

# Federal Deposit Insurance for Banks and Credit Unions

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## Summary

The federal deposit insurance system in the United States protects depositors from losses that would occur in the event that a financial institution becomes insolvent, meaning that the institution's lending activities did not generate enough revenue to repay depositors their principal and interest. By guaranteeing depositor accounts up to a set limit, deposit insurance may also help prevent "runs," which occur when bank customers lose confidence in the ability of a financial institution to repay its depositors and rush to withdraw deposits. A bank run, or panic, can spread and threaten the solvency of other financial institutions should the public also doubt their soundness, thus suddenly and simultaneously withdrawing deposits from those institutions as well. In other words, deposit insurance aims to promote and help maintain public confidence in the U.S. financial system, particularly at times when some depository entities suffer large losses or become insolvent.

The Federal Deposit Insurance Corporation (FDIC) was established to insure bank deposits as an independent government corporation under the authority of the Banking Act of 1933, also known as the Glass-Steagall Act (48 Stat. 162, 12 U.S.C.). The FDIC is not funded by appropriations; it 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 (48 Stat. 1216) formed a national system to charter and supervise federal credit unions. The National Credit Union Administration (NCUA), which administers deposit insurance for credit unions, became an independent federal agency in 1970 (P.L. 91-468, 84 Stat. 994). The NCUA is not funded by appropriations, but 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). Proceeds from 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. Credit union failures also increased, and five large corporate credit unions were placed under conservatorship by the NCUA. The 111<sup>th</sup> Congress subsequently provided both the FDIC and the NCUA with greater ability to replenish the insurance funds and stabilize liquidity among depository institutions through a variety of measures. Should insurance claims (resulting from failures) exceed the sizes of the insurance fund reserves, additional legislative action may be necessary for one or both agencies to continue to resolve failed institutions.

Current congressional interest in deposit insurance relates to oversight of how the FDIC and the NCUA protect deposits and address solvency issues associated with their insurance funds. This report provides an overview of the FDIC and NCUA, the status of both the DIF and NCUSIF, and describes the procedures followed to resolve failed depository institutions. Appendixes to this report describe measures taken to reduce the loss exposure and total risks to the funds.

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## Introduction

The federal deposit insurance system in the United States, which was established in the 1930s, protects depositors from losses that may result from at least two causes. First, a financial institution may use deposits to fund lending activities that may later prove to be unprofitable, leading to substantial losses that make it difficult to repay depositors. Second, a financial institution may find itself unable to repay depositors if its customers suddenly and simultaneously withdraw their deposits based upon speculation or knowledge about the health of similar or neighboring institutions. This phenomenon is generally known as a bank run. Hence, deposit insurance has arguably promoted and helped to sustain public confidence in the U.S. financial system, particularly at times when depositories have suffered large losses.

As the financial crisis of 2008 developed, the number of failures of depository institutions increased. The Federal Deposit Insurance Corporation (FDIC) administered 25 bank failures in 2008, 140 bank failures in 2009, 157 bank failures in 2010, and 92 bank failures in 2011. In contrast, no banks failed in 2005 and 2006, and only three bank failures occurred in 2007.<sup>1</sup> Funds used to reimburse depositors when banks fail are maintained in the Deposit Insurance Fund (DIF), which is managed by the FDIC. The pace of bank failures has, so far, declined since 2011.

According to the National Credit Union Administration (NCUA), 15, 16, and 12 credit unions failed in 2005, 2006, and 2007, respectively; in comparison, 18 credit unions failed in 2008, 28 in 2009, 28 in 2010, and 16 in 2011.<sup>2</sup> 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 to reimburse credit union members are maintained in the National Credit Union Share Insurance Fund (NCUSIF), which is managed by the NCUA. The pace of credit union failures has declined since 2011.

