of funding for community banks have steadily declined and largely are being replaced by loans from the Federal Home Loan Banking System.

Once this idea was floated, Senator Gramm, an ever-pure free marketer, reacted with a resounding "No way—not on my watch!" At a recent Senate Committee hearing—on an unrelated subject—Gramm gained support for his position from the Secretary of the Treasury and the Fed Chairman. Treasury said it does not agree with the proposal because it increases risk taking and possible Government liability; Greenspan said "no" because he feels it is a subsidy for the rich. I guess he has

been in Government so long that anyone who has over $100,000 is really rich. Do these opinions nix the possibility for a change in the deposit insurance ceiling? I do not believe so. This is a complex issue that will require Congressional hearings and much research, because it relates to "too big to fail" policies and overall financial reform. Here are some of the important points to be weighed in this debate: Do these opinions nix the possibility for a change in the deposit insurance ceiling? I do not believe so.

Increasing Deposit Insurance Brings More Financial Risk to Government—Possible, but unlikely, since the bank insurance fund has never cost the Treasury a penny—the thrift insurance fund is the one that went broke. Even Chairman Tanoue and Fed Governor Meyer have pointed out that the greatest risk to the fund is likely to be the failure of a large complex bank. Moreover, the risk is much greater to the Federal Government when it supports a huge home loan bank financing institution—another quasi-governmental agency such as Fannie Mae or Freddie Mac—where any trouble means big trouble.

It Distorts the Operations of the Free Market—This is also referred to as creating a "morale hazard," the idea being that FDIC depositors won't have to worry about the condition of the bank. Of course, the so-called free market is out of kilter anyway, what with the Federal Reserve's discount window and the Treasury's bailout of Mexico and half of Asia through the IMF. In fact, the Government seldom does anything that does not impact the free market—think environmental protection, antitrust, regulation of good drugs, bad drugs, and so on. The issue of whether to increase the deposit insurance ceiling has less to do with the distortion of the free market than it does with whether this particular action in total is "good for the country." In the case of Mexico, for instance, the free marketers decided that a U.S. bailout of rich U.S. business leaders was good for the country and the world; bingo, the funds were granted.

It Is a Subsidy for the Rich—It is debatable whether FDIC insurance is a subsidy at all. Most economists—though not Greenspan—doubt that there is much of a subsidy because the banks have paid for all of the insurance and the insurance fund has covered any losses.

Now that I have laid out the opposing views, here are several good reasons for approving the FDIC deposit guarantee increase:

It Will Level the Competitive Playing Field—Historically, governments have protected all bank depositors when very large banks are in trouble, thus providing an implicit guarantee of unlimited insurance for those institutions—that is, Japan, Saudi, Korea, Thailand, and the United States Therefore, at the very least, the increase to $200,000 tends to give community banks a better chance to maintain their deposit base against a too-big-to-fail competitor.

The Increase Will Reduce the Risk that Smaller Banks and the Communities They Serve Will Stagnate Due to the Banks' Inability to Obtain Funding at a Reasonable Cost—It could also reduce future FDIC insurance payments if these weak banks fail in the next recession. Incidentally, an FDIC study shows that if the insurance level had been at $200,000 during the problems of the 1980's and 1990's, it would not have materially increased FDIC insurance costs.

The Increase Will Help to Maintain a Banking System that Is Decentralized and Diverse—This type of system helps the economy, boosts productivity, and promotes entrepreneurship—important factors in our present prosperity.

It Provides a Savings Incentive—As more baby boomers retire with savings in excess of $100,000, the increased FDIC insurance coverage will provide a convenient and conservative savings option and will encourage savings, which all economists agree would be good for the U.S. economy.

You may have guessed by now that I am rooting for the corner with little David (Chairman Tanoue) in this important policy showdown—and the battle is far from over. Why? I will simply use the litmus test that applies to all other proposed reforms: It is good for the country.

PREPARED STATEMENT OF HOWELL E. JACKSON

FINN M.W. CASPERSEN AND HOUSEHOLD INTERNATIONAL PROFESSOR OF LAW AND ASSOCIATE DEAN FOR RESEARCH AND SPECIAL PROGRAMS
HARVARD LAW SCHOOL

NOVEMBER 1, 2001

Chairman Johnson, Ranking Member Bennett, Chairman Sarbanes and Members of the Committee: I am very pleased to be here today to discuss the reform of FDIC insurance coverage for retirement savings and to join the expanding discussion of

deposit insurance reform that the FDIC launched more than a year ago with the release of its Options Paper.

Justifications for Mandatory Federal Deposit Insurance

Although the subject matter of this hearing is coverage levels for retirement accounts, I will begin my testimony with a few general comments about insurance coverage. In brief, mandatory Federal deposit insurance serves three distinct public purposes.

First, deposit insurance provides individual borrowers a convenient way to save that, for all practical purposes, is risk-free. Without mandatory deposit insurance, members of the general public would have to expend time and effort ascertaining and comparing the current solvency and future prospects of particular depository institutions in search of low-risk depositories. At a minimum, this process would impose costs on many members of society. In addition, some individuals—most likely the least wealthy and the least well-educated—would make mistakes in evaluating the creditworthiness of particular institutions and might expose themselves to unwanted risks. Mandatory Federal deposit insurance eliminates this problem by extending a Federal guarantee to effectively protect all deposits up to the current coverage limit of $100,000.

Second, deposit insurance reduces the likelihood of irrational runs on healthy depository institutions. Before the advent of deposit insurance, financial downturns occasionally triggered liquidity problems for depository institutions. These panics caused problems for otherwise healthy institutions and also had adverse macroeconomic consequences, most notably a rapid contraction of the money supply. While other public programs also combat liquidity crises, deposit insurance ameliorates the problem because individuals with deposits of less than the FDIC coverage limit have no need to withdraw funds from FDIC-insured institutions even in the face of financial distress.

Third, Federal deposit insurance can effect visions of the proper structure of our political economy. Throughout the financial history of the United States, public sentiment and political leaders have favored a decentralized and fragmented financial services industry. Federal deposit insurance can advance this preference by helping smaller, less diversified depository institutions compete with larger, national organizations. The presence of Federal deposit insurance coupled with many other legal rules—notably, historical restrictions on geographical expansion—explain why the banking industry in the United States is so much less concentrated than comparable sectors of the financial services industry in other industrialized countries.

The Case for Increasing Current Coverage Limits

As I understand the current debate, proponents of higher coverage levels base their case on an assertion that the current coverage of $100,000 per deposit no longer satisfies the first—collective action—and third—political economy—justifications for deposit insurance. At this point, few are arguing that macroeconomic considerations warrant higher coverage levels.[1] The task of evaluating the two lines of argument being advanced by proponents of expanded coverage is complicated, and I cannot provide the Committee a definitive assessment of either claim. I would, however, offer the following preliminary thoughts.

First, as a general matter, I think the burden should be on the proponents of expanded FDIC coverage to make a compelling case for the extension of Federal protection. I would not understand this burden to be overwhelming—indeed, as explained below, I believe that the burden may well be satisfied in the case of retirement savings[2]—but I do think that a sensible premise is that Government insurance programs should be maintained at the minimum level necessary to achieve specific public goals. Placing the burden of persuasion on proponents of expanded coverage helps effect this principle.

