Congressional Research Service

Federal Deposit Insurance for Banks and Credit Unions

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March 23, 2011

Congressional Research Service
7-5700
www.crs.gov
R41718

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The Federal Deposit Insurance Corporation (FDIC) was established as an independent government corporation under the authority of the Banking Act of 1933, also known as the Glass-Steagall Act (P.L. 73-66, 48 Stat. 162, 12 U.S.C.), to insure bank deposits. The FDIC is funded through insurance assessments collected from its member depository institutions and held in what is now known as the Deposit Insurance Fund (DIF). The proceeds in the DIF are used to pay depositors if member institutions fail.

The Federal Credit Union Act of 1934 (P.L. 73-467) formed a national system to charter and supervise federal credit unions, and the National Credit Union Administration (NCUA) became an independent federal agency in 1970 (P.L. 91-468, 84 Stat. 994). The NCUA is funded through insurance assessments collected from its member credit union institutions and held in what is now known as the National Credit Union Share Insurance Fund (NCUSIF). The proceeds in the NCUSIF are used to pay share depositors if member institutions fail.

Beginning in 2008, the number of bank failures increased substantially, and the DIF fell below its statutory minimum requirement. In addition, the pace of credit union failures increased, and large corporate credit unions were placed under conservatorship by the NCUA. The 111th Congress subsequently provided both the FDIC and the NCUA with greater ability to meet the needs of the insurance funds and stabilize liquidity among depository institutions. Determining whether additional legislative action by the 112th Congress would be necessary may depend on the number and pace of failures by depository institutions.

This report begins with an overview of the FDIC, recent status of the DIF, and efforts to reduce the loss exposure and total risk to the fund. Next, an overview of the NCUA, recent status of the NCUSIF, and efforts to reduce the loss exposure and total risk to the fund are presented. An appendix to this report provides information regarding the procedures that the FDIC and NCUA follow to resolve failed depository institutions. Other appendices summarize the efforts by the agencies to support the funds during the recent period of financial distress and describe other initiatives to maintain liquidity.

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Introduction

Beginning in 2008, the number of failures of depository institutions increased. The Federal Deposit Insurance Corporation (FDIC) administered 25 bank failures in 2008 and 140 bank failures in 2009; no banks failed in 2005 and 2006, and only three bank failures occurred in 2007.[1] According to the National Credit Union Administration (NCUA), there were 15, 16, and 12 credit union failures that occurred in 2005, 2006, and 2007, respectively; in comparison, 18 credit unions failed in 2008 and 28 in 2009.[2] In addition, five corporate credit unions, which provide financial services for retail credit unions, saw severe liquidity pressures and were eventually placed under conservatorship by the NCUA.

Funds used to reimburse depositors when banks fail are maintained in the Deposit Insurance Fund (DIF), which is managed by the FDIC. Funds to reimburse credit union members are maintained in the National Credit Union Share Insurance Fund (NCUSIF), which is managed by the NCUA. The surge in bank failures has led to the depletion of the DIF, and the NCUSIF temporarily fell below its statutory level during 2010. The NCUA, however, has borrowed funds from the U.S. Treasury via the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) to administer the conservatorships of the corporate credit unions, and these losses must be repaid. Given that both federal deposit insurance systems have suffered large losses, member institutions will pay higher deposit insurance assessments. In addition, the 111th Congress provided the FDIC and the NCUA with greater ability to meet their funding needs and stabilize liquidity among depository institutions. Determining whether additional legislative action in the 112th Congress would be necessary is likely to depend upon the future number and pace of failures by depository institutions.

This report begins with an overview of the FDIC, presents the recent status of the DIF, and explains efforts to reduce the loss exposure risk to the fund. Similarly, an overview of the NCUA, the recent status of the NCUSIF, and efforts to reduce the loss exposure risk to the fund are presented. **Appendix A** provides information regarding the resolution procedures taken by the FDIC and NCUA when depository institutions fail. **Appendix B** summarizes the FDIC's initial efforts to support the DIF during the recent period of financial distress, which includes information about the Temporary Liquidity Guarantee Program (TLGP), prior to the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203). **Appendix C** summarizes recent actions taken by the NCUA to minimize losses to the NCUSIF that were not directly related to passage of the Dodd-Frank Act.

Deposit Insurance for Banks

The FDIC was established as an independent government corporation under the authority of the Banking Act of 1933, also known as the Glass-Steagall Act, to insure bank deposits.[3] The FDIC insures demand deposit (non-interest bearing) accounts, interest bearing checking accounts,

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[1] See http://www2.fdic.gov/qbp/2009dec/qbp.pdf.

[2] See NCUSIF and TCCUSF Statistics http://www.ncua.gov/Resources/Reports/ncusif/2011/2011JanBoardSlides.pdf.

[3] P.L. 73-66, 48 Stat. 162, 12 U.S.C. See Christine Bradley, *A Historical Perspective on Deposit Insurance*, Federal Deposit Insurance Corporation, FDIC Banking Review, Washington, DC, December 2000, p. 3, http://www.fdic.gov/bank/analytical/banking/2000dec/brv13n2_1.pdf.

savings accounts, and certificates of deposit.[4] The FDIC also insures funds held in traditional and Roth Individual Retirement Accounts (IRAs).[5] The FDIC provides separate coverage for deposits held in different account ownership categories, such as single accounts, joint accounts, and IRAs. For example, the funds in a deposit account and those in an IRA would be insured separately by the FDIC, even if the accounts belonged to the same individual.[6]

When a bank is insolvent or has failed, according to the FDIC, the depositors need not worry about repayment of principal up to the deposit insurance limits. Typically, most depositors have access to their insured funds within one business day after the FDIC closes the bank. With certain deposits, such as 401(k) accounts and retirement accounts, additional time is required to make an insurance determination. The FDIC estimates that this should not be longer than several days. In some situations, depositors may also receive a portion of their uninsured funds, depending on the sale of the failed bank's assets, a process which may take one or two years.[7]

To help discourage runs or panics on banks, Congress has periodically increased the amount of deposit insurance coverage.[8] For example, the Federal Deposit Insurance Reform Act, which was enacted on February 8, 2006, raised the limit on deposit insurance for IRAs from $100,000 to $250,000.[9] The Emergency Economic Stabilization Act of 2008 (EESA; P.L. 110-343) temporarily raised deposit insurance until December 31, 2009.[10] Under the new 2008 deposit insurance limits, an individual checking account may be covered up to $250,000 and an IRA may be covered up to $250,000. An individual having both of these accounts would receive total coverage of up to $500,000 in a single bank. On May 20, 2009, the Helping Families Save Their Homes Act of 2009 (HFSTHA; P.L. 111-22) made the increase in deposit insurance effective until December 31, 2013.[11] On July 21, 2010, the Dodd-Frank Act made the increase permanent.[12]

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[4] P.L. 111-203, Section 627 repeals the prohibition of payment of interest on demand deposit accounts beginning one year after enactment. The FDIC also insures Money Market Deposit Accounts, which are savings accounts that allow a limited number of checks to be written each month, Negotiable Orders of Withdrawal (NOW), and outstanding cashiers' checks.

[5] The FDIC also insures the following retirement accounts: Keogh retirement accounts for the self-employed, 457 Plan retirement accounts for state government employees, and employer-sponsored defined contribution plan retirement accounts that are self-directed, which are primarily 401(k) accounts and include SIMPLE 401(k) accounts, Simplified Employee Pension (SEP) IRAs, and Savings Incentive Match Plans for Employees (SIMPLE) IRAs.

