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Federal Deposit Insurance Reform Legislation (Including Budgetary Implications)

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Summary

Two major deposit insurance reform bills are currently before Congress. The Federal Deposit Insurance Reform Act of 2005, H.R. 1185, was initially approved by the House on May 4, 2005. The Safe and Fair Deposit Insurance Act of 2005, S. 1562, was reported as amended by the Committee on Banking, Housing, and Urban Affairs on October 18, 2005.

Because both bills would effectively raise assessments paid by banks and savings associations to the deposit insurance funds, they contribute to the budget reconciliation process. The House bill reduces net direct spending by about $200 million over five years ($2.5 billion over 10 years), whereas the Senate bill scores reductions of $300 million over five years ($2.46 billion over 10 years). As a result, both bills have been attached to the budget reconciliation process. S. 1562 is Title II, Subtitles A and B of S. 1932, the Deficit Reduction Omnibus Reconciliation Act of 2005, passed by the Senate on November 3, 2005. In the House, H.R. 1185 is Title IV of H.R. 4241, the Deficit Reduction Act of 2005. Both deposit insurance bills, as passed (House) and as reported (Senate), are identical to their respective reconciliation versions.

These measures, culminating years of congressional attention, share many provisions, yet differ significantly in others. Both would merge the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into a new Deposit Insurance Fund (DIF) for all depository institutions (except credit unions, which would continue with their own insurance fund). Both would replace the designated reserve ratio with a range within which the Federal Deposit Insurance Corporation (FDIC) would operate DIF. Both would raise the $100,000 coverage limit for deposit insurance for at least some accounts. Credit union coverage would change in step with banks and thrifts. Both bills would allow for refunds of excess reserves to well-capitalized banks. Both bills would require the FDIC to give credit to institutions for past premium payments if the FDIC must make new assessments, thus accounting for the disparity between old and newer institutions.

The bills differ in important respects. Insurance coverage limits rise immediately for most accounts in the House bill and would be indexed for inflation automatically at five-year intervals in the future. The Senate bill increases coverage limits immediately for retirement accounts and allows the FDIC, at its discretion, to increase limits for all accounts at five-year intervals in the future. The House allows for both one-time and ongoing credit pools against future premiums, whereas the Senate allows only an initial credit. The House, but not the Senate, would limit premiums paid by well-capitalized and operated banks, so long as the new insurance fund was within the reserve range.

This report will be updated as warranted by events.

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Federal Deposit Insurance Reform Legislation (Including Budgetary Implications)

Introduction

Two major deposit insurance reform bills are currently before Congress. The Federal Deposit Insurance Reform Act of 2005, H.R. 1185, was approved by the House on May 4, 2005.[1] The Safe and Fair Deposit Insurance Act of 2005, S. 1562, was reported as amended by the Committee on Banking, Housing, and Urban Affairs on October 18, 2005. Because of their budgetary implications, both bills have subsequently been attached to the budget reconciliation process in the House and Senate. The House bill is unchanged from the version that was passed in May. These measures, culminating years of congressional attention, share many provisions, yet differ significantly in others.

Regulatory Considerations

The impetus for reform legislation lies in the structure of the current deposit insurance system. The Federal Deposit Insurance Corporation (FDIC) oversees deposit insurance operations for banks and savings associations. (The National Credit Union Association [NCUA] is responsible for credit unions.) The FDIC runs two separate funds — the Bank Insurance Fund (BIF) for banks and the Savings Association Insurance Fund (SAIF) for thrift institutions — and assesses premiums according to the adequacy of the separate funds as determined by a "designated reserve ratio."