Regulators and legislators reacted to (1) the depletion of the DIF that resulted from the surge in bank failures and (2) a temporary dip in the NCUSIF below its statutory level during 2010. For example, regulators increased deposit insurance assessments on member institutions. In addition, the NCUA borrowed funds (which must be repaid) from the U.S. Treasury via the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) to administer the conservatorships of the corporate credit unions. The 111<sup>th</sup> Congress also provided the FDIC and the NCUA with greater ability to meet the liquidity needs of depository institutions, which are discussed later in this report. Whether additional legislative action becomes necessary depends in part upon the future number and pace of failures of depository institutions.

This report provides an overview of the FDIC and the NCUA, the status of the DIF and NCUSIF, and the resolution procedures that are implemented when depository institutions fail. **Appendix A** summarizes efforts to support the DIF during the recent period of financial distress prior to the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203, 124 Stat. 1376). **Appendix B** summarizes recent actions taken to minimize losses to the NCUSIF and the credit union system.

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<sup>1</sup> See <http://www2.fdic.gov/qbp/2009dec/qbp.pdf>.

<sup>2</sup> See NCUSIF and TCCUSF Statistics, <http://www.ncua.gov/Resources/Reports/ncusif/2011/2011JuneBoardSlides.pdf>.

## 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.<sup>3</sup> The FDIC insures demand deposit (non-interest bearing) accounts, interest bearing checking accounts, savings accounts, and certificates of deposit.<sup>4</sup> The FDIC also insures funds held in traditional and Roth Individual Retirement Accounts (IRAs).<sup>5</sup> It 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.<sup>6</sup>

When a bank becomes insolvent or fails, the FDIC assumes responsibility for repayment of the principal balance in depositor accounts 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, but 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.<sup>7</sup>

Congress has periodically increased the maximum amount of deposit insurance coverage as deemed necessary to enhance public confidence and reduce the risk of bank runs.<sup>8</sup> 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.<sup>9</sup> The Emergency Economic Stabilization Act of 2008 (EESA; P.L. 110-343, 122 Stat. 3765) temporarily raised the limit on

<sup>3</sup> 48 Stat. 162, 12 U.S.C. See Christine Bradley, "A Historical Perspective on Deposit Insurance," Federal Deposit Insurance Corporation, *FDIC Banking Review*, December 2000, p. 3, [http://www.fdic.gov/bank/analytical/banking/2000dec/brv13n2\\_1.pdf](http://www.fdic.gov/bank/analytical/banking/2000dec/brv13n2_1.pdf).

<sup>4</sup> 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) accounts; and outstanding cashiers' checks.

<sup>5</sup> 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.

<sup>6</sup> 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, "One-Stop Shopping for Financial Services: A Window of Opportunity for the Informed Consumer," *FDIC Consumer News—Spring 2001*, FDIC, 2001, <http://www.fdic.gov/CONSUMERS/consumer/news/cnspr01/cvrstry.html>.

<sup>7</sup> FDIC, "Fall 2008—Special Edition: Your New, Higher FDIC Insurance Coverage," *FDIC Consumer News*, 2008, <http://www.fdic.gov/consumers/consumer/news/cnfall08/misconceptions.html>.

<sup>8</sup> 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 A**.

<sup>9</sup> P.L. 109-171, 110 Stat. 9.

deposit insurance until December 31, 2009.<sup>10</sup> 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, 123 Stat. 1632) made the increase in the deposit insurance limit effective until December 31, 2013.<sup>11</sup> On July 21, 2010, the Dodd-Frank Act made the increase permanent.<sup>12</sup>

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.<sup>13</sup> 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 the Dodd-Frank Act to be a minimum of 1.35% of total insured deposits.<sup>14</sup> Should the DRR fall below its statutorily mandated range, the FDIC is then required to devise a restoration plan to recapitalize the fund. A well-capitalized DIF arguably would help maintain public confidence in the FDIC's ability to protect deposits.