[6] The FDIC does not insure stocks, bonds, mutual funds, money market funds, life insurance policies, annuities, or municipal securities, even if these products were purchased from an insured bank. The FDIC does not insure the contents of safe deposit boxes, losses due to theft or fraud at the bank, losses due to accounting errors, and investments backed by the U.S. government, such as Treasury securities and Savings Bonds. See Federal Deposit Insurance Corporation, *FDIC Consumer News - Spring 2001*, FDIC, Washington, DC, 2001, http://www.fdic.gov/CONSUMERS/consumer/news/cnspr01/cvrstry.html.

[7] FDIC, "Fall 2008 – Special Edition: Your New, Higher FDIC Insurance Coverage," *FDIC Consumer News*, Washington, DC, 2008, http://www.fdic.gov/consumers/consumer/news/cnfall08/misconceptions.html. For more information about resolving a bank failure, see **Appendix A**.

[8] In addition to deposit insurance coverage, the FDIC announced the creation of the Temporary Liquidity Guarantee Program on October 14, 2008, to encourage liquidity in the banking system. One component of the program guarantees senior unsecured debt issued by depository institutions. The Transaction Account Guarantee component insures payroll processing accounts used by businesses, which are non-interest bearing deposit accounts. See **Appendix B**.

[9] P.L. 109-171, 110 Stat. 9.

[10] See also CRS Report RL34730, *Troubled Asset Relief Program: Legislation and Treasury Implementation*, by Baird Webel and Edward V. Murphy.

[11] Section 204.

[12] P.L. 111-203, Section 335. The increase in deposit insurance was also made retroactive to cover funds for depositors that were uninsured in the 6 institutions for which the FDIC was appointed receiver or conservator after January 1,
(continued...)

To cover losses or costs associated with bank failures, the FDIC collects insurance premiums from member depository institutions and places the monies in the DIF.[13] The designated reserve ratio (DRR), which is the ratio of total funds in the DIF relative to the estimated amount of insured deposits, provides some indication about the adequacy of reserves available to protect depositors and maintain public confidence. The DRR is required by statute to be a minimum of 1.35%.[14] Should the DIF fall below its statutorily mandated range, the FDIC is then required to devise a restoration plan to recapitalize the fund. A well-capitalized DIF would likely maintain public confidence in the FDIC's ability to protect deposits.

Recent Status of the DIF

During 2010, there were 157 bank failures.[15] Given the increase in depository institutions on the FDIC's problem list, from 52 banks in 2005 to 884 for the recent quarter, the industry may experience more bank failures.[16] The DRR, which was 1.25% at the end of December 2005, was -0.12 as of December 31, 2010. Large losses to the DIF have come from failures of such institutions as IndyMac Bank, Downey Savings and Loan, PFF Bank and Trust, Franklin Bank, and First National Bank of Nevada.[17]

Legislative Efforts to Support the DIF

Failure of one or more large financial institutions could in theory overwhelm the DIF. In addition, numerous failures of small institutions after a significant economic or financial market downturn can drain the DIF as quickly as a failure of a large bank. For example, small banks may securitize many consumer loans (e.g., mortgages, automobile, and credit card loans) and specialize in commercial loans, which they retain in their portfolios.[18] If many small banks hold portfolios that consist of similar types of assets, a sudden rash of defaults by merchants or commercial borrowers during a severe economic downturn could set off a wave of small bank failures. Furthermore, the total losses to administer a bank failure generally exceed the costs to reimburse depositors given that asset liquidation and disposal may be difficult and costly. Congress and the FDIC, therefore, have made efforts to support the DIF and realign assessments to better reflect the costs incurred by the FDIC to resolve bank failures.

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2008. See announcement at http://www.fdic.gov/news/news/press/2010/pr10162.html. For a brief summary of changes relevant to the FDIC after passage of the Dodd-Frank Act, see http://www.fdic.gov/regulations/reform/summary.html or CRS Report R41339, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Titles III and VI, Regulation of Depository Institutions and Depository Institution Holding Companies*, by M. Maureen Murphy.

[13] See "Final Rule on Special Assessment" at http://www.fdic.gov/news/board/May22no2.pdf.

[14] P.L. 111-203, Section 334. The FDIC must take necessary steps to meet this requirement by September 30, 2020.

[15] See FDIC *Quarterly Banking Report* as of December 31, 2010, at http://www2.fdic.gov/qbp/2010dec/qbp.pdf.

[16] Banks that are counted on the problem list do not meet all required safety and soundness standards and may be at higher risk for failure.

[17] For the FDIC's complete Failed Bank List, see http://www.fdic.gov/bank/individual/failed/banklist.html. For a brief description of each bank failure, see http://www.fdic.gov/BANK/HISTORICAL/BANK/index.html.

[18] For example, the FDIC's *Quarterly Banking Report* as of December 31, 2009, reported that 56 of the institutions with more than $1 billion in assets did not meet the definition of a commercial lender, which was met by 4,456 institutions. The 4,456 institutions were not likely to be in the 'over $10 billion' asset category. See FDIC *Quarterly Banking Report* as of December 31, 2009, at http://www2.fdic.gov/qbp/2009dec/qbp.pdf.

Increase in FDIC Borrowing Authority

On February 3, 2009, the FDIC asked Congress to increase its line of credit from the U.S. Treasury to $100 billion from $30 billion.[19] The increased borrowing authority would be used in case funds from the DIF were not immediately available to meet the demands of rising bank closures.[20] HFSTHA temporarily increased the FDIC's borrowing authority from $30 billion to $500 billion until December 31, 2010; as of January 1, 2011, the FDIC has $100 billion of borrowing authority from the U.S. Treasury.[21]

Elimination of a Procyclical Bias in Deposit Insurance Pricing

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) granted the FDIC authority to implement a risk-based assessment system, and this was put in place on January 1, 1993.[22] Under a risk-based assessment system, financial institutions that pose more risk to the DIF are assessed higher deposit insurance premiums relative to those that pose lower risks. The Deposit Insurance Funds Act of 1996, however, mandated that institutions that are both well-capitalized and have received high examination ratings should not be charged premiums when the DIF is at or above the statutorily set DRR.[23] Some economists have argued that this limitation injected a procyclical bias into the pricing of deposit insurance.[24] In other words, the DIF would not be permitted to accumulate reserves in excess of the DRR during financially stable periods; consequently, deposit premiums may increase dramatically during a financial downturn, when it is more difficult for banks to pay higher assessments while maintaining sufficient profitability.

In 2001, FDIC Chair Donna Tanoue testified that this statutory provision resulted in 92% of insured depository institutions in the FDIC's best-risk category not having to pay deposit insurance assessments, which rendered its risk-based premium system ineffective.[25] For this reason, the FDIC requested elimination of the statutory restrictions on its ability to charge risk-based premiums to all institutions even when the DIF level exceeds its statutory requirement. On February 8, 2006, the Federal Deposit Insurance Reform Act of 2005 (Reform Act; P.L. 109-171) was signed by the President into law, giving the FDIC the authority to charge premiums, after notice and comment rulemaking, based upon the riskiness of the institutions, regardless of the level of the DRR.[26] The FDIC then proposed new risk-based deposit premium assessments on

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[19] See Statement of John F. Bovenzi, Deputy to the Chairman and Chief Operating Officer, FDIC on Promoting Bank Liquidity and Lending Through Deposit Insurance, Hope for Homeowners, and Other Enhancements before the Committee on Financial Services; U.S. House of Representatives, February 3, 2009, at http://www.fdic.gov/news/news/speeches/archives/2009/spfeb0309.html.

