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Federal Deposit and Share Insurance: Proposals for Change

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Summary

Deposit insurance for holders of accounts at banks and thrift institutions has been under scrutiny for the last several Congresses. Successive Congresses have seen introduced legislation to change the pricing of insurance, the coverage for customers' accounts, and the finances of the insuring Federal Deposit Insurance Corporation (FDIC). Changes could affect the condition of insured depository institutions, the strength of the insurance funds, and competition among financial institutions. Increases in some kinds of financial risks have led some to suggest that deposit insurance may need reform. The 108th Congress reexamined these issues. H.R. 522, the Federal Deposit Insurance Reform Act of 2003, revisited an even earlier House-passed measure. It sought to restructure the FDIC, change the pricing of insurance, increase basic per-account coverage to $130,000, indexed for future inflation, and increase insurance of municipal deposits. H.R. 522 passed the House on April 2, 2003, but went no further. In the 109th Congress, H.R. 1185, the Federal Deposit Insurance Reform Act of 2005, received approval from the House by 413-10 on May 4, 2005. The Administration continues to support reform in similar terms, but opposes raising basic coverage of accounts to $130,000. This report will be updated as warranted.

What is Deposit Insurance and How is It Administered?

The full faith and credit of the United States stands behind more than $3.7 trillion of insured deposits at banks and savings associations. This insurance guards savers' accounts up to $100,000, providing stability to banks and to the economy. Congress legislated deposit insurance in the 1930s, and modified it in 1989 and 1991 in response to financial crises. All banks and savings associations must carry this insurance. The insurance does not cover deposits held in foreign offices, nor deposits above the legislated ceiling, despite their importance to very large banks. Smaller institutions find deposit insurance, including extra coverage for certain special accounts, very valuable.

Pursuant to P.L. 101-73 and P.L. 102-242, the independent agency Federal Deposit Insurance Corporation (FDIC) has two funds. Both funds are interest-earning accounts maintained with the U.S. Treasury. The Bank Insurance Fund (BIF) dates from 1934. Congress intended it and its ancestor the Permanent Insurance Fund to cover commercial bank deposits. BIF members are predominantly commercial and savings banks supervised by the FDIC, the Office of the Comptroller of the Currency (OCC), or the Federal Reserve (Fed). Some are "industrial loan companies" not otherwise federally regulated. (See CRS Report RL32767.) The Savings Association Insurance Fund (SAIF) is the successor to a failed fund (the Federal Savings and Loan Insurance Corporation) covering savings institution deposits. SAIF members are predominantly thrift institutions supervised by the Office of Thrift Supervision. Many institutions have deposits that the "other" fund insures because of mergers. Institutions do not "own" either fund. BIF and SAIF balances are on-budget assets of the federal government. Except for the specific institutions covered, BIF and SAIF are essentially identical.

Federal law requires institutions to pay semiannual assessments reflecting their own risk and other factors, and makes premiums reflect the relative sizes of BIF and SAIF. Both funds have target reserve ratios of 1.25% ($1.25 per $100) of insured deposits. That percentage is the statutory Designated Reserve Ratio (DRR). When either fund exceeds that value, its members do not have to pay assessments, unless capital or managerial deficiencies place them in a risk category above the safest. Institutions regard fund balances much above than 1.25% as "excess deposit insurance" that the FDIC should refund to them. Institutions argue that, in the general spirit of tax cuts, that banks having paid into their respective fund should get back their "surplus." In the other direction, should either fund fall below its DRR, institutions must pay to fill the fund's shortfall. That would greatly increase the near-zero cost of deposit insurance. Many would prefer to smooth out assessments over time as needed to maintain adequate fund balances, which as **Table 1** shows, have fluctuated markedly since 1990. Since 2003, fund ratios have been trending downward.

A separate organization has insured accounts at credit unions since 1970: the National Credit Union Share Insurance Fund (NCUSIF). The National Credit Union Administration administers the fund. While all federally chartered credit unions must belong to NCUSIF, state-chartered ones may elect it. Credit unions, owning NCUSIF, have put 1% of their total "shares" (deposits) into NCUSIF, beginning in 1985. Their contributions remain assets of the credit unions. While it may levy a premium, the NCUA has done so only when three large New England credit unions failed in 1992. NCUSIF's reserve ratio is 1.28% of insured deposits, based on a balance of $6.4 billion, within its targeted 1.25% to 1.30% range. Like the FDIC funds, the "full faith and credit of the U.S. Government" backs it. Its coverage is essentially identical to that of both FDIC funds.

Observers have universally deemed federally backing essential, as history has shown that guarantees short of the national level are inadequate to prevent panics, runs, and severe economic damage when called upon. The original state funds insuring bank deposits, and most of their descendants, collapsed under pressure, and, while private deposit insurance remains vestigially available, it is not significant.