By the end of 2013, there were \$6,011 billion estimated FDIC-insured deposits and 24 bank failures for the year.<sup>15</sup> The FDIC reports that the decline in insured deposits from 2012 to 2013 is primarily due to the expiration of the temporary unlimited insurance coverage on noninterest-bearing transaction accounts.<sup>16</sup> **Figure 1** illustrates the evolution of the total amount of FDIC-insured deposits and the DRR. The DRR, which was 1.25% at the end of December 2005, was 0.79% as of December 31, 2013. The DRR movements reflect losses to the DIF as well as a substantial increase in insured deposits. **Figure 2** illustrates the DRR along with the number of bank failures.<sup>17</sup> The FDIC has adopted a restoration plan to recapitalize the DFF to meet the 1.35% minimum requirement by September 30, 2020.<sup>18</sup> **Appendix A** summarizes efforts to support the DIF during the recent period of financial distress.

<sup>10</sup> See also CRS Report RL34730, *Troubled Asset Relief Program: Legislation and Treasury Implementation*, by (name redacted) and (name redacted).

<sup>11</sup> P.L. 111-22, 123 Stat. 1632, Section 204.

<sup>12</sup> P.L. 111-203, 124 Stat. 1376, §335. The increase in deposit insurance was also made retroactive to cover funds for depositors that were uninsured in the six institutions for which the FDIC was appointed receiver or conservator after January 1, 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 (name redacted).

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

<sup>14</sup> P.L. 111-203, §334.

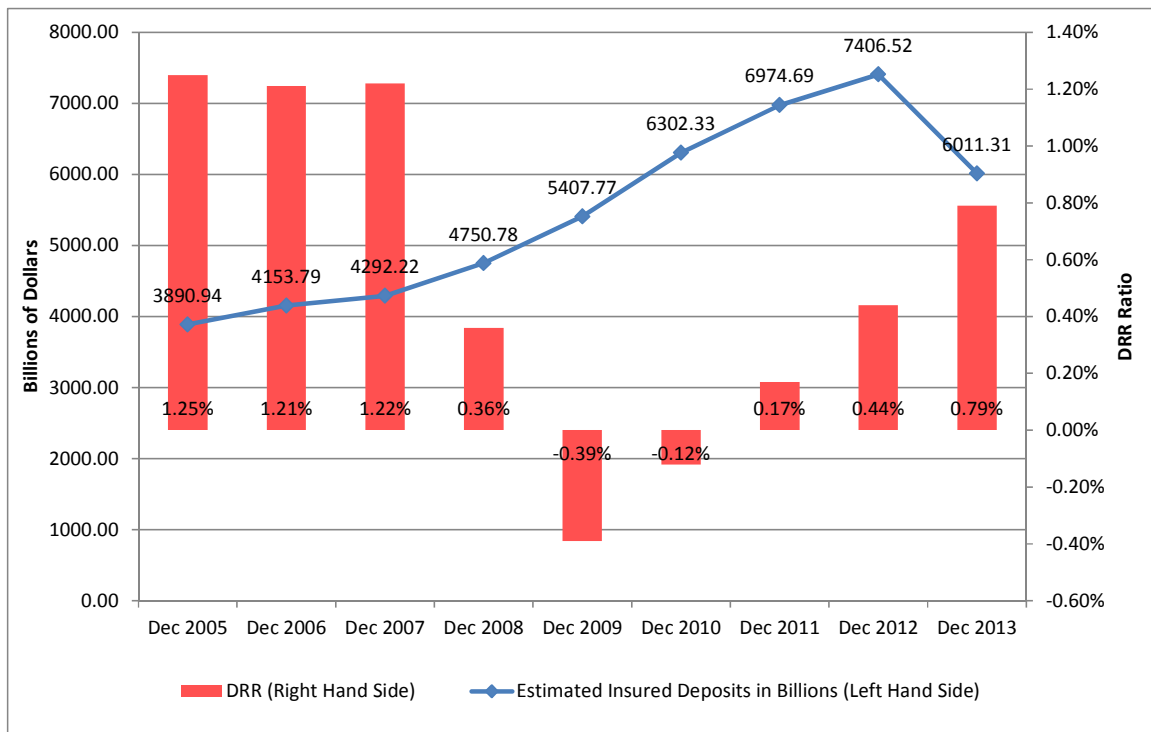
<sup>15</sup> See FDIC *Quarterly Banking Report* as of December 31, 2013, at <http://www2.fdic.gov/qbp/2013dec/qbp.pdf>.