[20] For more detailed information concerning FDIC authority, see CRS Report RL34657, *Financial Institution Insolvency: Federal Authority over Fannie Mae, Freddie Mac, and Depository Institutions*, by David H. Carpenter and M. Maureen Murphy.

[21] P.L. 111-22, Section 204.

[22] P.L. 102-242. See "Assessment Rate Cases" at http://www.fdic.gov/deposit/insurance/assessments/rate_cases.html.

[23] P.L. 104-208.

[24] See Alan S. Blinder and 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.

[25] See http://www.house.gov/financialservices/media/pdf/051601ta.pdf, http://www.fdic.gov/deposit/insurance/initiative/direcommendations.html#ReCurrent, and http://www.frbsf.org/publications/economics/letter/2002/el2002-14.html.

[26] See http://www.fdic.gov/deposit/insurance/initiative/index.html for highlights regarding coverage of the law and a (continued...)

July 16, 2006, and these were approved on November 2, 2006.[27] The FDIC was still unable to collect assessments, however, when the DIF exceeded 1.35% at the end of a calendar year. Given that the Reform Act requires the FDIC to rebate excess assessments in the form of dividends to financial institutions, a procyclical bias in the pricing of deposit assessments remained.[28]

The Dodd-Frank Act eliminates procyclical deposit insurance assessments by giving the FDIC sole discretion to suspend or limit the declaration of the payment of dividends to financial institutions.[29] This provision allows the FDIC to continue collecting assessments regardless of the DRR level. This authority would enhance the effectiveness of a risk-based assessment system (discussed below) designed to encourage prudent lending practices. Furthermore, the FDIC announced on December 20, 2010, that it would pursue a DRR of 2% as a minimum level to reduce the risk that the DIF would become negative in a future crisis similar to the magnitude of the most recent crisis.[30]

Expansion of the Deposit Assessment Base

The deposit assessment base was previously set to cover the losses associated with protecting depositors and not necessarily to cover the total costs associated with resolving a bank failure. With passage of the Dodd-Frank Act, the assessment base is now defined as the average total consolidated assets during the assessment period minus *the sum* of (1) the average tangible equity and (2) any additional amount the FDIC determines is necessary to reflect risks posed by certain financial institutions such as custodial banks.[31] In other words, the assessment base has been expanded to cover both deposit and non-deposit liabilities.[32]

A broader assessment base, however, may increase the overall funding costs for financial institutions. Under the previous assessment structure, banks may have been able to select non-deposit short-term funding options to reduce the amount of deposit insurance assessments they would have to pay. With an expanded assessment base, premiums for the DIF would be collected regardless of the funding strategies pursued. Banks could respond to the higher funding costs in a variety of ways. Banks could make fewer loans and reduce their costs. Banks could charge higher rates and fees to customers and pass some of the additional funding costs on to customers. Banks could also take on more risk to try to generate higher returns, which would cover the additional costs. At this point, it is difficult to anticipate the strategies financial institutions would adopt to recoup the additional funding costs.

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link to the Reform Act.

[27] See "FDIC Proposes New Risk-Based Insurance Assessment System" at http://www.fdic.gov/news/news/press/2006/pr06070.html and "FDIC Approves New Risk-Based Premiums for Deposit Insurance" at http://www.fdic.gov/news/news/press/2006/pr06101.html.

[28] See "Assessment Dividends" at http://www.fdic.gov/deposit/insurance/reform.html#drr.

[29] P.L. 111-203, Section 332.

[30] See http://www.federalregister.gov/articles/2010/12/20/2010-31829/designated-reserve-ratio#p-24.

[31] P.L. 111-203, Section 331.

[32] See Financial Institutions Letter (FIL-78-2010) at http://www.fdic.gov/news/news/financial/2010/fil10078.html, which defines the assessment base as "average consolidated total assets minus average tangle equity," as required by the Dodd-Frank Act.

FDIC Risk Analysis Approach to Price Assessments

On April 8, 2010, the FDIC announced proposed revisions to the current system of determining assessments via a Notice of Proposed Rulemaking (NPR) on Assessments.[33] On November 10, 2010, the FDIC made further revisions to the system in light of the Dodd-Frank Act.[34] On February 7, 2011, the FDIC approved a final rule on assessments, dividends, the assessment base, and the pricing of deposit insurance for large banks, with an effective date of April 1, 2011.[35] The new system takes a formal risk analysis approach, similar to methodologies used in credit underwriting.[36] This approach attempts to better capture risk at the time the institution assumes the risk and, therefore, to better predict when an institution's risk profile may change. A summary overview of the proposed assessment system follows below; the FDIC provides a complete description in the final announcement.[37]

The assessment system would have separate assessment structures for large depository institutions, highly complex institutions, and small depository institutions, respectively. A large depository institution would be defined as one having $10 billion or more in total assets for at least four consecutive quarters. A highly complex institution would be defined as a depository institution with more than $50 billion in total assets that is fully owned by a parent company with more than $500 billion in total assets (or fully owned by one or more intermediate parent companies with more than $500 billion in assets), or a processing bank and trust company with more than $10 billion in total assets.[38] Small institutions, which do not fit into the other categories, are assessed separately.

Data for the large depository institutions and the highly complex institutions, which would be collected during examinations, would be evaluated using a scorecard that would use variables from the following categories:[39]

- A weighted average CAMELS rating;[40]
- Variables that represent the ability to withstand a decline in asset holdings or an increase in credit or default risk, such as risk-based capital-to-asset ratios;

[33] See Financial Institutions Letter (FIL-14-2010) at http://www.fdic.gov/news/news/financial/2010/fil10014.html; the Federal Register at http://www.fdic.gov/regulations/laws/federal/2010/10proposead57.pdf; and other links at http://www.fdic.gov/deposit/insurance/new.html, http://www.fdic.gov/news/board/april05.pdf, and http://www.fdic.gov/news/board/april06.pdf. The comment period for the proposed rule ended on July 2, 2010.

[34] See Financial Institutions Letter (FIL-77-2010) at http://www.fdic.gov/news/news/financial/2010/fil10077.html and the Federal Register at http://www.fdic.gov/deposit/insurance/2010-29137.pdf for more details.

[35] See Financial Institutions Letter (FIL-8-2011) at http://www.fdic.gov/news/news/financial/2011/fil11008.html and http://www.fdic.gov/news/news/press/2011/pr11028.html.

[36] See John W. Straka, "A Shift in the Mortgage Landscape: The 1990s Move to Automated Credit Evaluations," *Journal of Housing Research*, vol. 11, no. 2 (2000), pp. 207-232.

[37] See http://www.fdic.gov/deposit/insurance/11RuleAD35.pdf.

[38] For a more precise definition of a highly complex institution, see http://www.fdic.gov/news/board/april05.pdf.

[39] A scorecard refers to scoring models and statistical automated methods used to assess the credit risk of individuals or entities based upon various characteristics. For example, the mortgage industry uses scorecards to categorize mortgage applicants into risk groups and set mortgage rates and terms. See John W. Straka, "A Shift in the Mortgage Landscape: The 1990s Move to Automated Credit Evaluations," *Journal of Housing Research*, vol. 11, no. 2 (2000), pp. 207-232.