Second, I would accept the political case for expanded deposit insurance coverage as a legitimate consideration. I would, however, be mindful that Government inter-

[1] The absence of attention to the macroeconomic role is sensible. In modern times, similar liquidity crises have occasionally occurred at the State level when State deposit insurance systems run into financial troubles. However, in the past two decades, these State systems have disappeared, and almost all depository institutions are now insured at the Federal level. To the best of my knowledge, there have been no recent, system-wide liquidity crises at Federally-insured depositories, even during the thrift and banking crises of the 1980's and early 1990's or the disruptions in stock markets after September 11 or October of 1987. Indeed, during periods of financial crisis, funds now tend to flow into depository institutions not out.

[2] Among other things, expanded Federal deposit insurance coverage tends to raise the FDIC's costs when banks fail and may also increase the moral hazard problems associated with Federal deposit insurance.

vention to maintain existing industry structures can be costly—both in promoting efficient financial services firms and in retarding innovation. In addition, it is possible that intervening developments—such as adoption of the Community Reinvestment Act of 1977, expanded access to capital markets for small companies, and improvements in antitrust oversight—now address concerns over monopolization of sources of credit that underlay public antipathy to large-scale financial institutions in the past.[3] So before accepting the political case for expanding Federal deposit insurance, I would recommend that Members of Congress consider both the economic costs of such a decision and the possibility that other statutory regimes adequately address the concerns underlying our historical preference for local banking institutions.

Arguments that the current level of FDIC insurance is too low to provide an adequate amount of risk-free savings for individuals are, in my view, the most difficult feature of the current debate over expanded FDIC insurance coverage. For the most part, recent testimony has assumed that the coverage levels should be inflation-adjusted, and then focused on selecting an appropriate historical point in time to accept for determining an inflation-adjusted baseline for future deposit insurance coverage.[4] Analytically, this approach is unsatisfying, as it provides no explanation why one should choose one particular baseline as opposed to many plausible alternatives. As a theoretical matter, one could imagine a number of considerations that should influence the optimal level of deposit insurance coverage: the financial sophistication of the general public, the level and distribution of financial assets, the availability of reliable information about the solvency of depository institutions, and a host of other factors, including the cost and moral hazard impact of deposit insurance. Over time, one would expect that these factors would change and thus the optimal level of deposit insurance coverage would also rise and fall.[5] Balancing these evolving features of our financial environment is a daunting task.

In lieu of offering the Committee any original analysis of this subject, I would propose instead to point Members and the Committee staff to a paper on deposit insurance recently written by Gillian Garcia, an economist with the IMF.[6] In an effort to establish an international benchmark for deposit insurance coverage, Garcia recommends, as a rule of thumb, deposit insurance coverage equal to one or two times per capita GDP.[7] (Two times per capita GDP for the United States would be ap-

---

[3] I would further distinguish arguments in favor of expanded deposit insurance that are based on a perceived need to offset the "too-big-to-fail" policy said to support larger financial institutions. Enhancing deposit insurance coverage to counteract the effect of the "too-big-to-fail" policy is, in my view, a dubious proposition. First, there is considerable doubt that the policy remains in effect. In 1991, the FDIC Improvements Act established important procedural and political constraints on large bank bailouts. In addition, a number of substantive reforms—from prompt corrective action to heightened oversight of interbank lending—reduce the likelihood of Continental Illinois-style bailouts. Moreover, to the extent that larger banks are still implicitly supported by a lingering "too-big-to-fail" policy, Congress could consider addressing that problem directly rather than making a compensatory increase in deposit insurance coverage for small banks.

I would be similarly skeptical of arguments for expanded deposit insurance coverage based solely on the fact that other sectors of the financial services industry have grown faster than depository institutions in the past two decades. It is by no means clear that maintaining the market share of depository institutions in 1980 is an appropriate goal of public policy. Indeed, growth in other sectors, such as money market mutual funds, could well indicate that these alternative forms of saving better suit the needs of an increasing number of consumers.

[4] For example, if the current level of coverage ($100,000 per deposit) were used as a baseline, the real level of coverage would be much lower than if the value of deposit insurance coverage back in the early 1980's were used. For a good review of the relative value of Federal deposit insurance coverage, see FDIC Options Paper 31–43 (August 2000) (available at http://www.fdic.gov/deposit/insurance/initiative/OptionsPaper.html). See also Alan S. Binder & Robert F. Wescott, Reform of Deposit Insurance: A Report to the FDIC (March 20, 2001) (available at http://www.fdic.gov/deposit/insurance/initiative/reform.html) (discussing indexing FDIC coverage levels to median income).

[5] For example, within the United States over the past 20 years, the assets of depository institutions as a percentage of GDP has increased from 56.6 percent in 1980 to 81.5 percent in 2000, suggesting that an increase in real FDIC coverage may be in order. On the other hand, financial sophistication of the general public and the availability of information about depository institutions—via the Internet among other sources—has probably also improved, suggesting the need for less governmental paternalism and perhaps even less deposit insurance coverage today than in the past.

[6] See Gillian Garcia, Deposit Insurance and Crisis Management (IMF Working Paper, March 2000) (available at http://www.imf.org/external/pubs/ft/wp/2000/wp0057.pdf).

[7] Garcia also contends that the coverage limit may be set with more precision by examining the distribution of deposits by size, proposing that coverage limit should be set to include the majority of the total number of deposits (roughly 80 percent), but only the total value of deposits of a minority (roughly 20 percent).

proximately $70,138.80 in 2000).[8] Elsewhere, Garcia reports ratios of deposit insurance coverage to per capita GDP for 66 selected countries, and finds that only 28 have explicit deposit insurance coverage greater than two times per capita GDP. Of these, only two countries have explicit deposit insurance coverage greater than the current United States level (Italy and Norway).[9]

While there is nothing magical about the Garcia analysis of deposit insurance coverage, the work does suggest one informed analyst's view of the issue, and also offers a comparative dimension to the topic, suggesting that current FDIC coverage levels are at or near the top of explicit governmental insurance schemes. To be sure, Garcia's survey does not report implicit coverage levels—which may be substantial and even unlimited in some countries. Moreover, it is possible that considerations of political economy unique to the United States justify coverage levels higher than those found in other industrialized countries. Still, for me at least, the Garcia analysis raises questions about the appropriateness of raising general coverage levels at the present time.

Special Features of Retirement Savings

The one area in which I think a strong case may be made for raising current FDIC coverage levels is the area of retirement savings. Numerous trends increase the importance of retirement savings for American citizens. Greater life expectancy, earlier retirements, potential shortfalls in our principal public insurance program (Social Security), all counsel for a greater importance of private savings for retirement. It is, moreover, quite reasonable to posit that some members of the general public will want to be able to place their retirement savings in a simple, safe, and familiar investment vehicle, such as a depository institution.[10] Finally, if we accept the premise that the Government has a role in ensuring the availability of such a vehicle for amounts sufficient to provide adequate retirement security, then I think the case for raising the level of FDIC coverage for retirement accounts has been made. Essentially, the argument is an extension of the first (collective action) justification for deposit insurance in the special case of retirement savings.[11]

The Amount of Retirement Savings Coverage: Theoretical and Practical Considerations

But what level of coverage is appropriate for retirement savings? Clearly an unlimited support for retirement accounts seems inappropriate, both because there is no strong governmental interest in protecting all of the retirement savings of the very wealthy and because the extension of retirement savings coverage could distort competition among different sectors of the financial services industry. But is there a principled way to provide a benchmark comparable to what Garcia advances for general coverage levels? Recognizing that there is no clearly right answer, I offer the following rough cut at the question.