<sup>16</sup> For more information about the Transaction Account Guarantee program, see **Appendix A** and CRS Report R42787, *An Overview of the Transaction Account Guarantee (TAG) Program and the Potential Impact of Its Expiration or Extension*, by (name redacted).

<sup>17</sup> 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. 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>.

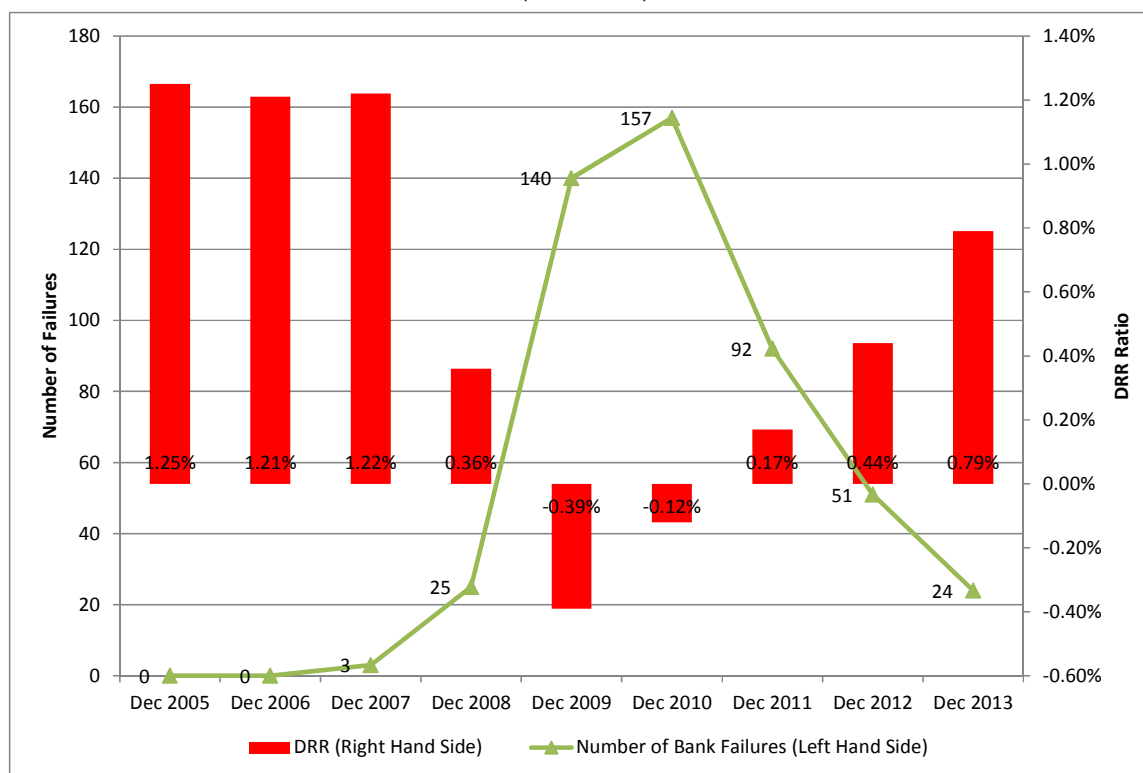
<sup>18</sup> See FDIC's 2012 Annual Performance Plan at <http://www.fdic.gov/about/strategic/performance/insurance.html>.