[40] The CAMELS rating assesses six components: Capital adequacy, Asset quality, Management administration, Earnings, Liquidity, and Sensitivity to market risk. See http://www.federalreserve.gov/boarddocs/press/general/1996/19961224/default.htm.

- Variables that represent the ability to withstand an increase in liquidity or funding risk, such as the ratio of core deposits to total liabilities;
- A loss severity score that measures the relative magnitude of potential losses to the FDIC, which is computed as a ratio of possible losses to the total domestic deposits, averaged over three quarters.

The scorecards for highly complex institutions will include a market indicator category, which will include a capital asset ratio, specifically the tangible common equity ratio, from the parent company of the institution. After the data have been entered, the scorecard would compute a performance score between 0 and 100 as a weighted average of the first three categories of inputs for the large depository institutions. For the highly complex institutions, the performance score between 0 and 100 would still be a weighted average, but the market indicator category is included for a total of four categories. The loss severity score would also generate a quantitative measure between 0 and 100 for both groups. The performance and the loss severity scores would then be converted to an *initial* base assessment rate. The *final* assessment rate would then be computed by adjusting the initial base assessment rate for holdings of certain long-term unsecured debt, secured liabilities, and brokered deposits. Use of the scorecard allows assessments to vary with the levels of risk taken by institutions each quarter. Consequently, this system may provide incentives to institutions to reduce excessive risks, in particular during economic expansions when loan underwriting standards tend to be relatively more relaxed.

For small depository institutions, a risk-based deposit insurance assessment would still be calculated based primarily upon their CAMELS ratings and capitalization levels. Financial institutions receive a composite CAMELS rating from 1 to 5, with 1 being the most favorable rating of an institution's overall condition and performance. Next, they are assigned capitalization classifications, which are determined by their various leverage ratios: Well capitalized, Adequately capitalized, Undercapitalized, Significantly undercapitalized, and Critically undercapitalized. The institutions can now be grouped into four risk categories:

- Risk Category I (Well capitalized and with CAMELS ratings of 1 or 2);
- Risk Category II (Adequately capitalized and with CAMELS ratings of 2 or 3);
- Risk Category III (Undercapitalized with higher CAMELS ratings or currently not undercapitalized with CAMELS ratings of 4 or 5); or
- Risk Category IV (all other undercapitalized institutions).

Under the proposed rule, the final assessment rate for each risk category would be computed using a predetermined initial base assessment rate and adjustments for holdings of unsecured debt, secured liabilities, and brokered deposits.

Share Insurance for Credit Unions

Credit unions are non-profit depository financial institutions that are owned and operated entirely by their members. *Natural person* or retail credit unions hold member deposits, which are referred to as "shares;" interest earned by members is referred to as "dividends;" and the shares may be used to provide loans to members, to other credit unions, and to credit union organizations. *Corporate credit unions* operate as wholesale credit unions, providing financing, investment, and clearing services to retail credit unions. Corporate credit unions accept deposits from retail credit unions and invest them in longer-term assets. The retail credit unions are cooperative owners of the corporate credit unions. The *U.S. Central Federal Credit Union*, which is one of the 28 corporate credit unions, functions as a wholesale corporate and provides services to the other 27.

The Federal Credit Union Act of 1934 formed a national system to charter, supervise, and examine federal credit unions; the NCUA became an independent federal agency in 1970.[41] Typically, the Office of the Comptroller of the Currency charters and supervises commercial banks; the FDIC provides deposit insurance and liquidates failed banks; and the Federal Reserve provides lender-of-last-resort liquidity via its discount window.[42] The NCUA, by comparison, provides all three functions for federally regulated credit unions.[43] All of the 28 corporate credit unions are federally insured.

Share deposit insurance may help bolster public confidence and prevent the type of panic behavior that can lead to failing institutions, which would require the NCUA to arrange an assisted merger, a purchase and assumption action, or an involuntary liquidation.[44] The NCUA provides insurance coverage for each individual account holder, per federally insured institution, up to the legal limit; funds in IRA and KEOGH accounts are treated as separate accounts that are insured up to the legal limit, per institution.[45] The Emergency Economic Stabilization Act of 2008 temporarily raised the basic limit of $100,000 on federal deposit insurance coverage for individual accounts to $250,000 until December 31, 2009; the limit was made permanent by the Dodd-Frank Act. Retirement accounts retain their existing $250,000 insurance coverage limit.[46]

The NCUA manages the NCUSIF, which was created in 1970 to be the insurance fund for all federally regulated credit unions. Premiums from insured credit unions are the fund's primary source of income. These arrangements are similar to those of the FDIC's DIF. Premiums are used to pay the fund's operating expenses, cover losses, and build reserves. Premiums were originally set at one-twelfth of 1% of the total amount of member share accounts. P.L. 98-369 required each federally insured credit union to place a deposit with the fund in an amount equaling 1% of its insured share accounts.[47] Examination fees and any penalties collected by the board from insured institutions are also deposited into the NCUSIF. Portions of the fund not applied to current operations can be invested in government securities, and those earnings also generate income for the fund. Hence, the NCUSIF's reserves consist of the 1% deposit, the fund's accumulated insurance premiums, fees, and interest earnings.

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[41] P.L. 73-467, the Federal Credit Union Act. P.L. 91-468, 84 Stat. 994 made the NCUA an independent agency, which is governed by a three-member Board.

[42] Prior to the Dodd-Frank Act, the Office of Thrift Supervision chartered and supervised thrift institutions. After Dodd-Frank, thrifts are now supervised by the Office of the Comptroller of the Currency. The Federal Reserve also provides payment settlement services to financial institutions. See http://www.kansascityfed.org/publicat/PSR/ Briefings/PSR-BriefingAug06.pdf.

[43] State regulators have primary supervisory authority over state-chartered credit unions that are federally insured. Given that federal deposit insurance is optional in some states, some state-chartered credit unions are privately insured by American Share Insurance, which means the share deposits are not backed by the full faith and credit of the U.S. government. See http://www.americanshare.com/Public/Home.aspx.

[44] For more information about resolving a credit union failure, see **Appendix A**.

[45] See http://www.ncua.gov/resources/shareinsurance/ncuainsurancefundfaqs.htm.

[46] The insurance coverage for eligible retirement accounts was raised by two laws passed in the 109th Congress, P.L. 109-171 and P.L. 109-173; see 12 U.S.C. 1781-1790d.

[47] July 18, 1984, 98 Stat. 494. The 1% is carried on each individual institution's books as an asset.

The statutory equity ratio, which is analogous to the DRR of the DIF, was set by P.L. 91-468 at a minimum 1.2%. The NCUA Board annually determines the "normal operating level" for the ratio of fund equity to insured shares that statutorily must fall between 1.2% and 1.5%.[48] In recent years, the NCUA has set a goal of achieving an equity ratio of 1.3%. The NCUA board may assess a premium when the ratio falls between 1.2% and the declared operating level; and it is required to assess a premium if the equity ratio falls below 1.2%. Similarly, the NCUA board may declare a dividend if, at the end of the calendar year, the equity level exceeds the normal operating level; and it must declare a dividend if the equity ratio exceeds 1.5%. Consequently, a procyclical bias that existed with the pricing of FDIC deposit insurance assessments prior to the Dodd-Frank Act appears to exist with the pricing of NCUA share deposit insurance given the equity ratio cap.[49] HFSTHA, however, does extend to eight years the period of time available to complete restoration of the equity ratio should it fall below 1.2%, which may possibly reduce the size that assessments would need to rise to restore a fall in the equity ratio below the minimum statutory level. Nevertheless, the burden of the procyclical bias on credit unions, in particular during episodes of economic downturns when it is more difficult to maintain profitability and pay higher premiums, would still be affected by the pace of failures and losses to the NCUSIF.