For several years, the best capitalized and managed banks and thrifts have paid nothing into the fund because regulators rate them in the highest categories of safety and soundness, and because both BIF and SAIF were above their reserve ratios. During the same period, however, deposits have grown, both at long-established banks and at newly started banks, so that insurance reserves have fallen as a percentage of total covered deposits. Should the reserves fall below the designated reserve ratio (1.25% of covered deposits for each fund), the FDIC will be forced to raise premiums charged to fund members to maintain capitalization of the insurance

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[1] For background information on deposit insurance and its legislative issues, see CRS Report RS20724, *Federal Deposit and Share Insurance: Proposals for Change*, by William Jackson; CRS Report RL31552, *Deposit Insurance: The Government's Role and Its Implications for Funding*, by Gillian Garcia, William Jackson, and Barbara Miles; and CRS Report RS21719, *Bank and Thrift Deposit Insurance Premiums: The Record from 1934 to 2004*, by Barbara Miles and William Jackson.

funds. Because financial institutions operate on low profit margins but a large dollar volume of transactions, small percentage changes in premiums can result in large profitability swings.

This situation has produced a series of issues.

- Should Congress merge the BIF with the smaller, better capitalized SAIF? A merger would be largely a matter of bookkeeping, there being little or no regulatory difference between banks and savings associations. A merger would delay, for a short time, the need to raise premiums on BIF-covered institutions.

- Should Congress raise coverage for some or all types of accounts to reflect the effects of inflation since the last increase (in 1980, to $100,000 for general accounts)? Higher coverage would allow greater protection to depositors. It also would raise the moral hazard risk for the insurer, in that banks would arguably take greater risks in their lending to produce greater rewards, knowing that depositors had no reason to be concerned about the safety of their savings.[2] Any increase in coverage would also further dilute the insurance reserve(s) and cause banks to pay higher premiums sooner.

- Should the designated reserve ratio remain at its current, statutorily set minimum percentage of covered deposits or at a range within which the fund(s) operate(s)? A range would allow the FDIC greater discretion in assessing premiums and would add a ceiling to the allowable reserves, above which bankers would pay no premiums and might receive refunds of excessive reserves.

- Should de novo (newly formed) banks, which have never paid premiums, be required to pay premiums before requiring new premiums from older institutions that have recapitalized the funds over the years? Alternatively, should older institutions receive some credit for premiums they have paid in earlier years?

- Should there be a limit on assessments made on banks in the highest categories of safety and soundness? Should there be refunds to such banks when the insurance fund is above the designated reserve ratio?

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[2] Moral hazard is the natural result of the major purpose of deposit insurance, which is to protect banks from panics in which depositors, fearing bank failures, withdraw their funds and leave banks unable to make new loans or even maintain outstanding loans. Because banks hold only fractional reserves, no bank, not even one that is healthy, could long withstand a serious "run" on deposits. Lending would contract, and the economy with it, as occurred most notably in the 1930s, when there was no deposit insurance to allay depositor concerns.

Budgetary Considerations

The Federal Deposit Insurance Corporation accounts are on-budget. Because both bills would effectively raise assessments paid by banks to the deposit insurance funds, they contribute to the budget reconciliation process by reducing net direct spending by about $200 million over five years or by $2.5 billion over 10 years for the House bill, and $300 million over five years or $2.46 billion over 10 years for the Senate bill.[3] S. 1562 provided the Senate Banking Committee's reconciliation recommendation and is part of the Deficit Reduction Omnibus Reconciliation Act of 2005 (S. 1932, Title II, Subtitles A and B). The Senate approved S. 1932 on November 3, 2005.

Similarly, the Financial Services Committee voted on October 27 to recommend H.R. 1185 to the House budget reconciliation process. The House provisions appear in Title IV of H.R. 4241, the Deficit Reduction Act of 2005. The House Budget Committee approved its measure on November 3.