**Figure I. Total FDIC-Insured Deposits and Designated Reserve Ratio (DRR)**  
(2005-2013)



**Source:** FDIC Quarterly Banking Report.

**Figure 2. FDIC Designated Reserve Ratio and Annual Bank Failures**  
(2005-2013)



**Source:** FDIC Quarterly Banking Report.

**Note:** Figures are annual or cumulative for the given year.

## Share Insurance for Credit Unions

Credit unions are non-profit depository financial institutions that are owned and operated entirely by their members.<sup>19</sup> *Natural person* credit unions, also known as 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. Retail credit unions are cooperative owners of 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 National Credit Union Administration (NCUA) became an

<sup>19</sup> For additional information about the credit unions along with comparisons to banks, see CRS Report R42574, *Credit Union Commercial Business Lending: Key Issues for Legislation in the 112<sup>th</sup> Congress*, by (name redacted).



independent federal agency in 1970.<sup>20</sup> Typically, the Office of the Comptroller of the Currency (OCC) charters and supervises commercial banks; the FDIC provides deposit insurance and liquidates failed banks; and the Federal Reserve provides lender-of-last-resort liquidity to solvent banks via its discount window.<sup>21</sup> The NCUA, by comparison, serves all three functions for federally regulated credit unions.<sup>22</sup> All 28 corporate credit unions are federally insured.

Share deposit insurance may help bolster public confidence and prevent panic behavior that can lead institutions to fail, which would require the NCUA to arrange an assisted merger, a purchase and assumption action, or an involuntary liquidation. 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.<sup>23</sup> ESSA temporarily raised the basic limit of \$100,000 on federal deposit insurance coverage for individual (non-retirement) accounts to \$250,000 until December 31, 2009; the limit was made permanent by the Dodd-Frank Act. Retirement accounts retained their existing \$250,000 insurance coverage limit.<sup>24</sup>

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, but 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.<sup>25</sup> 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 the earnings also generate income for the fund. Hence, the NCUSIF's reserves consist of the 1% deposit, plus the fund's accumulated insurance premiums, fees, and interest earnings.

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%.<sup>26</sup> 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

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<sup>20</sup> The Federal Credit Union Act of 1934 (48 Stat. 1216). P.L. 91-468, 84 Stat. 994 made the NCUA an independent agency, which is governed by a three-member Board.

<sup>21</sup> Prior to passage of 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>.

<sup>22</sup> 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>.

<sup>23</sup> See <http://www.ncua.gov/DataApps/Pages/SI-FAQs.aspx>.

<sup>24</sup> The insurance coverage for eligible retirement accounts was raised by two laws passed in the 109<sup>th</sup> Congress, P.L. 109-171, 120 Stat. 4 and P.L. 109-173, 119 Stat. 3601; see 12 U.S.C. 1781-1790d.

<sup>25</sup> July 18, 1984, 98 Stat. 494. The 1% is carried on each individual institution's books as an asset.

<sup>26</sup> The Federal Credit Union Act (12 USC 1782(h)(4)). See [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/bedinger\\_-\\_nafcua.pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/bedinger_-_nafcua.pdf).

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; it is required to do so if the equity ratio exceeds 1.5%. Consequently, a procyclical bias exists with the pricing of NCUA share deposit insurance given the equity ratio cap.<sup>27</sup> Thus, the burden to the NCUSIF, particularly during an economic downturn, depends upon the procyclical bias in share deposit insurance pricing as well as the pace of failures and losses in the credit union system. HFSTHA extends the period of time available to complete restoration of the equity ratio (should it fall below 1.2%) to eight years, which may possibly reduce the amount that assessments would need to rise to restore a fall in the equity ratio below the minimum statutory level.

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.<sup>28</sup> 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.

At the end of 2013, there were \$865 billion NCUA-insured share deposits and 17 credit union failures for the year.<sup>29</sup> **Figure 3** illustrates the total amount of NCUA-insured share deposits and the NCUSIF equity ratio. The NCUSIF equity ratio, which was 1.28% at the end of December 2005, was 1.30% as of December 31, 2013. **Figure 4** illustrates the NCUSIF equity ratio along with the number of credit union failures.<sup>30</sup> **Appendix B** discusses the Temporary Corporate Credit Union Stabilization Fund (TCCUSF), which accounts for the corporate credit union losses, as well as other actions taken to minimize losses to the NCUSIF and the credit union system.