Recent Status of the NCUSIF

During 2008, the NCUA chairman reported that corporate credit unions faced increasing liquidity pressures. A significant portion of their mortgage-backed securities had lost value and were downgraded below investment grade due to deterioration of the underlying collateral.[50] In March 2009, the NCUA placed two corporate credit unions, the U.S. Central Federal Credit Union and the Western Corporate Federal Credit Union, into conservatorship. In September 2010, Constitution Corporate Federal Credit Union, Members United Corporate Federal Credit Union, and Southwest Corporate Federal Credit Union were also placed into conservatorship. The chairman reported that the five corporates under conservatorship had represented approximately 70% of the entire corporate system's assets and 98.6% of the investment losses within the system.

During 2010, 28 credit unions failed.[51] The number of credit unions on the NCUA's problem list increased from 280 in 2005 to a total of 368 as of December 31, 2010. The NCUSIF ratio, which was 1.27% at the end of December 2005, was 1.28% as of December 31, 2010. Given that the corporate credit union conservatorships are accounted for in the Temporary Corporate Credit Union Stabilization Fund (discussed below), the total losses to the credit union system are not reflected in the NCUSIF's equity ratio.

[48] The Federal Credit Union Act (12 USC 1782(h)(4)). See http://www.house.gov/apps/list/hearing/financialsvcs_dem/bedinger_-_nafcu.pdf.

[49] See http://www.federalregister.gov/articles/2010/12/20/2010-31829/designated-reserve-ratio.

[50] See Statement of Deborah Matz, Chairman, National Credit Union Administration, "The State of the Credit Union Industry," p. 3 at http://www.ncua.gov/GenInfo/Members/Matz/speeches/MatzStateOfIndustryDec2010-Final.pdf, which was given U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, 111th Cong., 2nd sess., December 9, 2010.

[51] See http://www.ncua.gov/Resources/Reports/ncusif/2011/2011JanBoardSlides.pdf.

Legislative Efforts to Support NCUSIF

Failures of the large corporate institutions or numerous failures of small institutions burden the entire credit union industry and can overwhelm the NCUSIF. Given that a credit union faces membership restrictions, a significant economic or financial downturn that adversely affects the members would adversely affect the credit union. For example, the recent recession saw large job losses in the construction industry, and credit unions with members consisting primarily of construction workers would be more likely to experience higher default rates.[52] Credit unions that hold residential mortgages of members that had to live in areas that saw large declines in home values would likely experience higher default rates. The NCUSIF would be affected by the costs to reimburse depositors, liquidate collateralized loans, and then dispose of the collateral assets. Legislative efforts to support the NCUSIF, along with legislative requests by the NCUA to reduce the costs to resolve failures, are discussed in this section.

HFSTHA established the Temporary Corporate Credit Union Stabilization Fund (TCCUSF, or Stabilization Fund) to absorb losses related to the corporate credit union investments. The NCUA may borrow from the Stabilization Fund, which is a line of credit provided by the U.S. Treasury for a seven-year period, to pay only for the expenditures associated with conservatorship or a liquidation of a corporate credit union.[53] In addition, HFSTHA raised the NCUA borrowing authority from the U.S. Treasury from $100 million to $6 billion as well as emergency borrowing up to $30 billion.[54] The aggregate total is available to both the NCUSIF and the TCCUSF. The NCUA is responsible for imposing premium assessments on federally insured credit unions to repay the Treasury in seven years.[55] The assessments theoretically should also be large enough to restore the equity ratio of the NCUSIF.[56]

The Central Liquidity Facility (CLF) is a mixed-ownership U.S. government corporation that Congress created in 1978 to provide a source of seasonal and emergency liquidity for credit unions.[57] The CLF exists within the NCUA and is owned by member credit unions. Credit unions, however, are encouraged not to rely upon the CLF as a conventional funding or liquidity source; instead, it should be used as a back-up source of funds, similar in manner to the Federal Reserve System's discount window. Congress raised the CLF's borrowing cap from $1.5 billion to its full statutory limit of $41 billion.[58]

The National Credit Union Authority Clarification Act of 2010 (NCUACA; P.L. 111-382) made the following statutory changes that would help reduce losses to the NCUSIF:[59]

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[52] For additional information on large job losses during the recent recession, see CRS Report R41434, *Job Growth During the Recovery*, by Linda Levine.

[53] See http://www.ncua.gov/Resources/OIG/Files/Reports/2010/OIG-10-13FY2009FSATCCUSF.pdf.

[54] See http://www.ncua.gov/Resources/CorporateCU/Files/CULetters/09-CU-14CorpStabilizationFundImplementation.pdf.

[55] See Board Action Bulletin, May 20, 2010 at http://www.ncua.gov/GenInfo/BoardandAction/reports/2010/BAB10-0520.pdf.

[56] See **Appendix C** for information regarding higher assessments on credit unions.

[57] P.L. 95-630. For additional information on the Central Liquidity Facility, see http://www.ncua.gov/Resources/CLF/Index.aspx and http://www.ncua.gov/Resources/CLF/CLF%20FAQs.pdf.

[58] P.L. 110-329 and see http://www.ncua.gov/Resources/Reports/NCUA2008-2009AnnualReport.pdf, p. 9.

[59] For discussions of the issues that required amending, see http://www.ncua.gov/newspublications/News/Newsletters/NCUAReportFeb2011.pdf and Statement of Deborah Matz, Chairman, National Credit Union Administration, "The (continued...)

- Changes in accounting definitions and standards, which are made by the Financial Accounting Standard Board (FASB), may indirectly affect the NCUSIF when its loans and account ledger definitions must remain the same by statute.[60] For example, the net worth of a healthy or surviving credit union would be diluted after a merger with a troubled credit union given that the statutory definition of "net worth" did not treat NCUA assistance as capital. Consequently, the NCUA had to liquidate a failed credit union rather than arrange for a merger with a healthier credit union, and such liquidation may have been a more costly option for the NCUSIF.[61] NCUACA gives the NCUA Board the authority to modify accounting definitions as accounting standards change, thus opening another viable and less costly option for resolving a failed institution.
- NCUACA clarified the definition of the NCUSIF equity ratio. Given that credit unions must maintain 1% of their deposits in the NCUSIF, a recent change in accounting standards concerning mergers may have resulted in the consolidation of the NCUSIF financial statements with those of the participating credit unions. The equity ratio would likely fall below its statutory limit and trigger additional mandatory premium assessments to re-capitalize the NCUSIF if it were computed using a consolidated balance sheet, which would also include the Stabilization Fund and any credit unions under conservatorship. The amendment, therefore, states that the equity ratio is solely based upon the unconsolidated financial statements of the NCUSIF. This amendment also gives the NCUA more flexibility in terms of when and how much assessments should rise such that repayment of the Stabilization Fund does not become too burdensome on the credit union system.
- Prior to NCUACA, the Stabilization Fund had to borrow from the U.S. Treasury to manage losses in the corporate credit union system. This eliminated the option to raise premiums on credit unions until after a debt obligation to Treasury had been incurred. The credit union system must repay both the costs associated with the failures and interest costs when it borrows from Treasury. The ability to raise premiums on the credit union system to repay losses without having to incur additional borrowing costs, therefore, may be less burdensome.[62]

(...continued)

State of the Credit Union Industry," p.3 at http://www.ncua.gov/GenInfo/Members/Matz/speeches/MatzStateOfIndustryDec2010-Final.pdf, which was given U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, 111th Cong., 2nd sess., December 9, 2010.