Major Differences Between House and Senate Bills

The House and Senate bills agree on most points: both would merge BIF and SAIF into a new Deposit Insurance Fund (DIF) for all depository institutions (except credit unions, which would continue with their own insurance fund). Both would replace the designated reserve ratio with a range within which the FDIC would operate DIF. Both would raise the $100,000 coverage limit for deposit insurance for at least some accounts. Credit union coverage would change in step with banks and thrifts. Both bills would allow for refunds of excess reserves to well-capitalized banks, and both would require the FDIC to give credit to institutions for past premium payments if the FDIC must make new assessments, thus accounting for the disparity between old and newer institutions.

The bills differ in some important details. The Senate-designated reserve range is wider (with a higher ceiling) than that of the House. The House would raise coverage for nearly all deposits and index future increases for inflation. The Senate would restrict initial coverage increases to retirement accounts and allow the FDIC discretion to increase coverage generally, beginning in 2010 and at five-year intervals thereafter. The House would allow for continuing premium credits for banks that have paid into the funds in the past, whereas the Senate proposes a one-time only credit. The House limits the FDIC to a one-basis-point ceiling on the percentage of covered deposits to be paid as premiums by banks in the best safety and soundness categories.[4] The Senate has no limit.

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[3] Congressional Budget Office Cost Estimates for H.R. 1185, Apr. 29, 2005, and Reconciliation Recommendations of the Senate Committee on Banking, Housing, and Urban Affairs, Oct. 24, 2005.

[4] A basis point is one one-hundredth of a percent, or 0.0001 times covered deposits.

The differences between the two bills led to separate cost estimates from the Congressional Budget office with respect to budget reconciliation. The major difference between the versions lies in the coverage increases included in the House bill, but not the Senate bill. These increases raise liabilities to the insurance fund and, therefore, increase the anticipated cost of resolving institutions that may fail in the future. The combination of expected premiums and credit in the House bill are also scored as producing higher revenues for the insurance fund than in the Senate bill, but not by enough to offset the increased future expected payouts. The merger of BIF and SAIF produces a temporary timing change in premium receipts that disappears over time. During a 10-year budget window, the House measure is scored as increasing collections by $3.8 billion, whereas the Senate bill boosts receipts by $2.8 billion, both net of credits. The House bill would increase future costs of resolving failed financial institutions by $1.4 billion; the Senate would increase resolution costs by $350 million.

The following table provides a side-by-side summary of the two proposals. Neither was changed when included in their respective budget reconciliation packages.

Table 1. Provisions of Deposit Insurance Reform Legislation

Provision	H.R. 1185 (as attached to H.R. 4241, Title IV)	S. 1562 (as attached to S. 1932, Title II)
Short Title	Federal Deposit Insurance Reform Act of 2005	Safe and Fair Deposit Insurance Act of 2005
Deposit Insurance Funds		
Merge BIF and SAIF	Merges BIF and SAIF into new Deposit Insurance Fund (DIF).	Same.
Effective Date	First day of first calendar quarter after the end of the 90-day period beginning on date of enactment.	Same.
Deposit Insurance Coverage		
Increase Standard Deposit Insurance Ceiling	Increases from $100,000 to $130,000 for institutions covered by DIF and the NCUA. Provides that agencies must calculate an inflation adjustment starting April 1, 2007, and the first day of each subsequent 5-year period, using the change from enactment to the preceding end-of-year Personal Consumption Expenditures Chain Index of the Department of Commerce, rounded to the nearest $10,000. Agencies must publish the new maximum insurance amount in the *Federal Register* and report to Congress no later than April 5 of any calendar year in which an adjustment is required.	No increase in standard coverage. By April 1, 2010, and the first day of each subsequent 5-year period, the FDIC shall determine whether to increase the standard deposit insurance ceiling, based on economic conditions affecting insured depositories; risk to the DIF; demonstrated need by depositories for inflation adjustment; ability of depositories to identify and obtain alternative funding sources; ability of depositories to meet community credit needs; potential problems affecting depositories; and other factors deemed appropriate. Similar calculation to House bill.
Retirement Accounts	Increases retirement account insurance from $100,000 to twice the standard insurance ceiling ($260,000 initially).	Increases coverage to $250,000. Provides for inflation adjustment at 5-year intervals beginning with 2010.
Passthrough Insurance for Employee Benefit Plans	Insurance coverage on a prorated basis to participants in an employee benefit plan. Institutions not "well" or "adequately" capitalized may not accept these plan deposits.	Same.