I approach this problem with the premise that the Government should offer sufficient deposit insurance coverage so that a household with up to the median level of income should have access to an absolutely safe investment vehicle for retirement. I would implement this concept as follows. I start with the median household income in the United States, which was approximately $42,000 in 2000.[12]

Within the financial planning industry, a typical target for retirement income is 80 percent of preretirement income. So, under this measure, a household at the median level of household income would need $33,600 of income per year during retire-

[8] This figure is based on an estimated 2000 per capita GDP of $35,069.40 as reported in the 2001 World Economic Outlook Database, October 2001, available at http://www.imf.org/external/pubs/ft/weo/2001/02/data/index.htm (last accessed 10/29/01). According to the WEO estimates, two times per capita GDP for the United States would be $67,953.60 in 1999, $72,024.80 in 2001, and $74,455 in 2002.

[9] Gillian Garcia, *Deposit Insurance—A Survey of Actual and Best Practices* (IMF Working Paper, April 1999).

[10] The triple requirements of simplicity, safety, and familiarity are essential to my argument because the general public already has safe alternatives—investments in Government bonds or bond funds—that are not familiar, as well as familiar investments—splitting retirement savings among a number of banks—that are not simple.

[11] Many experts agree that expanded coverage of retirement savings is unlikely to create additional moral hazard problems as the kind of person who is apt to invest retirement savings in bank deposits is unlikely to seek out high-risk, high-return institutions. See Letter from FDIC Chair Donna Tanoue (April 2001). See also Testimony of Jeff L. Plagge before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs (August 2, 2001).

[12] For recent census data on median income of households in the United States, see http://www.census.gov/hhes/income/income00/incxrace.html (avail. October 31, 2001). I use household income because retirement savings often must support a household rather than an individual.

ment. Although one could argue that FDIC insurance for retirement savings should be set to cover retirement savings sufficient to finance this full amount, I think it is important to recognize that Social Security provides substantial retirement savings for most Americans, particularly those at lower income levels. For current purposes, I think it would be appropriate to assume Social Security replacement rates of 40 percent of preretirement income,[13] leaving only 40 percent to be covered by private savings or $16,800 of income per year.

Formulated in this way, the question is how much retirement savings would an individual need to supply $16,800 of inflation-adjusted income in retirement? To answer this question, one must make assumptions about life expectancy and real rates of industry. Using what I consider to be plausible estimates of these factors, I have calculated that a retirement savings balance of approximately $250,000 would be an appropriate target level of coverage.[14] To put this in relationship to median household incomes, a $250,000 coverage level would suggest a retirement savings coverage target of roughly six times median household income. In comparison, our current coverage level of $100,000 is just a shade under 2.4 times median household income.[15] The ratio between the level of coverage I propose for retirement savings ($250,000) and current FDIC coverage ($100,000) is, coincidentally, the same 2.5 to 1.0 ratio that prevailed between 1974 and 1980, the only previous time that the FDIC has offered different coverage levels for retirement savings.[16]

Having proposed a plausible target for retirement savings coverage, let me immediately add several caveats. This back-of-the-envelope calculation includes numerous assumptions about replacement rates, assumed life expectancies, rates of return, and Social Security coverage. All of these assumptions are subject to debate, and different assumptions would generate different target levels. What I have offered is my best guess of how a retirement savings coverage level might be justified based on my own notions of the Government's appropriate role in the field. Others—particularly those representing other sectors of the financial services industry—may well have different views.

On a more practical dimension, I should stress that these coverage levels dramatically exceed the current levels of retirement savings of most Americans. According to recent Census Bureau data, middle-income American households do not now accumulate anything close to $250,000 of retirement savings. For example, the median net worth of householders in early retirement years (65 to 69) was $106,408 in 1995, but the largest median investment was in homeownership not financial assets.[17] Accordingly, the theoretical case for retirement savings of roughly one quarter of a million dollars seems well beyond the current capabilities of most average Americans.[18] To some degree, this unfortunate financial fact moots the debate over retirement savings coverage. However, some individuals will have accumulations at the level

[13] See C. Eugene Steuerle & Jon M. Bakija, Retooling Social Security for the 21st Century 06 (1994) (reporting Social Security replacement rates for different categories of workers).

[14] For this purpose, I assume a real rate of return of 3.0 percent—roughly the current payment rate on inflation-adjusted long-term Government bonds—and a life expectancy of 20 years. Obviously, individual experience will vary, particularly on the dimension of life expectancies. But for purposes of setting targets, I think these are reasonable estimates. In addition, the use of the median household income—as opposed to some lower level—is probably a generous statement of the Government's obligation in this area.

[15] Note that the methodology proposed in the text assumes that deposit insurance coverage levels should be adequate to cover the maximum balance necessary to finance a targeted level of retirement income. For any particular savers, these balances would be present only on the eve of retirement—before the balances would still be in an accumulation phase and afterwards the balances would decline as withdrawals occurred. One could imagine a lower coverage level that would provide only partial protection of a $250,000 retirement savings account at its point of peak accumulation. If, for example, the coverage level were set at $200,000, much of the time, even our median household achieving the proposed savings targets would be fully covered, but for a certain number of years, up to $50,000 of savings would be uninsured. In practice, such a saver would not be exposed to a complete loss of this $50,000, as depositors typically only lose a relatively small fraction of the balances of uninsured accounts and legislative reforms of the past decade make it likely that these loss exposures will remain small—perhaps on the order of 10 percent of uninsured balances or less.

[16] At that point, the nominal coverage levels were $100,000 for retirement savings and $40,000 for general FDIC coverage. See Testimony of Jeff L. Plagge before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs (August 2, 2001). In real terms, however, the coverage level for retirement savings is quite similar to the one I propose.

[17] See http://www.census.gov/hhes/www/wealth/1995/wealth95.html (avail. October 31, 2001).

[18] See, e.g., FDIC Roundtable Discussion of Deposit Insurance Reform 22 (May 2000) (available at http://www.fdic/deposit/insurance/initiative/transcript/index.html) (citing Federal Reserve Board study indicating that bank retirement accounts of people making more than $100,000 were typically only $2,400 and ranged up to only $93,000).

envisioned,[19] and for others a governmental policy endorsing retirement savings on the order of six times median household income may offer some encouragement to increase retirement savings, particularly if financial institutions publicize the level of coverage.

Issues of Implementation in Developing a Separate Coverage Level for Retirement Savings

To the extent that the Committee pursues the concept of adopting a separate coverage level for retirement savings, there are a number of additional issues of implementation that need to be addressed.

Which Tax-Favored Vehicles to Cover? First, there is the matter of defining the concept of retirement savings. Most discussion of the subject refers to Individual Retirement Accounts (IRA's) and Keogh Plans, but it is not clear that these are the only categories to which expanded FDIC coverage should extend. Historically, these plans were individualized accounts, distinct from traditional defined benefit pension plans. But Keogh Plans are a relatively minor component of overall retirement savings. IRA's are much more important, but largely because they are the depositories of roll-overs from employer-based plans. (I would expect that the overwhelming majority of IRA accounts that exceed the current $100,000 FDIC insurance coverage levels are roll-over IRA's).[20] If extended FDIC coverage is to reach these roll-over accounts, it is not clear why it should not also extend to other tax-favored individual account plans—most notably 401(k) and 403(b) plans—that many employers maintain. After all, if the public needs a risk-free investment vehicle for roll-over IRA's, a similar argument[21] should apply to extending such protections to comparable retirements accounts maintained through employers, as well as privatized Social Security accounts (should they ever be created).[22] At a minimum, the Committee should carefully consider which tax-favored savings vehicles are to be eligible for supplemental FDIC coverage for retirement savings.