[60] For more information about FASB, see http://www.fasb.org/home.

[61] See http://www.ncua.gov/Resources/Reports/plans-and-reports/2010/SupplementalCapitalWhitePaper.pdf and http://www.ncua.gov/resources/RegulationsOpinionsLaws/proposed_regs/Prompt%20Corrective%20Action%20Amended%20Definition%20of%20Post%20Merger%20Net%20Worth.pdf.

[62] The FDIC required its members to prepay deposit insurance assessments for three years to avoid having to borrow from Treasury, which was deemed less expensive on the industry. See **Appendix B** for more information.

NCUA Restructuring of Corporate Credit Union Regulatory Framework

On September 24, 2010, NCUA issued final amendments to its rule governing corporate credit unions.[63] Among the numerous revisions, corporate credit unions will now be regulated for safety and soundness under a risk-based capital scheme similar to that of Basel I and FDIC banks. Rather than just a single capital ratio, the corporates must now meet three minimum capital ratios—a leverage ratio, a tier-1 risk-based capital ratio, and a total risk-based capital ratio. The new capital requirements would be phased in over a 10-year period.

In addition, prompt corrective actions will now apply to corporates that fail to meet the capital requirements. A prompt corrective action may include restrictions on activities, investments, payment of dividends, restrictions on executive compensation, requirements to dismiss management and elect new directors, and possible conservatorship. In addition, corporates may no longer purchase private label residential mortgage backed securities and subordinated securities. A two-year limit has also been placed on the weighted average life of a corporate's assets, thus limiting their ability to make loans (to retail credit unions) that mature after two years.[64]

[63] See http://www.ncua.gov/letters/2010/CU/10-CU-20.pdf and http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item1b10-0924.pdf.

[64] A loan is an asset for the originator. In this case, a loan made by a corporate credit union can only be made for two years since the loan is an asset.

Appendix A. Resolution Process for Insolvent Depository Institutions

This appendix discusses the process for resolving the failure of an insured depository institution. Generally speaking, a depository institution is closed after failing to maintain sufficient capital to meet safety and soundness requirements. The assets of the institution are acquired and sold to another qualified depository institution. FDIC and NCUA procedures as well as the costs to the DIF and NCUSIF are described.

Bank Failures and the FDIC

Bank assets are the consumer and commercial loans that banks originate and hold in portfolio; bank liabilities are the funds that banks borrow to provide loans to consumers and businesses. Whenever customers make savings or checking deposits into a bank, the bank is effectively borrowing from depositors and using the proceeds to originate loans. A bank typically borrows the funds from its depositors for shorter periods of time with the expectation that its short-term borrowings must be continuously renewed until the longer-term consumer loans are repaid. For example, suppose a bank makes a consumer loan with a duration of two years. Over the life of the consumer loan, the bank may "fund the loan" or borrow cash from depositors in a sequence of quarterly periods (for a total of eight short-term loans) or monthly periods (for a total of 24 short-term loans).

Deposits have traditionally been considered the most stable and inexpensive source of funding for customer loans, in particular for community banks, because depositors typically are the least sensitive to short-term interest rate fluctuations.[65] Banks also fund loans from creditors that are not depositors. They may borrow funds via participation in the federal funds market, using repurchase agreements, obtaining advances (loans) from the Federal Home Loan Bank System (FHLB), and some of the larger banks may issue short-term commercial paper. Although banks frequently refinance their short-term borrowings with depositors and non-deposit creditors, their assets are relatively less liquid. The composition of the short-term liabilities of a financial institution will change more often than the composition of its long-term assets, which means that total amounts of insured deposits are estimates at any point in time and not known with certainty until an institution fails.[66]

If the bank's activities are unable to generate enough income to repay depositors' principal and interest, then the bank becomes insolvent.[67] The FDIC uses a similar definition to determine the solvency of a bank, expressed in the form of a ratio. A capital-asset ratio is computed by dividing

[65] The cost to fund bank assets with deposits increases when households shift from holding assets in the form of bank deposits to non-bank investment vehicles, which may offer higher returns, or when deposit insurance premiums increase. For more information on the decline of core deposits and the impact on small banks, see http://www.kansascityfed.org/banking/bankingpublications/prs01-4.pdf.

[66] See Andrew M. Davenport, Joseph V. Fellerman, and Lynn Shibut, et al., *An Evaluation of the Denominator of the Reserve Ratio*, Federal Deposit Insurance Corporation, FDIC Staff Study, Washington, DC, February 12, 2007, http://www.fdic.gov/deposit/insurance/initiative/Denominator_Board.pdf.

[67] Note that a bank does not have to be insolvent to be illiquid. A bank can hold more of its assets in the form of loans as opposed to cash. If, however, those assets cannot quickly be turned into cash, the bank may face cash flow problems, perhaps if there is an unusual demand for cash by depositors.

the bank's capital by its assets. The FDIC computes a variety of capital-asset ratios, using various accounting methods and asset risk-weighting methods, to determine the soundness of a bank. These are commonly known as the total risk-based capital, tier 1 risk-based capital, tier 1 leverage, and tangible equity ratios. Under-capitalized banks, which typically have capital-asset ratios below the FDIC's minimum thresholds, would be considered insolvent. If a bank lacks sufficient capital, the regulator or chartering authority may shut it down and appoint the FDIC as the receiver.[68]

As the receiver of a failed bank, the FDIC determines the least costly resolution transaction by evaluating possible resolution alternatives and then computing the costs on a net present value basis. The FDIC is required by law to pursue the least-costly transaction to minimize the impact on taxpayers.[69] Typically, the least-costly transaction will involve some form of the purchase and assumption (P&A) process.[70] A P&A is a resolution transaction in which a healthy institution *purchases* some or all of the assets (outstanding loans) of a failed bank or thrift and assumes some or all of the *liabilities* (deposits).[71] The FDIC seeks bids from qualified institutions for the failed bank's assets.[72] Once the FDIC accepts the bid that is judged to be the least-costly option to the DIF, it then closes the failed bank.

The total losses to the DIF generally exceed the costs of reimbursing depositors because the losses to the DIF are not limited to reimbursement costs of insured depositors. Other costs associated with resolving a bank failure also apply. Given that the composition of a financial institution's liabilities normally changes more often than the composition of its assets as previously discussed, it is difficult to know exactly the amount of insured deposits until after the failure has occurred. In addition, some of the bank creditors may require repayment ahead of depositors. For example, suppose a bank funded some of its assets with FHLB advances. Upon failure, the FDIC must repay the FHLB advances immediately since advances have priority over depositors (or "super lien" status), and prepayment fees assessed by the FHLB could be an additional cost to the DIF.[73] Another reason for the difficulties associated with predicting DIF loss exposure has to do with the additional costs associated with administering a bank failure. The

[68] See http://www2.fdic.gov/qbp/Glossary.asp?menuitem=GLOSSARY for table that summarizes risk-based capital groups or the capital-asset ratios used to evaluate safety and soundness compliance of covered depository institutions.