Provision	H.R. 1185 (as attached to H.R. 4241, Title IV)	S. 1562 (as attached to S. 1932, Title II)
Municipal Deposits	For municipal depositors in the same state as the office or branch of the depository where they hold the deposits, the insurance ceiling is raised to the lesser of $2,000,000 or the sum of the standard insurance amount and 80% of deposits above the standard insurance amount. No state may deny any depository in its jurisdiction the authority to accept such deposits, nor prohibit in-state municipal depositors from making deposits in such depository.	No change. No inflation adjustments.
Effective Date	Coverage changes are effective on the date that final regulations take effect. Regulations must be final by 270 days after enactment.	Same.
FDIC Assessments		
Setting Assessments	In setting assessments for insured depositories, the FDIC is to consider the estimated operating expenses of the DIF; estimated case resolution expenses and income of the DIF; projected effects of paying assessments on capital and earnings of insured depositories; risk and other factors under the risk-based system; and other factors the FDIC deems appropriate.	Similar.
Base Rate	A base rate of not more than one basis point (exclusive of any credit or dividend) for depositories in the lowest-risk category. No institution is barred from the lowest-risk category solely because of size. The one-basis-point limit may be set aside if the DIF is below 1.15% of aggregate insured deposits.	No provision.

Provision	H.R. 1185 (as attached to H.R. 4241, Title IV)	S. 1562 (as attached to S. 1932, Title II)
Record-Keeping Period	The period a depository must keep assessment-related records is shortened to three years from assessment due date or resolution of a dispute between the depository and the FDIC, whichever is later.	Same.
Penalty for Late Assessment Payments	Except in cases of dispute, failure to pay any assessment is subject to a penalty of not more than 1.0% of the assessment due for each day the payment is late.	Same.
Lifeline Accounts	Lifeline accounts are to be assessed at half the rate that would otherwise apply.	No provision.
Designated Reserve Ratio		
Replace Ratio with a Range	The FDIC shall at least annually determine a ratio not to exceed 1.4% nor fall below 1.15% of insured deposits. The FDIC is to take into account risk of losses to the DIF in the current and future years; economic conditions affecting depositories to allow the ratio to rise during favorable conditions and to decrease in less favorable conditions; prevention of sharp swings in assessment rates; and other factors as appropriate.	Range for the reserve ratio is 1.15% to 1.5% of insured deposits. Otherwise similar.

Provision	H.R. 1185 (as attached to H.R. 4241, Title IV)	S. 1562 (as attached to S. 1932, Title II)
Risk-based Assessment System		
Information and Modification	In determining risk of losses at depositories and economic conditions affecting them, the FDIC is to collect information from all federal banking agencies as well as available data from state bank supervisors, insurance and securities regulators, the Securities and Exchange Commission, Secretary of the Treasury, Commodity Futures Trading Commission, Farm Credit Administration, Federal Trade Commission, Federal Reserve Banks and Home Loan Banks, and other regulators, and credit rating entities and other private economic or business analysts. Consultation with federal banking agencies is required in assessing risk of loss to the DIF. Modifications to the risk-based assessment system may be final only after a period of notice and comment.	No provision.
Refunds, Dividends, and Credits from Deposit Insurance Fund		
Refunds	Overpayments of assessments may be refunded or credited toward subsequent assessments.	No provision.