Retirement Savings in Other Forms. An analogous question arises as to whether the extended coverage should even be limited to tax-favored vehicles. While tying coverage extension to categories of retirement savings already defined in Federal law and administered through the ERISA agencies has some appeal, there are also several drawbacks to this approach. To begin with, tax incentives are most important to wealthy Americans, who have higher marginal tax rates and greater proclivities to saving. If extended coverage is limited to tax-free forms of savings, the benefit will be skewed toward upper-income Americans, even though the justification for extending coverage is largely based on concern for the less advantaged and less sophisticated. Consider further that the principal source of wealth of middle class Americans is home equity. For elderly households that sell their homes upon retirement, this equity might easily be converted into a bank account and used to support

[19] For example, the FDIC Options Paper suggests that "several . . . financially unsophisticated" depositors in recently failed banks had retirement accounts in excess of the current $100,000, see FDIC Options Paper, supra note 4, at 36. The FDIC Paper does not, however, indicate the extent of the losses imposed on these accounts. See supra note 14 (discussing the relevance of loss rates on uninsured portions of retirement savings accounts).

[20] Traditional IRA's have always been limited to relatively low annual contributions. Even if an individual had invested the full $2,000 annual contribution allowed for IRA accounts for most of the past 25 years, that individual's account balances would only recently have reached the current $100,000 threshold. Based on existing data about the actual size of IRA accounts, I would expect that very few individuals have been such active savings in IRA accounts. While recent changes in tax laws substantially loosen restrictions on IRA savings, it is unclear how many low- and middle-income savers will take advantage of these opportunities. For a median income saver to get to the $250,000 level proposed above, and annual contribution of roughly $3,300 a year over 40 years would be required. That level of savings assumes an annual contribution of approximately 8 percent of median household income per year. For most workers, who start their working careers with much lower levels of income, the savings rates would have to be higher. For these reasons, I am not sure that I can concur in FDIC Chair David Powell's assertion that "middle-income families routinely save well in excess of [the current $100,000 FDIC] limit." See Statement of Donald E. Powell before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services (October 17, 2001) (available at http://www.fdic.gov/news/news/speeches/chairman/sp17oct01.html).

[21] One difference is that participants in employer-sponsored enjoy some protection under ERISA's fiduciary rules. However, these safeguards are limited, and do not ensure that employees will place their retirement savings in low-risk, cost-effective savings vehicles.

[22] To the extent that the Committee does consider extending expanded FDIC insurance coverage to other tax-favored retirement plans, some attention would have to be given to ensuring that the coverage levels applied to beneficiaries of these plans and not the plan trustees. Several years ago, after the failure of the Executive Life Insurance Company, a wave of litigation arose over comparable questions of coverage under State insurance guaranty funds. See Howell E. Jackson & Edward L. Symons, The Regulation of Financial Institutions ch. 7 (1999).

the households in retirement. But retirement savings of this sort would not typically be covered through expanded FDIC insurance coverage limited to tax-preferred retirement accounts. Nor would it cover the proceeds from the sale of a small business or many other kinds of savings.

Problems of Expanding the Definition of Retirement Savings. The problem with expanding the definition of retirement savings is that a liberal definition could threaten to convert extra coverage for retirement savings into an across-the-board increase in Federal deposit insurance coverage, at least for individuals. Particularly, if depositors could open "retirement savings" accounts at multiple institutions, the potential for unlimited coverage would be real. One could imagine various ways to deal with this problem—i.e., limiting individuals to only one retirement savings account throughout the banking system or at least throughout networks of affiliated banks. Drafting such rules would require considerable care and likely delegation to the Federal Deposit Insurance Corporation for implementing regulations.[23]

Potential for Abuses with Retirement Savings Account. On the assumption that the technical issues of designing a viable system of expanded FDIC insurance for retirement savings can be overcome and balances in these accounts grow over time, the Committee should be mindful that these accounts may become the subject of unscrupulous business practices. For a variety of reasons, bank-based retirement savings accounts are likely to attract less sophisticated individuals, who may be less inclined to keep track of prevailing interest rates or move accounts—particularly retirement savings accounts—to other institutions.[24] Knowing these characteristics of bank-based retirement savers, bankers may be tempted to lower the interest rate paid on retirement savings accounts. To the extent that the Federal Government would be implicitly endorsing bank-based retirement savings through the expansion of FDIC coverage for retirement accounts, I think attention should be given to ensuring that these accounts offer an appropriate rate of return. While direct regulation of interest rates would be excessive, one could imagine a statutory requirement that, to be eligible for expanded FDIC insurance coverage, retirement savings accounts would have to pay an interest rate no lower than an inflation-adjusted Government bond. Such a floating average would set a floor beneath with interest payment could not fall, but would leave ample room for free market competition above that level. Again, responsibility for implementing regulations to establish an appropriate minimum rate of interest could be delegated to the FDIC.

Educational Aspects of Expanding Retirement Savings Coverage. As mentioned above, an ancillary benefit of expanding FDIC coverage for retirement savings accounts is the possibility that such a reform could encourage the American public to save more for retirement—even suggesting a target level of six times preretirement income as an appropriate savings goal. Financial supervisors in other jurisdictions—most notably the new Financial Services Authority in the United Kingdom—have recently been given explicit charges to educate the general public on such matters. In my view, it would be desirable if legislation adopting a higher level of FDIC coverage for retirement savings also included an educational component—either to be conducted directly by Government agencies or through some public-private alliance. While expanded FDIC coverage may marginally strengthen retirement savings in the United States, the primary mechanism for solving the problem will have to come through personal decisions made by millions of individual savers. Government sponsored education can help Americans meet that challenge.

Retirement Savings and the Debate Over Deposit Insurance Coverage

Let me conclude with a few words about the relationship between retirement savings and the broader debate over deposit insurance coverage. As explained above, compelling theoretical arguments support the expansion of FDIC insurance coverage for retirement savings. However, the task of structuring an appropriate extension—that is, an extension likely to reach low- and middle-income savers—is not trivial. And it is possible that the practical problems of implementing such a regime will

[23] The practice of financial conglomerates dividing deposit balances among two or more affiliated banks is a problem that goes beyond the issue of retirement savings coverage. To the extent that Federal banking law increasingly disregards the corporate separateness of affiliated banks, see Howell E. Jackson, The Expanding Obligations of Financial Holding Companies, Harv. L. Rev. (February 1994). I believe there are strong arguments for treating affiliated banks as a single unit for purposes of deposit insurance coverage. (The larger question of whether all insurance coverage levels should be based on total individual accounts or on the current bank-by-bank basis is beyond the scope of this testimony.)

[24] As others have noted, holders of IRA and Keogh bank accounts are unlikely to engage in aggressive shopping for higher rates. This is the principal reason why experts believe that expanded coverage for retirement savings is not likely to increase moral hazard problems of deposit insurance.

prove so substantial as to derail the entire effort. At this point, I can offer no clear prediction as to how these tradeoffs balance.[25] However, to the extent that the Committee can devise a sensible approach to extending FDIC coverage for retirement savings, I think the case for raising the basic coverage levels is greatly reduced. As I mentioned earlier, the strongest argument for a general increase in FDIC coverage is that the public's needs for deposit insurance have increased over time. The most compelling component of this argument relates to an increased need for risk-free investment vehicles for retirement savings. To the extent that expanded FDIC coverage addresses this concern, the need for a general increase in FDIC coverage is much diminished and the appropriate level for indexed general deposit insurance perhaps even somewhat reduced.

Thank you very much.