[69] See Statement of Mitchell L. Glassman, Director of the Division of Resolutions and Receiverships at the FDIC on the Condition of Financial Institutions: Examining the Failure and Seizure of an American Bank before the Subcommittee on Financial Institutions and Consumer Credit; House Committee on Financial Services, January 21, 2010, at http://www.fdic.gov/news/news/speeches/chairman/spjan2110.html.

[70] Although the FDIC has various resolution options and chooses the least costly one, the P&A process is the most frequently used option. See CRS Report RL34657, *Financial Institution Insolvency: Federal Authority over Fannie Mae, Freddie Mac, and Depository Institutions*, by David H. Carpenter and M. Maureen Murphy; Federal Deposit Insurance Corporation, *Managing the Crisis: The FDIC and RTC Experience 1980-1994* (Washington, DC: Federal Deposit Insurance Corporation, 1998) at http://www.fdic.gov/bank/historical/managing/contents.pdf; and http://www.fdic.gov/bank/historical/managing/history1-02.pdf for more details regarding the resolution process.

[71] See Chapter 3 of the FDIC's *Resolution Handbook* at http://www.fdic.gov/bank/historical/reshandbook/ch3pas.pdf.

[72] Qualified institutions are those that obtain approval from their chartering authorities. See http://www.fdic.gov/buying/financial/index.html for more information about the qualification process for financial institutions wanting to participate in an FDIC asset sale.

[73] For more information about the FHLB's super lien status, see http://www.fdic.gov/about/learn/advisorycommittee/fhlb_advances.html , http://www.fdic.gov/about/learn/advisorycommittee/minutes111903.html, and CRS Report R41102, *The Federal Home Loan Bank System and Resolution of a Failure*, by N. Eric Weiss and Todd Garvey. For information on the National Depositor Preference Law, which stipulates the priority of payment structure that the FDIC must follow to resolve depository failures, see http://www.clevelandfed.org/Research/commentary/1994/0215.pdf.

FDIC often provides assistance to or enters into loss sharing agreements with acquirers. This assistance limits the amount of potential losses that may arise from loans transferred to the books of acquiring institutions that could threaten their solvency. Any assets not purchased by an acquirer must be liquidated by the FDIC.[74]

Credit Union Failures and the NCUA

The NCUA, similar to the FDIC, uses a net worth ratio to determine the solvency of a credit union.[75] The NCUA computes a net worth-asset ratio by dividing a credit union's net worth (or capital) by its assets, and it also applies various accounting methods and asset risk-weighting methods to determine the soundness of a covered institution. Under-capitalized credit unions, which typically have capital-asset ratios below the NCUA's minimum thresholds, would be considered insolvent.[76] If a credit union lacks sufficient net worth, the chartering authority may shut it down and appoint NCUA as the receiver.

The NCUA, similar to the FDIC, is also required by law to pursue the least-costly transaction to minimize the impact on taxpayers of a failing credit union. The NCUA also employs a P&A process in which bids are obtained from qualified institutions for the assets of a failed credit union, and the accepted bid is the one judged to be the least-costly option to the NCUSIF.[77] The total losses to the NCUSIF, as in the case of all financial institution failures, are not limited to the reimbursement costs of insured share deposit holders. Additional costs associated with resolving a credit union failure—such as FHLB advances that have priority over depositors, loss sharing agreements entered with acquiring institutions, and the liquidation of assets not purchased by acquirers—would also be incurred.[78]

[74] For information regarding some of the unusual bank assets that the FDIC has had to liquidate after various bank failures, see http://www.fdic.gov/bank/historical/managing/Chron/1933-79/.

[75] 'Capital' and 'net worth' are terms that may be used interchangeably. The difference between assets minus liabilities is referred to as 'capital' by the FDIC and as 'net worth' by NCUA.

[76] For a table that summarizes the net worth (capital)-asset ratios used to evaluate safety and soundness compliance of NCUA insured credit, See Table 1—Statutory Net Worth Category Classification at http://www.ncua.gov/resources/RegulationsOpinionsLaws/rules_and_regs/NCUA%20R%20&%20R%20Book%201%20May%208%202008.pdf.

[77] See http://www.ncua.gov/letters/2010/CU/10-CU-11.pdf for more details regarding the NCUA's P&A process.

[78] On November 17, 2010, the NCUA authorized the creation of a loss share pilot program to facilitate the resolution of large credit unions, based upon the FDIC's use of loss share agreements, to minimize losses to the NCUSIF. See http://www.ncua.gov/news/press_releases/2010/MA10-1117NCUAInitiatesPilotLossShareProgram.pdf.

Appendix B. Recent FDIC Actions to Replenish the Deposit Insurance Fund

The FDIC's risk-based deposit insurance pricing system had been in place for less than two years when the pace of bank failures increased in the latter part of 2008 and into 2009.[79] A chronology of actions taken by the FDIC to replenish the DIF is presented in this appendix.[80]

Increase in Deposit Insurance Assessments

On October 7, 2008, the FDIC announced a plan to restore the DIF to its statutory requirement by the end of 2013.[81] Under the plan, deposit insurance assessments increased by 7 basis points (or 0.07 percentage points) beginning January 1, 2009. The FDIC announced modifications to its original restoration plan on February 27, 2009.[82] The time horizon deemed necessary to accumulate the DRR level for the DIF was extended to seven years from the initial five.

In the February 27, 2009, announcement, the FDIC also imposed a special assessment fee on all banks to help replenish the DIF. The FDIC's response in the event of a banking crisis was consistent with academics' earlier warnings of a procyclical bias in the deposit assessment pricing system. The FDIC initially proposed an emergency special assessment of 20 basis points (0.2%) that would be imposed on member banks on June 30, 2009, and collected on September 30, 2009. In the final ruling, however, the FDIC lowered the emergency special assessment to 5 basis points (0.05%).[83]

Prepaid Insurance Assessments

On November 12, 2009, the FDIC approved a final rule that requires its member institutions to prepay deposit insurance assessments covering all of 2010, 2011, and 2012, to be collected on December 30, 2009, along with the regular assessments due for the fourth quarter of 2009.[84] The assessment *rate* would be calculated using the institution's rate as of September 30, 2009, and the rate applied to 2011 and 2012 would be 3 basis points (0.03%) higher. The assessment *base* or amount of deposits would be calculated using the institution's third quarter assessment base, and the base would be estimated to grow at 5% annually through the end of 2012. The FDIC would

[79] See CRS Report RL34182, *Financial Crisis? The Liquidity Crunch of August 2007*, by Darryl E. Getter et al.

[80] For specific details, see http://www.fdic.gov/deposit/insurance/new.html. This page lists recent proposed rules, approved rules, and other recent items of note regarding the deposit insurance fund and assessment rates.

[81] See "FDIC Board Adopts Restoration Plan—Proposes Higher Assessments on Insured Banks" at http://www.fdic.gov/news/news/press/2008/pr08094.html.

[82] See "FDIC Extends Restoration Plan; Imposes Special Assessment" at http://www.fdic.gov/news/news/press/2009/pr09030.html.

[83] See "Final Rule on Special Assessment" at http://www.fdic.gov/news/board/May22no2.pdf, which is a link to the memorandum to the FDIC Board of Directors, and also http://www.fdic.gov/news/board/May22no1.pdf for the official announcement of the final rule in the *Federal Register*.

