



1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

*World-Class Solutions,
Leadership & Advocacy
Since 1875*

Keith Leggett
Senior Economist
Tel: 202-663-5506
Fax: 202-828-4547
Email: kleggett@aba.com

July 31, 2007

Joann Conrad
Project Manager/Specialist Consultant
Washington State Department of Financial Institutions
P.O. Box 41200
Olympia WA 98504-1200

Re: Proposed Rule: Credit Union Alternative Share Insurance Program

Dear Ms. Conrad:

The American Bankers Association (“ABA”) is responding to the Department of Financial Institutions (“DFI”) proposed rule regarding an alternative share insurance program. The ABA, on behalf of the more than two million men and women who work in the nation’s banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

From a public policy perspective, it is important for the DFI to consider the economic disruption that would arise should a private primary insurer’s reserves prove inadequate and also whether taxpayers will be at risk.

History demonstrates that private primary deposit insurers in the past have lacked the liquidity necessary to withstand a large concentration of financial institution failures.¹ A 2003 study by the General Accounting Office concluded, a private share insurer “could find it difficult to cover catastrophic losses under extreme economic conditions because it does not have the backing of any governmental agency.”²

Unlike life or automobile casualty insurance, each individual insured loss in the financial services industry is not necessarily independent of other losses.

As former Federal Reserve Board Chairman Alan Greenspan testified in 2003,

Banking is subject to systemic risk and is thus subject to a far larger extreme loss in the tail of the probability distributions from which real insurance premiums would have to be calculated. Indeed, pricing deposit insurance risks to fully fund potential losses--pricing to eliminate subsidies--could well

¹ Supplemental private deposit insurance, on the other hand, has worked well.

² Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management. General Accounting Office, October 2003 (GAO-04-91), p 70.

require premiums that would discourage most depository institutions from offering broad coverage to their customers.

I note that the difficulties of raising risk-based premiums explain why there is no real private-insurer substitute for deposit insurance from the government. No private insurer would ever be able to match the actual FDIC premium and cover its risks. A private insurer confronted with the possibility, remote as it may be, of losses that could bankrupt it would need to set especially high premiums to protect itself, premiums that few, if any, depository institutions would find attractive. And if premiums were fully priced by the government or the private sector, the depository institutions would likely lower their offering rates, thereby reducing the amount of insured deposits demanded, and consequently the amount outstanding would decline.³

Therefore, in the analysis of then Federal Reserve Board Chairman Greenspan, if a private insurer priced its services to cover its risk, it would find few takers, and they would be likely to reduce the amount of deposits that they would accept from customers. Alternatively, if it lowered its premiums to make its service attractive, it would not have adequate reserves to cover its potential losses.

Furthermore, sound insurance underwriting practices advocate the diversification of risk. However, private share insurance has limited geographic diversification, unlike federal deposit insurance. Only nine states actively authorize state-chartered credit unions to have private primary share insurance. Three states (CA, IL, and NV) account for almost 75 percent of insured deposit exposure, and 42 percent of insured deposits are in California alone. This means a private share insurer is highly susceptible to local economic shocks.

Moreover, another concern of ABA is that adoption of private primary share insurance for credit unions would make bad public policy, as it would allow insured credit unions to circumvent the Prompt Corrective Action (“PCA”) capital triggers and the aggregate business loan cap of 12.25 percent of assets established by Congress in 1998. Doing so would allow privately insured credit unions to engage in riskier activities, while lowering the minimum amount of capital they would be required to hold against potential risks, a combustible combination fraught with potential for financial disaster.

When Congress passed the Credit Union Membership Access Act of 1998 (CUMAA), it imposed a limit on business lending, set at 12.25 percent of total assets. This was intended to ensure that credit unions remained focused on meeting the needs of consumers and kept a low exposure to riskier commercial lending. The legislative history for CUMAA explained that the business lending restrictions--

...are intended to ensure that credit unions continue to fulfill their specified mission of meeting the credit and savings needs of consumers, especially persons of modest means, through the emphasis on consumer rather than business loans. The Committee action will prevent significant amounts of

³ <http://www.federalreserve.gov/boarddocs/testimony/2003/20030226/default.htm>

credit union resources from being allocated to large commercial loans that may present additional safety and soundness concerns for credit unions and that could potentially increase the risk of taxpayer losses through the National Credit Union Share Insurance Fund. (Senate Report 105-193, May 21, 1998, pp.9-10)

Congress, also, established a minimum leverage ratio of six percent for a credit union to be adequately capitalized to ensure the financial stability of the credit union industry, because (1) credit unions can and should only build capital through retained earnings, and (2) credit unions hold “investments” in their insurance fund and corporate credit unions which are claims on the credit unions’ capital that must be taken into account.

In conclusion, the lack of diversification and any government backing raise major policy concerns about the adequacy of reserves for a private insurer, and the private insurance option is an avenue for credit unions to proceed to riskier operations while reducing their capital cushion against losses. Therefore, the ABA recommends that the DFI withdraw its private share insurance proposal.

Sincerely,

A handwritten signature in black ink, appearing to read "Keith Leggett". The signature is written in a cursive style with a large, stylized initial "K".

Keith Leggett