PREPARED STATEMENT OF GLENN C. DAHLKE

PRESIDENT, DAHLKE FINANCIAL GROUP

NOVEMBER 1, 2001

Introduction

Mr. Chairman, I appreciate the opportunity to testify today before the Senate Banking Subcommittee on Financial Institutions on the topic of Federal deposit insurance coverage of retirement accounts. I am Glenn Dahlke, President of the Dahlke Financial Group of Glastonbury, Connecticut, a family-owned sales and asset management company.

Mr. Chairman, it is my strong recommendation that Congress should substantially increase the value of Federal deposit insurance for retirement accounts. Congress should recognize that the cost of retirement has skyrocketed since 1978, when retirement coverage was last increased.

In addition, those Americans who take responsibility for remaining self-sufficient in their later years should not be forced to jump through complicated and potentially costly hoops to protect those savings. I urge Congress to increase deposit insurance coverage for retirement savings well in excess of the outdated $100,000 limit, and to ensure that coverage keeps pace with the true costs of retirement.

This afternoon, I want to make four points:

First, without other assets, $100,000 in retirement savings is simply insufficient to support most retired individuals, especially given increased life expectancy and dramatically rising medical costs.

Second, it is rational for retirees who have low-risk tolerance and need a predictable income stream to invest savings in excess of $100,000 primarily or exclusively in insured deposits.

Third, many retirees who invest in insured deposits are ill-equipped to cope with Federal distribution requirements that are made vastly more complicated when accounts must be spread across institutions.

And finally, I believe it is inappropriate to require retirees to choose between the safety of their life savings and banking with someone they trust.

Background

Getting Above $100,000

Happily, America's "retirement years" are lengthening: we are living longer, and many Americans are retiring early to make way for a new generation of workers in a low-unemployment environment. As a result, however, careful planning is required to ensure self-sufficiency during this period, although the amount needed to sustain a comfortable lifestyle must obviously be determined on a case-by-case basis.

---

[25] An important area of future research is the actual distribution of current and potential bank-based retirement savings accounts. In my view, the best argument in favor of expanded insurance coverage for retirement savings is based on the notion that substantial numbers of unsophisticated and lower-income savers need this protection. As indicated above, relatively few such individuals appear to have retirement accounts at or in excess of current FDIC insurance levels. According to the testimony of industry representatives, some bankers believe that there are substantial amounts of retirement accounts in excess of $250,000 that will be attracted into depository institutions if insurance coverage increases. Most likely, however, these funds are from wealthy and more sophisticated individuals. Providing additional FDIC insurance coverage to such individuals does not advance the interests of low- and middle-income savers, although it might improve the competitive posture of certain depository institutions.

Over the years, Congress has created important tax incentives to encourage people to set aside money for retirement, recognizing the benefits to our society of individual self-sufficiency.

Several different pension and benefit plans exist, the better known of which include Individual Retirement Accounts ("IRA's"), 401(k) plans, and Keogh plans, among others. Under these plans, individuals may invest pretax dollars, the earnings on which are tax-deferred until the funds are eventually withdrawn, in many cases subject to a lower tax bracket than when the money was earned.

In a resounding reendorsement of the principle that Americans should save for retirement and a recognition that retirement costs have increased dramatically, Congress earlier this year significantly increased the amount that individuals may save through tax-deferred programs such as IRA's. Over the course of the next several years, annual contribution limits will increase from $2,000 to $5,000 for IRA and Keogh accounts, with subsequent indexing for inflation, and $10,500 to $15,000 for 401(k) plans. Other defined benefit and contribution programs are based on a percentage of income, and permitted deposits often far exceed $5,000 annually.

Even without taking into consideration these higher contribution limits, a middle class individual who works for 20 or 30 years and saves in a disciplined manner will easily amass over $100,000 in savings. According to the FDIC, a worker who sets aside $2,000 annually at a tax-deferred 6 percent rate of return will reach $100,000 in savings after 20 years. For those who set aside higher annual amounts of retirement money through 401(k) plans and roll those funds into an IRA, the time period required to exceed $100,000 in savings is drastically reduced.

For purposes of this testimony, I focus primarily on IRA's, because that would be the most pervasive vehicle through which an individual would likely place retirement money into an insured depository.

Retirement Savings Vehicles

It is useful to review the fundamental rules governing tax-preferred IRA's. All single workers not covered by an employer-sponsored pension plan or earning less than $25,000 ($40,000 for married filing jointly) are eligible to contribute to an IRA and deduct the contribution amount from taxable income. Workers earning above the $25,000/$40,000 limits are subject to a phase-out of deductibility.

Below the income thresholds, workers may contribute up to $2,000 per person or $4,000 per couple (or up to 100 percent of compensation, if less than $2,000) to an IRA and deduct that amount from taxable income. Those limits are set to rise to $3,000/$6,000 next year, $4,000/$8,000 in 2005, and $5,000/$10,000 in 2008, with indexation thereafter. Individuals over 50 years of age may take advantage of special "catch-up" provisions.

Above income thresholds, individuals may contribute the same amount to IRA's; however, they may not deduct the deposits from taxable income. This may nevertheless be desirable because earnings on IRA's are not taxed until that money is eventually withdrawn, and accordingly savings compound more quickly than many investments.

IRA's come with significant restrictions to ensure that these tax-preferred vehicles are used to support people in their later years. Withdrawals—for any reason except disability or medical costs—from IRA's before an individual reaches the age of 59½, with some narrow exceptions, are charged an excise tax of 10 percent on the amount withdrawn, which is also subject to income tax.

Once an individual reaches 70½ years of age, certain prescribed amounts, based on longevity tables, must be withdrawn from an IRA. Failure to withdraw the prescribed amount results in a stiff penalty of 50 percent of the amount of the difference that should have been withdrawn, which is also subject to income tax. For example, assume a 75 year old woman has $100,000 invested in an IRA, which is subject to a 5 percent withdrawal rate in 2002. To avoid a penalty, she is obligated to distribute $5,000 out of her account in 2002. However, assume she distributes only $3,000. She owes a penalty of $1,000, for example, 50 percent of $2,000. In addition, she is taxed on the full $5,000 of ordinary income.

It is important to note that middle class retirees without the benefit of professional financial advice are far more likely to fall subject to these penalties. In addition, while it may not be politically correct to point this out, in many cases the surviving spouse of a traditional one-worker family may lack an established understanding of the family's finances, further increasing the risk of incurring penalties.

As the previous example illustrates, it is important to understand that IRA holders are required to reduce the size of their accounts gradually, based on established longevity tables. IRA's can be understood to take the shape of a bell curve. In the early years, individuals may contribute to, but not withdraw from, a retirement account, resulting in a build-up of principal. Between the ages of 55 and 70½, individ-

uals may, but are not required to, withdraw savings as needed. After 70½, IRA's will eventually decline (though they may stand still during years where distribution rates may equal rates of return on investment).

Arguments

- $100,000 in retirement savings is simply insufficient to support most retired individuals, especially given increased life expectancy and skyrocketing medical costs.

In some important respects, $100,000 is not worth $100,000 in the retirement context. That is, where that money serves as the major source of income other than Social Security, $100,000 may be barely sufficient to cover basic living expenses.

For example, assume a 72 year old widow has $100,000 plus a $10,000 annual Social Security pension on which to support herself. From the $100,000, assuming a 5 percent distribution rate (see discussion below), she will receive $5,000, which is taxable as ordinary income, along with the $10,000 in Social Security benefits, which may or may not be taxed depending on her circumstances. In other words, this widow has $15,000 annual income on which to support herself.

Mindful of the fact that many parts of America have lower cost of living than Connecticut, I am nevertheless prepared to declare to this Subcommittee that this woman is unlikely to enjoy a lavish lifestyle, and in fact could not absorb predictable financial shocks that might include anything from a new roof to an uninsured medical procedure.