Provision	H.R. 1185 (as attached to H.R. 4241, Title IV)	S. 1562 (as attached to S. 1932, Title II)
Dividends	Dividends are payable to depositories according to the reserve ratio: when the ratio exceeds 1.4% of insured deposits, the fund pays the full amount in excess of 1.4% to depositories; when it is at or above 1.35%, up to 1.4%, the fund pays half the amount needed to maintain 1.35%. Distribution of dividends depends on (1) the ratio of a depository's assessment base on December 31, 1996, to the aggregate base of all eligible depositories on that date; (2) the total amount of assessments paid on or after January 1, 1997 by the depository to DIF (or BIF or SAIF); (3) assessments paid that reflect higher levels of risk at the depository; (4) other factors deemed appropriate.	Similar, except full dividends occur when the reserve ratio exceeds 1.5%, and half dividends when the ratio equals 1.4% up to 1.5%.
One-time Credit Pool	One-time credit based on total assessment base, year-end 1996: by 270 days after enactment, the FDIC shall provide for a credit to eligible depositories, based on the assessment base of the institution on December 31, 1996, compared with the aggregate base of all eligible depositories. Aggregate credits shall equal what the FDIC could collect if it imposed a 12-basis point assessment on the combined base of the BIF and the SAIF as of December 31, 2001. Eligible depositories are those that were in existence on December 31, 1996 (or successors), and paid an assessment before that date.	Same except the aggregate credits available are based on a 9-basis point assessment instead of 12.

Provision	H.R. 1185 (as attached to H.R. 4241, Title IV)	S. 1562 (as attached to S. 1932, Title II)
Application of Credits	Credits are applied to assessments due after effective date of regulations. Institutions with financial, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory, or that are not adequately capitalized, may use credits only up to the amount calculated by applying the average assessment rate for all depositories.	Similar, but institutions with weaknesses are not mentioned in this context.
Ongoing Credit Pool	Besides the one-time credit, the FDIC is to apply a system of credits to future assessments on the same basis as dividends. No credits are awarded if the reserve ratio of the DIF is below the designated ratio, or if the reserve ratio is less than 1.25% of insured deposits.	No provision.
Deposit Insurance Fund Restoration		
DIF Restoration	The FDIC shall implement a restoration plan within 90 days whenever it projects that the reserve ratio of DIF will fall below the minimum ratio within six months; or if the ratio falls below minimum. The plan is adequate if it provides for reaching the minimum within 10 years. The agency may restrict application of credits during such restoration period to the lesser of any assessment or three basis points.	No provision.
Regulations Required		
Regulations	Within 270 days, the FDIC shall issue final regulations (1) designating the reserve ratio for DIF, (2) effecting increases in insurance coverage, (3) implementing the one-time credit, and (4) providing for assessments under restoration conditions.	Similar, except adds regulations for qualifications and procedures that the FDIC may use to provide the one-time assessment credits.

Provision	H.R. 1185 (as attached to H.R. 4241, Title IV)	S. 1562 (as attached to S. 1932, Title II)
Studies		
By the Comptroller General	Study and report within one year on (1) efficiency and effectiveness of prompt corrective action programs and (2) appropriateness of FDIC's organizational structure considering size and complexity of depositories, how agency structure affects operational costs, and effectiveness of internal controls.	No provision.
By the FDIC and NCUA	Study and report within one year on (1) feasibility of voluntary deposit insurance system for deposits above the maximum federal coverage and (2) feasibility of privatizing deposit insurance.	Study and report within one year on (1) voluntary insurance as in House bill and (2) increasing coverage of "general local government" accounts.
By the FDIC	Study and report within one year on feasibility of using actual domestic deposits rather than estimated insured deposits for DIF reserve ratios. Study and report within six months on reserve methodology and loss accounting used between January 1, 1992, and December 31, 2004 with respect to troubled institutions.	Study and report within one year on the feasibility of using alternatives to estimated insured deposits in calculating the reserve ratio of the Deposit Insurance Fund.
Bi-Annual Survey on the Unbanked	The FDIC shall conduct a biannual survey on efforts by depositories to bring the "unbanked" into the conventional finance system.	No provision.