[84] See http://www.fdic.gov/news/board/2009nov12no4.pdf for the official announcement of the final rule in the *Federal Register*.

consider, on a case-by-case basis, requests to be exempted from the prepayment requirement. The FDIC estimated that it would collect $45 billion in prepaid assessments for the DIF.[85]

The FDIC has other options for reducing its liquidity needs. The FDIC could impose additional special assessments. The FDIC could also exercise its authority to borrow from the U.S. Treasury or the Federal Financing Bank, though these options would still result in higher assessments on member institutions. According to the FDIC, member institutions would repay such borrowings through assessments. Consequently, member institutions will pay either today or in the future to restore the DIF. The prepayment option arguably would be less expensive for the industry than borrowing from the Treasury today and repaying later with additional interest charges. Paying more for deposit insurance may be burdensome for some member institutions, in particular during a period of financial uncertainty when loan defaults may increase and earnings from lending activities decrease.

Temporary Liquidity Guarantee Program

On October 14, 2008, the FDIC created the Temporary Liquidity Guarantee Program (TLGP) to encourage liquidity in the banking system.[86] One component of the program guarantees senior unsecured debt issued before October 31, 2009.[87] Such debt structures include commercial paper, interbank funding debt, promissory notes, and any unsecured portion of secured debt. The guarantee remains in effect until June 30, 2012, even if the maturity of these obligations extends beyond that date. Also, a surcharge was imposed on any debt issued on or after April 1, 2009, with a maturity date of one year or more.[88] The Transaction Account Guarantee (TAG) component insures all non-interest-bearing deposit accounts, primarily payroll processing accounts used by businesses, which often exceed the $250,000 deposit insurance limit.[89]

Financial institutions eligible for participation in the TLGP program include entities insured by the FDIC, bank holding and financial holding companies headquartered in the United States, and savings and loan companies under Section 4(k) of the Bank Holding Company Act of 1956. Although the TLGP is a voluntary program, eligible financial institutions were automatically registered to participate unless they had requested not to be by November 12, 2008. Eligible entities could also opt out of one or both of the program components.

After the first 30 days, institutions that remained in the program paid insurance fees.[90] To insure senior unsecured debt, the FDIC assessed an annualized fee corresponding to 75 basis points. A 10-basis-point surcharge was applied for non-interest-bearing deposit accounts above the $250,000 deposit insurance limit. According to testimony by the FDIC's deputy to the chairman,

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[85] See "FDIC Board Approves Final Rule on Prepaid Assessments" http://www.fdic.gov/news/news/press/2009/pr09203.html.

[86] See the initial announcement at http://www.fdic.gov/news/news/press/2008/pr08100.html. See http://www.fdic.gov/news/news/press/2008/pr08105.html, which provides further details of the program.

[87] On March 17, 2009, the FDIC extended the original deadline from June 30, 2009 to October 31, 2009.

[88] See http://www.fdic.gov/news/news/press/2009/pr09041.html. Monthly reports on debt issuance under the TLGP program may be found at http://www.fdic.gov/regulations/resources/tlgp/reports.html.

[89] P.L. 111-203, Section 627 repeals the prohibition of payment of interest on demand deposit accounts beginning one year after enactment.

[90] The list of institutions requesting not to participate in the TLGP program is available at http://www.fdic.gov/regulations/resources/TLGP/optout.html.

of 8,300 FDIC-insured institutions, almost 7,000 opted in to the transaction account guarantee program, and nearly 7,100 banks and thrifts and their holding companies opted in to the debt guarantee program.[91]

On April 13, 2010, the FDIC adopted a final rule extending the TAG portion of the TLGP for six months through December 31, 2010.[92] After passage of the Dodd-Frank Act, participation in TAG became mandatory for all insured depository institutions, and the unlimited insurance for their non-interest bearing accounts was extended for two years beginning December 31, 2010.[93]

[91] John F. Bovenzi, *Statement of John F. Bovenzi, Deputy to the Chairman and Chief Operating Officer, Federal Deposit Insurance Corporation on Promoting Bank Liquidity and Lending Through Deposit Insurance, Hope for Homeowners, and Other Enhancements before the Committee on Financial Services; U.S. House of Representatives,* February 3, 2009, http://www.fdic.gov/news/news/speeches/archives/2009/spfeb0309.html.

[92] See http://www.fdic.gov/news/news/financial/2010/fil10015.html.

[93] P.L. 111-203, Section 343.

Appendix C. Recent NCUA Actions to Stabilize the Credit Union System

The actions discussed in this appendix have been taken by the NCUA to alleviate liquidity pressures and thereby stabilize the corporate credit union system.

Increase in NCUSIF Premium Assessments

On September 16, 2010, the NCUA approved a share deposit premium charge of 12.42 basis points (or 0.1242 percentage points) of insured shares.[94] When combined with the premium charge for the Stabilization fund, the total premium being charged to credit unions is 26 basis points. The premium assessment reflected a plan to restore the NCUSIF equity ratio to 1.3%, which had fallen to 1.18% in August 2010.

Temporary Guarantees

As stated in the report, the U.S. Central Federal Credit Union provided services to the other corporate credit unions. The NCUA infused $1 billion into the U.S. Central Federal Credit Union by issuing a NCUSIF capital note and implementing a temporary guarantee on uninsured shares on deposit at corporate credit unions.[95] The purpose of this action was to maintain external sources of funding in the institution by preserving the confidence of creditors.

Similar to the FDIC's TLGP and TAG programs, the NCUA also established voluntary guarantee programs.[96] For example, the Temporary Corporate Credit Union Liquidity Guarantee Program (TCCULGP), which is analogous to TLGP, was approved by NCUA on October 16, 2008.[97] Under TCCULGP, the NCUF provided 100% guarantee on new unsecured debt obligations issued by eligible corporate credit unions on or before June 30, 2009, and maturing on or before June 30, 2010. These unsecured obligations included promissory notes, commercial paper, and inter-bank funding, any unsecured portion of secured debt.

Similar to the FDIC's TAG, the Temporary Corporate Credit Union Share Guarantee Program (TCCUSGP) guaranteed the uninsured shares of corporate credit unions (shares owned by the retail credit unions that exceed the NCUSIF insurance limits) through December 31, 2010.[98] After passage of the Dodd-Frank Act, TCCUSGP was extended through December 31, 2012.[99]

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[94] See http://www.ncua.gov/letters/2010/CU/10-CU-17.pdf and http://www.ncua.gov/GenInfo/BoardandAction/reports/2010/BAB10-0916.pdf.

[95] See http://www.ncua.gov/resources/CorporateStabilization/2009/samuelj@ncua.gov_20090618_105409.pdf.

[96] See **Appendix B** for more information on the FDIC's TLGP and TAG programs.

[97] See http://www.ncua.gov/news/press_releases/2008/MA08-1016.htm.

[98] See http://www.ncua.gov/letters/2009/CU/Enclosure_2TemporaryCorporateShareGuaranteeProgram.pdf.

[99] See http://www.ncua.gov/resources/CorporateCU/CSR/CSR-4.pdf and http://www.ncua.gov/GenInfo/BoardandAction/reports/2010/BAB10-0916.pdf.

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Acknowledgments

Walter Eubanks and Pauline Smale contributed to earlier versions of this paper.