This is a critical point, because many opponents of higher coverage limits often argue that anyone with $100,000 is well-off and can do without special favors. On the contrary, Mr. Chairman, Congress should ensure that those workers who save in a disciplined and responsible manner for their retirement have a secure investment option for an amount adequate to support themselves. It is fair, and frankly, it is good public policy.

- It is rational for certain retirees with savings in excess of $100,000 to invest primarily or exclusively in insured deposits.

Assuming an individual has over $100,000 in retirement savings invested through an IRA, the question becomes why would he or she choose to keep that money in a bank. During my career as a financial adviser, I have observed three principal factors at play for clients who choose to keep their money in a local insured depository: risk tolerance, need for predictability and local relationships.

Risk Tolerance

When I advise clients on investment strategies, the most important piece of information I gather relates to that individual's risk tolerance, or willingness to put his or her savings at risk in exchange for a possible higher rate of return.

Risk tolerance does not necessarily correlate to an individual's wealth cushion, nor to his or her future income needs. As a general matter, however, we expect risk tolerance to decline with age. In some sense, risk tolerance is a function of how much a person wants to increase his or her wealth, in addition to how much that person can "afford to lose."

For example, Charlie with $2 million may have a strong desire to increase that base to $10 million because of his lifestyle aspirations, and may be willing to risk losing some of his $2 million for the chance of a higher return. At the same time, Addie with $200 million may decide to pursue a no-risk investment strategy because she would have no use for more money, even though she could certainly afford to take a few high-risk bets without much risk to her future security. And Carol with $200,000 may be perfectly happy living on $12,000 a year, and be loath to risk that $200,000 for higher returns because she is content with the lifestyle her savings can afford. Bags of gold come in different sizes, and each individual decides what level of savings is enough for a comfortable retirement.

I have found, however, that individuals with a smaller wealth cushion tend to have a lower risk tolerance with respect to a wealth accumulation that is just enough to meet their future needs with little room for loss. In most cases, a conservative investment strategy where there is sufficient, but not ample, savings is a wise course, as recent stock market volatility has indicated. In fact, the current environment underscores the importance of increasing deposit insurance coverage of retirement accounts, especially as the risk of bank failures increases with economic softening.

Predictability

Individuals with a smaller wealth cushion may also prefer investments that have predictability with respect to providing a fixed income. While there are certainly secure investments, such as Treasury securities, that provide safety for the principal of the investment, these instruments are interest rate sensitive, and cannot be re-

lied upon to provide a fixed monthly income. I advise clients who want or require predictability in their monthly income to invest in certificates of deposit, because these are the only investment that, assuming they are fully insured, can provide complete security of both the full principal, as well as a fixed-income stream.

Local Relationships

Clients who express a desire to invest significant resources in an insured depository often, but not always, want to keep their money with people they know and trust. Especially in small towns, personal relationships develop between bankers and clients, and while this may seem anachronistic to urban dwellers, local relationships remain an important feature of the modern banking system.

- Many retirees who invest in insured deposits are ill-equipped to cope with Federal distribution requirements that are made vastly more complicated when accounts must be spread across institutions.

Higher coverage levels for retirement accounts would significantly reduce the risk that a retiree with over $100,000 in insured deposits would become subject to the 50 percent penalty for underdistribution of IRA savings.

Because distribution requirements are based on an individual's aggregate IRA savings, diversification of IRA money across several accounts increases the risk of under-distribution, especially as an individual grows older and perhaps loses some ability to manage complex financial situations. This risk is enhanced when an individual needs to spread money across several financial institutions, which is the practical effect of the current $100,000 limit.

Because of ownership restrictions in the Internal Revenue Code, IRA holders typically need to spread accounts across different institutions to obtain coverage for more than $100,000. Unlike general accounts, IRA holders cannot benefit from higher coverage levels from multiple accounts at the same institution because of ownership restrictions.

For example, whereas an individual with $200,000 in nonretirement funds could secure full insurance coverage in a single institution by opening two accounts in different legal capacities, the same owner of a $200,000 IRA could not do so. Rather, the money would need to be spread over two separate institutions to maintain coverage. This would also be the case for a widow or widower whose spouse maintained an IRA at the same institution as the surviving spouse. Once the 6 month grace period had passed, the surviving spouse would need to transfer the account to another institution or risk holding uninsured deposits.

- It is inappropriate to require retirees to choose between the safety of their life savings and banking with someone they trust.

For many retirees who prefer insured deposits out of loyalty to a particular institution, this solution is unsatisfactory, and they are forced to choose between maintaining insured deposits and banking with someone they trust. For other retirees who live in small towns, there may in fact be only one local bank, and we cannot assume that they have access to a car or to the Internet.

And even when remote banking may be an option for rural Americans who live in a one-bank town, it is my strong sense that:

- On-line banking is unrealistic for Americans who are not served by broadband capacity;
- Many elderly Americans are not comfortable with electronic commerce and are less likely to take advantage of remote banking facilities even if they have access; and
- Elderly individuals with a strong personal connection to their local bank are far more likely to risk uninsured deposits than to trust an unfamiliar institution with their life savings.

As a general matter, we in the financial planning community encourage investors to diversify their investments to reduce risk to their savings. However, in all candor, we do not necessarily encourage investors to diversify their sources of financial advice.

But spreading insured deposits across several banks accomplishes no risk-spreading for the individual investor other than staying within the deposit insurance limits. In fact, diversification of assets across multiple institutions has serious drawbacks, not least of which is a confusing array of financial statements, which can lead to mistakes in planning, investing and tax reporting.

From a systemic point of view, as Chairman Greenspan has noted wisely, the deposit insurance coverage limit is designed to accomplish *exactly* this objective of encouraging individuals to spread money across banks to reduce the *Government's* risk in any given institutional failure.

In the retirement context, however, it is my strong belief that this is a bad trade-off. The benefits from maintaining an inadequate level of insurance for retirement savings pale in comparison to the potential costs to retirees forced to maintain multiple accounts.

For all these reasons, Mr. Chairman, I strongly urge Congress to increase coverage levels that have not been touched since 1978, and to take measures to ensure that these limits keep pace with the true costs of retirement.

I thank you for this opportunity to present my views to the Subcommittee, and I welcome your questions.

PREPARED STATEMENT OF AMERICA'S COMMUNITY BANKERS

NOVEMBER 1, 2001

America's Community Bankers (ACB)[1] is pleased to submit this statement on the need to increase Federal deposit insurance coverage for retirement accounts. ACB testified on the overall topic of deposit insurance reform on August 2, during which we presented the case for several urgently needed reforms and recommended a substantial increase in coverage for retirement savings. This statement focuses on retirement savings coverage.