Table 1. Financial Position of Bank and Savings Association Insurance Funds, 1990-2005

End of Year	BIF		SAIF	
	Balance, $Billions	Reserve Ratio, %	Balance, $Billions	Reserve Ratio, %
1990	$4.0	0.21%	$0.0	0.00%
1991	-7.0	-0.36	0.1	0.01
1992	-0.1	-0.01	0.3	0.04
1993	13.1	0.69	1.2	0.17
1994	21.8	1.15	1.9	0.28
1995	25.5	1.30	3.4	0.47
1996	26.9	1.34	8.9[a]	1.30[a]
1997	28.3	1.38	9.4	1.36
1998	29.6	1.39	9.8	1.39
1999	29.4	1.37	10.3	1.45
2000	31.0	1.35	10.8	1.43
2001	30.4	1.26	10.9	1.36
2002	32.1	1.27	11.7	1.37
2003	33.8	1.32	12.2	1.37
2004	34.8	1.30	12.7	1.34
2005: Q1	34.8	1.27	12.8	1.32

Source: Federal Deposit Insurance Corporation.

a. After recapitalization pursuant to the Deposit Insurance Funds Act, P.L. 104-208.

Issues

The current round of congressional consideration of changes in federal deposit insurance began in February 2000 when the House Banking Subcommittee on Financial Institutions held hearings. Questions raised included:

- Should Congress increase the $100,000 coverage for deposits at banks and savings associations, and shares at credit unions? Should inflation adjustment, perhaps retroactively since 1980, and in future years, "index" FDIC coverage?
- Should government and retirement deposits be insured at a greater level?
- What should institutions pay for deposit insurance coverage and associated regulation? Should premiums be smoothed out over time?
- If the balances in BIF and SAIF exceed amounts necessary to provide adequate coverage, what should be done with the excess? Would refunds weaken the FDIC?
- Is no- or very low-cost deposit insurance a subsidy to banks in their competition with nonbank financial firms? Or does it offset costs of bank-only regulations?
- Should BIF merge with SAIF, as P.L. 104-208 planned in 1996?
- Are there better avenues to monitor and restrain risk-taking before it results in FDIC payouts? Are some institutions too-big-to-fail?

- Should rapidly-growing banks who have paid little or no assessments, the so-called free riders, be assessed premiums to compensate for their increased exposure to payouts and decrease in fund reserve ratios?
- What changes affecting FDIC operations might apply to credit unions?

Policy Considerations

Policymakers must weigh many factors. A key issue is how to provide the benefits of deposit insurance without lessening the incentives for managers to engage in prudent operating practices. Owners and managers at covered institutions may take on greater risks, in the expectation of greater rewards, if they know that customers are unlikely to withdraw their insured deposits. Observers call such behavior a "moral hazard." The effectiveness of examination and supervision arrangements thus has an important bearing on risk exposure of the insurance funds. Regulation of banks and savings associations to prevent failure ideally would prevent the FDIC from having to make good on its guarantee. No system is failure-proof, however. In a competitive economy, bad business decisions resulting in closure guide future capital investment away from practices that failed. Banks and savings associations are not exempt from this fact.

Tradeoffs exist among proposals for change. For example, increased account coverage could require greater reserves at BIF and SAIF, making it less likely that the costs of FDIC insurance remain low. Alternatively, should risk increase in financial markets, or the funds' coverage of insured deposits become very thin, institutions might have to pay larger assessments. Competitive equality is an important consideration for different institutions (large versus small, banks and savings associations versus credit unions, for example). Expansion of the federal safety net through the FDIC would have to be funded. Payment would come from institutions; taxpayer funding appears unlikely.

FDIC Recommendations and Congressional Activity

2001. In the 107th Congress, outgoing FDIC Chairman Tanoue said the agency would like Congress to make improvements. It sought to merge the BIF and SAIF funds. It sought to charge regular premiums based on institutions' risks, whatever the level of the reserve ratio of the fund(s). It suggested adjusting premiums gradually up or down as the health of the fund(s) changes. If it made rebates, the agency would base them on past contributions. It also suggested indexing the basic account coverage, to keep pace with future inflation, not necessarily boosting standard account coverage to $130,000.