Last week, ACB's Chairman, David Bochnowski wrote in the *American Banker* that, "In uncertain times, one certainty remains: Americans must still save for retirement." He went on to say:

> The irony is that some Government policies are sadly out of touch with the realities of the market. When retirement savers moved away from equities and toward bank accounts to protect their financial assets, they discovered that deposit insurance coverage for tax-deferred retirement savings had fallen behind the times and behind inflation. It is past time for Congress to correct the imbalance. (full text attached)[2]

ACB is particularly pleased that FDIC Chairman Donald Powell strongly endorsed increased coverage for retirement accounts in his first statement on deposit insurance reform. On October 17 before the House Subcommittee on Financial Institutions and Consumer Credit, Chairman Powell made these comments:

> There is one class of deposits for which Congress should consider raising the insurance limit, and that is IRA and Keogh accounts. Such accounts are uniquely important and protecting them is consistent with existing Government policies that encourage long-term saving. When we think about saving for retirement in this day and age, $100,000 is not a lot of money. Middle-income families routinely save well in excess of this amount.
>
> Moreover, especially during this time of uncertainty when Americans may be concerned about the safety of their savings, I believe it is important for the U.S. Government to offer ample protection to facilitate saving through vehicles that will redeploy funds into the economy. In my view, we must do whatever we can to provide for ongoing productive investment in our economy and solid, sustainable growth. Higher deposit insurance protection for long-term savings accounts could help.
>
> There is some precedent for providing such accounts with special insurance treatment. In 1978, Congress raised coverage for IRA's and Keogh's to $100,000, while leaving basic coverage for other deposits at $40,000.
>
> The $220 billion of IRA and Keogh deposits currently at banks and thrifts is not large compared to the volume of overall deposits. Thus, if the coverage limit were raised for IRA and Keogh deposits, the initial impact on the fund reserve ratio would not be dramatic. The total volume of IRA's and Keogh's in the economy, more than $2.5 trillion, is enormous, and estimating the influx of retirement account deposits as a result of higher-coverage is subject to some of the same uncertainties that apply to deposits in general. The FDIC is prepared to investigate the implications of higher coverage for these accounts and provide this information to the Congress and the public. We would also note that a phasing-in of higher coverage limits for retirement account deposits could allow for some measure of con-

[1] ACB represents the Nation's community banks of all charter types and sizes. ACB members pursue progressive, entrepreneurial, and service-oriented strategies in providing financial services to benefit their customers and communities.

[2] *American Banker,* October 26, 2001. David Bochnowski is also Chairman and Chief Executive Officer of Peoples Bank in Munster, Indiana.

> trol over the impact on the fund reserve ratio. I urge the Congress to give serious consideration to raising the insurance limit on retirement accounts.

ACB agrees with Chairman Powell that Congress should focus on increasing protection for retirement savings. This is needed to provide adequate coverage for the variety of tax-advantaged savings accounts that have grown substantially over the years, as well as prepare for any Social Security reform, including self-directed accounts should Congress adopt that concept.

ACB agrees with Chairman Powell that retirement coverage should be increased to an amount substantially above the general coverage level. As he pointed out, this is not a new concept; in 1978 Congress provided for $100,000 coverage for retirement savings accounts, two and one-half times the then-current level for regular savings. Higher retirement account coverage would provide a stable funding source for community lending and is extremely important to retirees and those nearing retirement.

Additional retirement account coverage would help implement an important national policy. Congress has just provided substantially enhanced tax incentives to encourage individuals to accumulate retirement savings. These individual savings are often replacing resources that employers previously provided through defined-benefit pension plans. This shift in retirement funding has increased the burden on individuals to manage their own assets. As individuals respond to tax incentives, their retirement assets often exceed by substantial amounts the current $100,000 coverage limit. Since planners generally recommend that individuals shift these savings into more secure and stable investments as they approach retirement, a substantial increase in deposit insurance coverage for retirement savings would be particularly helpful. These plans could be easily defined by requiring that they meet the standards of the Internal Revenue Code. The increased coverage would also be useful if Congress adopts some version of private accounts under the Social Security system.

As long as the fund is above its statutory minimum of 1.25 percent of insured deposits, an increase in coverage for retirement savings should not require an additional minimal premium. Chairman Powell noted that these accounts currently represent a comparatively modest amount as compared to total deposits. We agree with him that a phase in of the increase coverage might be appropriate, since there is a substantial amount of retirement money outside of the banking system. That would mitigate any adverse effect on the FDIC's reserve ratio.

Notably, Chairman Powell did not recommend an increase in general coverage levels. Instead, he recommended that Congress provide for indexing coverage from the current $100,000 level. We agree with Chairman Powell that, "Protecting such an important program from the effects of inflation strikes me as plain common sense." He went on to say that, "The FDIC is not recommending that the safety net be increased. It is simply recommending that the safety net not be scaled back inadvertently because of inflation." Depository institutions and the economy have adjusted to the current level of coverage. Indexing would effectively maintain that level without the need for more Congressional action. Like the increase for retirement savings, indexing general coverage from today's levels should not lead to the imposition of premiums so long as the fund remains above the 1.25 percent level.

Conclusion

ACB appreciates this opportunity to present our views on proposals to increase deposit insurance coverage for retirement savings. This would be a welcome addition to a deposit insurance reform proposal that would merge the deposit insurance funds and give the FDIC the flexibility it needs to deal with the strains imposed by extraordinary growth in insured deposits at a few institutions. We look forward to working with the Congress on these important issues.

Retirement Account Coverage Has Fallen Behind the Times

■ BY DAVID A. BOCHNOWSKI

In uncertain times, one certainty remains: Americans must still save for retirement.

The irony is that some government policies are sadly out of touch with the realities of the market. When retirement savers moved away from equities and toward bank accounts to protect their financial assets, they discovered that deposit insurance coverage for tax-deferred retirement savings had fallen behind the times and behind inflation.

It is past time for Congress to correct that imbalance.

Americans are being asked to personally manage more and more of their retirement funds, so we believe it is essential that they be given far more than the $100,000 of coverage currently available for retirement savings.

With this in mind, America's Community Bankers offered its "strong support for a substantial increase in deposit insurance coverage for retirement accounts" in its comprehensive response to the Federal Deposit Insurance Corp.'s reform options.

Donald E. Powell, the new chairman of the FDIC, understands the problem and has added his views on how to correct it. He recommends phasing in increased deposit insurance coverage for individual retirement accounts and Keogh accounts. His recent proposal before the House subcommittee on financial institutions would increase coverage from $100,000 to as much as $500,000.

"In my view, we must do whatever we can to provide for ongoing productive investment in our economy and solid, sustainable growth," Chairman Powell testified. "Higher deposit insurance protection for long-term savings accounts could help."

We applaud Chairman Powell for his willingness, after less than two months in office, to tell Congress what it needs to hear.

In 1978 Congress raised the insurance coverage for IRA and Keogh accounts to $100,000 while leaving the coverage ceiling for other accounts at $40,000. The differential was eliminated in 1980, when all coverage was set at $100,000. America's savers need to get that differential back.

Congress must close the loop between the promise and the reality of the tax-advantaged savings vehicles it has created and increase the coverage on retirement accounts. Today $100,000 of coverage for retirement accounts is inadequate.

Retirement account deposits held in federally insured banks and savings institutions rose to about $221 billion last year, from about $216 billion in 1999. During the same time, the value of retirement savings invested in mutual funds declined.

Banks are now the first choice as a safe haven for retirement savings, and government policy must match that activity. Retirees and those saving for retirement need the protection that increased coverage for retirement savings would give. It would add stability to our economic system and a new measure of security for our senior citizens. And it could encourage saving, something Americans have not been doing sufficiently in recent years.

As we look to the future, retirement savings accounts, with appropriately increased coverage, could well be a safe and secure vehicle in which retirees could place part of their Social Security benefits — should they one day have that option. ACB urges that retirement savings accounts be part of the discussion when Congress renews its debate on Social Security privatization.

Consider the inconsistency savers face. On the one hand, the government encourages retirement savings through tax-deferred instruments, yet federal policy limits the coverage on those accounts in federally insured banks.

The $1.35 trillion tax reduction bill signed into law in June will raise the contribution limit for IRAs and Keogh accounts to $3,000 next year, $4,000 in 2005, and $5,000 in 2008, with indexing thereafter. Catch-ups of $500 next year and $1,000 in 2006 are provided for people older than 50.