2002. New FDIC Chairman Powell carried the effort forward. H.R. 3717, the Federal Deposit Insurance Reform Act of 2002, passed the House by 408-18 on May 22, 2002. The House-passed bill would have done several things: (1) Created a range of reserve ratios, rather than the DRR of 1.25%. The range could float between 1.15% and 1.40%. (2) Merged BIF with SAIF, into a single Deposit Insurance Fund. (3) Increased basic account protection to $130,000. (4) Indexed future basic coverage to inflation every five years. (5) Covered many retirement (IRA and "401(k)") accounts for $260,000. (6) Increased coverage of within-state municipal deposits, to a maximum of $2 million. (7) Given banks refunds of premiums should the Deposit Insurance Fund exceed 1.35%, ending their payments now required when the ratio of insured deposits to their fund falls short. (8) Provided FDIC flexibility for reserving against future losses, recapitalizing the new Fund, and adjust basic account coverage according to inflation. (9) Credited institutions for assessments based on their insured deposits at the end of 1996, reducing their net assessments. (10) Raised protection at credit unions to that of banks.

2003. In the 108th Congress, H.R. 522 was very similar to S. 229. Both mirrored the bills noted above from the 107th Congress. H.R. 453, introduced by Representative Gillmor, sought FDIC coverage of municipal (federal, state, local, etc.) governmental bodies up to $2 million per account or lesser coinsured amounts. The Administration sought merging of the two FDIC funds; making a new floating reserve ratio for the merged fund so that it would remain adequately capitalized; and requiring all institutions — despite capital rating — to pay assessments. The agency, which Congress would have granted more discretionary power under the plan, has been prohibited since 1996 from charging premiums to well-capitalized and well-run institutions, leaving fewer than 10% of depositories paying insurance premiums. Banks controlled by Citigroup and Merrill Lynch, for example have large amounts of insured deposits, yet have paid little or no premiums because of their safety and soundness ratings.

The Oxley-Frank Managers' Amendment to H.R. 522 aimed to do the same things as H.R. 3717 of the prior year. On April 2, 2003, the House approved the bill. Fears persisted that general coverage of $130,000, with indexing to inflation, would increase FDIC's liability in failures. Members defeated an amendment of Representatives Ose and Maloney to remove that coverage increase.

2004. Smaller banks, and at least potentially, retirees, were thought to be the main beneficiaries of higher deposit protection. Yet, the Administration and Fed were concerned that the increase would raise risk without much benefit. (The vast majority of depositors have fully insured accounts.) Larger institutions and many government officials opposed an increase as costly: to the FDIC, and to the industry paying for more insurance. In the Administration's view, more coverage would have lessened depositors' care in monitoring banks, which could lead to costly bank failures. Disagreement over the proposed $130,000 ceiling thus immobilized legislation in the Senate.

2005. In the 109th Congress, Chairman Powell suggested that a two-tiered safety net might cover differing sizes of banks. The largest institutions might enter a risk pool appropriate for systemic risk protection. Community banks could remain in much the current arrangement. In addition, the Administration's budget for FY2006 proposed that the BIF and SAIF Funds be merged, with the FDIC being allowed to set premiums as user charges for increasing insured deposits or above-average risk.

In the House, sponsors effectively merged two bills. H.R. 1185 was essentially identical to House-passed H.R. 522 of the 108th and H.R. 3717 of the 107th Congresses. H.R. 544, now folded into H.R. 1185, added a doubling of insurance on municipal deposits. The current Federal Deposit Insurance Reform Act of 2005, H.R. 1185, would

— merge the two funds into the new Deposit Insurance Fund,

— create a range of 1.15% to 1.40% for the FDIC to set the reserve ratio,

— require minimum assessments for all institutions,

— give the FDIC flexibility in setting assessments, including penalties,
— provide for dividends if the new fund exceeded 1.35%, and credits for institutions insured in 1996,
— increase coverage limits for individual accounts to $130,000,
— index future coverage limits to inflation,
— double coverage limits for certain types of retirement accounts and 401(k)s,
— increase coverage for instate municipal deposits up to the lesser of $2 million or $130,000 per account plus 80% greater than $130,000 (as in H.R. 544),
— increase credit union share insurance to conform to FDIC coverage, and
— require studies of deposit and share insurance and related matters.

The Financial Services Committee approved H.R. 1185 by voice vote on April 27, 2005. It received House floor approval by a vote of 413-10, essentially the same margin as did its predecessors. An amendment of Representative Rohrabacher to maintain the basic coverage of accounts at $100,000 was defeated.

For a framework to evaluate FDIC financing, see CRS Report RL31552. The potential for BIF premiums being levied on banks because of the downtrending reserve ratio and deposit growth has been an important driver of legislative activity. For analysis of premiums through 2004, some of which have been very high, see CRS Report RS21719. Increasing the coverage of most accounts remains contentious; see CRS Report RL31463. The latest Congressional Budget Office analysis of deposit insurance policy options appeared as *Modifying Federal Deposit Insurance* on May 9, 2005.