Congress must keep faith with retirement savers. It must close the loop between the promise and reality of the tax-advantaged savings products it has created. Retirees and those saving for retirement need the protection that increased coverage would give.

Community bankers know that increasing coverage on retirement savings accounts in our institutions would also supply an important, new, and stable source of funding. It would strengthen the nation's banking system, add stability to our economic system, and provide a new measure of security for senior citizens.

Many institutions are seeing a growing gap between traditional deposit funding and loan growth. We can no longer sit back and depend on core deposits flowing into the bank.

We need additional sources of funding — not just for the sake of our banks but also for the well being of our customers and communities. They depend on us as the source of funds that build their homes, buy their cars, operate and expand their businesses, buy the seed and fertilizer for their farms, provide consumer goods, and pay for college for their kids.

Retirement savings accounts are an increasingly important source of funding for the nation's banks. Money from these accounts is reinvested in an economy that urgently needs new money. In the case of community banks in particular, these funds are put where we know they will be used to create jobs and help instill a new level of optimism in our country.

America's Community Bankers supports adding higher coverage for retirement savings accounts to H.R. 1293, the Deposit Insurance Stabilization Act, which has won bipartisan support in Congress.

The bill would merge the Bank Insurance Fund and the Savings Association Insurance Fund. It would impose a premium on excessively fast-growing accounts that pay no premiums, and it would eliminate the threat of a 23-basis-point premium if the reserve ratio fell below the statutory minimum. Such a premium could be very damaging not only to banks but also to the economy.

Congress should take Chairman Powell's advice on dramatically increasing retirement savings coverage as it considers reforming the deposit insurance system.

Mr. Bochnowski is the chairman of America's Community Bankers and the chairman and chief executive officer of Peoples Bank in Munster, Ind.

RESPONSE TO A WRITTEN QUESTION OF SENATOR MILLER FROM L. WILLIAM SEIDMAN

Q.1. Mr. Seidman, yesterday in the hearing you said you agreed with raising the deposit insurance coverage level to $200,000 and that doing so would cover retirement accounts. You also said that a study undertaken when you were Chairman of the FDIC showed the increased cost of covering $200,000 versus $100,000 per account in a failure was minimal. So, you are willing to increase the moral hazard to the Government/taxpayer of covering $200,000 per account when an institution fails?

A.1. Yes, weighing the moral hazard risk against the benefits to the small community banks and its depositors, I believe the benefits outweigh the hazard.

NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS
P.O. BOX 3769 • WASHINGTON, DC • 20007-0269
(703) 522-4770 • (800) 336-4644 • FAX (703) 524-1082

October 29, 2001

The Honorable Tim Johnson
Chairman
Senate Banking Committee
Subcommittee on Financial Institutions
United States Senate
534 Senate Dirksen Office Bldg.
Washington, D.C. 20510

Dear Chairman Johnson:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association exclusively representing the interests of our nation's federal credit unions, I am writing to express our support of the idea of raising deposit insurance coverage for Individual Retirement Accounts (IRAs) and Keogh accounts in conjunction with your subcommittee's November 1st hearing on deposit insurance reform.

As you know, the private savings rate in the United States is at its lowest level in more than 40 years. As a result of deeply ingrained spending habits, large numbers of Americans have inadequate savings. Credit unions know that saving is a matter of choice and that the most important factor in long-term wealth accumulation is the act of saving itself. With passage of the *Economic Growth and Tax Relief Reconciliation Act of 2001*, P.L. 107-16, earlier this year, Congress recognized the important role of IRAs by increasing contribution limits. However, no increase in deposit insurance coverage was included in this legislation.

As of June 30, 2001, Federally insured credit unions held $38.4 billion in IRA/Keogh deposits. NAFCU believes that increasing the deposit insurance coverage on IRAs and Keogh Accounts would again spotlight the importance of retirement savings for millions of Americans, causing more people to choose to save. There is a precedent for providing these accounts with a higher insurance coverage. In 1978, Congress raised the coverage amount for IRAs and Keoghs to $100,000, while the basic coverage for other deposits was left at $40,000.

NAFCU is not seeking an overall general increase in the current level of deposit insurance coverage at this time, but strongly believes that whatever insurance coverage is provided for other financial institutions should be provided for credit unions as well. And if such coverage increase is limited to savings vehicles such as IRAs, then that request for "parity" would apply for this limited coverage increase as well.

I want to thank you for the opportunity to share this information with you and the members of the Subcommittee on Financial Institutions and Consumer Credit. If I or the staff at NAFCU may provide you with any further information or be of assistance in any way, please do not hesitate to contact me or our Senior Vice President and General Counsel, Bill Donovan, at (703) 522-4770 ext. 203.

Sincerely,

Fred R. Becker, Jr.
President/CEO

CUNA & Affiliates
A Member of the Credit Union System

Credit Union
National Association, Inc.

Madison, WI Office:
5710 Mineral Point Road (53705)
P.O. Box 431
Madison, WI 53701-0431
Telephone: (608) 231-4010
Fax: (608) 231-4874

Washington, D.C. Office:
Suite 300
805 15th Street NW
Washington, D.C. 20005-2207
Telephone: (202) 682-4200
Fax: (202) 682-9054

Daniel A. Mica
President & CEO

October 29, 2001

The Honorable Tim Johnson
Chairman, Financial Institutions Subcommittee
Senate Banking, Housing and Urban Affairs Committee
534 Senate Dirksen Building
Washington, DC 20510

Dear Chairman Johnson:

On behalf of the Credit Union National Association (CUNA) and more than 80 million credit union members nationwide, I am writing in connection with the November 1st hearing concerning proposals to restructure the federal deposit insurance system. We appreciate your efforts in examining how the federal deposit insurance system in this country is working. As you consider the proposals put forth by the Federal Deposit Insurance Corporation (FDIC), I would ask that for competitive reasons and consumer confidence you include credit union accounts insured by the National Credit Union Share Insurance Fund (NCUSIF) in any increases in insurance coverage limits, whether they are for individual retirement accounts (IRAs) or savings accounts. CUNA has not taken a position on any of the bills that are in front of your committee, but as we have discussed with you in the past, we believe that coverage for credit union accounts insured by NCUSIF must be identical to those accounts insured under the FDIC.

IRAs are the likely vehicles for a typical American household to have amassed an amount over the current $100,000 limit on deposit insurance. More businesses over the last several years have switched from defined benefit pension plans to defined contribution pension plans. As more baby-boomers retire, one result will be that more 401(k) and other defined benefit accounts will be rolled over into IRAs at their local credit unions. Over a lifetime of earnings, even at a modest annual salary, a defined contribution retirement plan could well be worth between $400,000 and $500,000 for a typical credit union member. People of modest means could understandably be hesitant to roll over such amounts of money if they had to worry about the security of their money.

As you know, our national savings rate is exceedingly low. People must be encouraged to save more. The recent tax incentives encouraging people to save for their retirement go a long way toward that goal. Raising the deposit limit on IRAs would work in connection with these tax incentives to entice people to save even more. And having the money in local credit unions will bring comfort to members who retire with a substantial retirement account. Of course, the country prospers when people are less dependent on the government, and policies that encourage people to save for retirement are sound for the future economic success of our country.

In conclusion, I urge you to include the NCUSIF in any effort to increase the insurance coverage limit for IRAs. I would also request that this letter be made a part of the record.

Thank you for your consideration of this matter.

Sincerely,

Daniel A. Mica
President & CEO