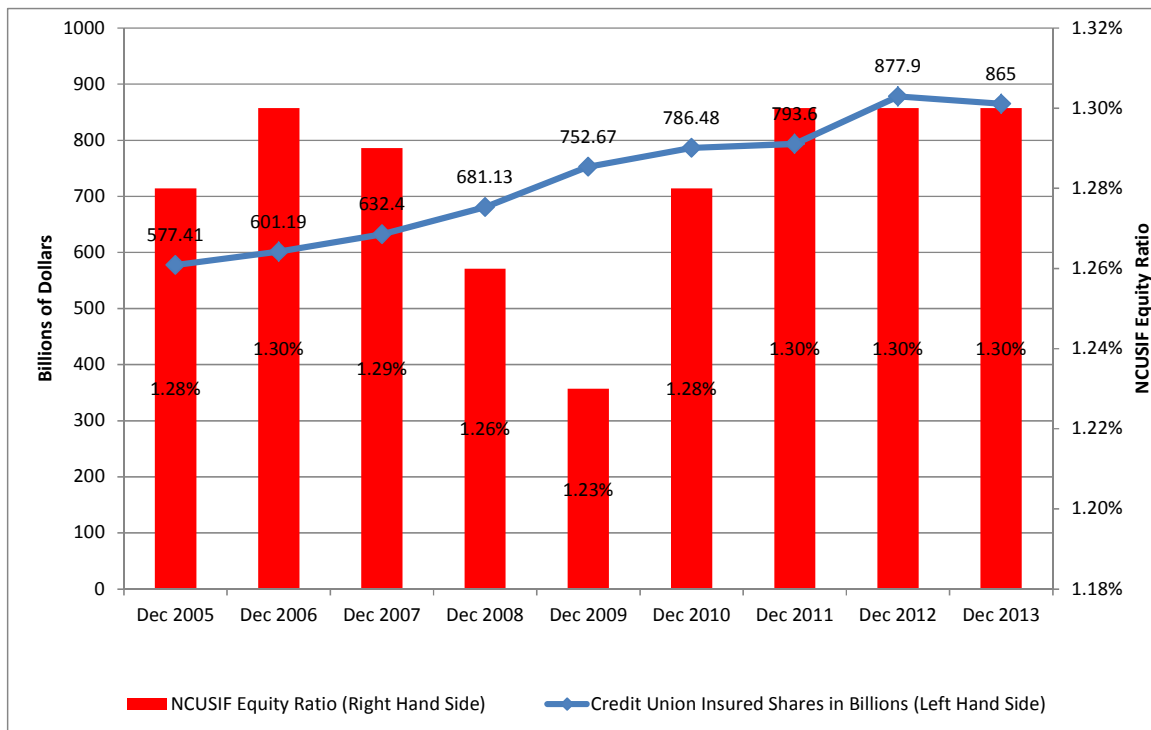
<sup>27</sup> In this context, a procyclical bias exists when the collection of assessments is tied to the size of the insurance fund, thus increasing the correlation between the insurance fund's solvency risk and the level of distress experienced by the insured depository institutions. Under a procyclical bias, credit unions would also be more likely see an increase in share deposit insurance premiums during economic downturns when it is more difficult to maintain profitability. The Dodd-Frank Act eliminated the procyclical bias with respect to the pricing of FDIC deposit insurance assessments, but the procyclical bias still exists with the pricing of NCUA deposit insurance assessments. For more information on this issue as it related to the FDIC, see **Appendix A**.

<sup>28</sup> See Statement of Deborah Matz, chairman, National Credit Union Administration, "The State of the Credit Union Industry," p. 3, at <http://www.ncua.gov/News/Documents/SP20101209Matz.pdf>, which was given in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, 111<sup>th</sup> Cong., 2<sup>nd</sup> sess., December 9, 2010.

<sup>29</sup> See <http://www.ncua.gov/Legal/Documents/Reports/IAG201312.pdf>.

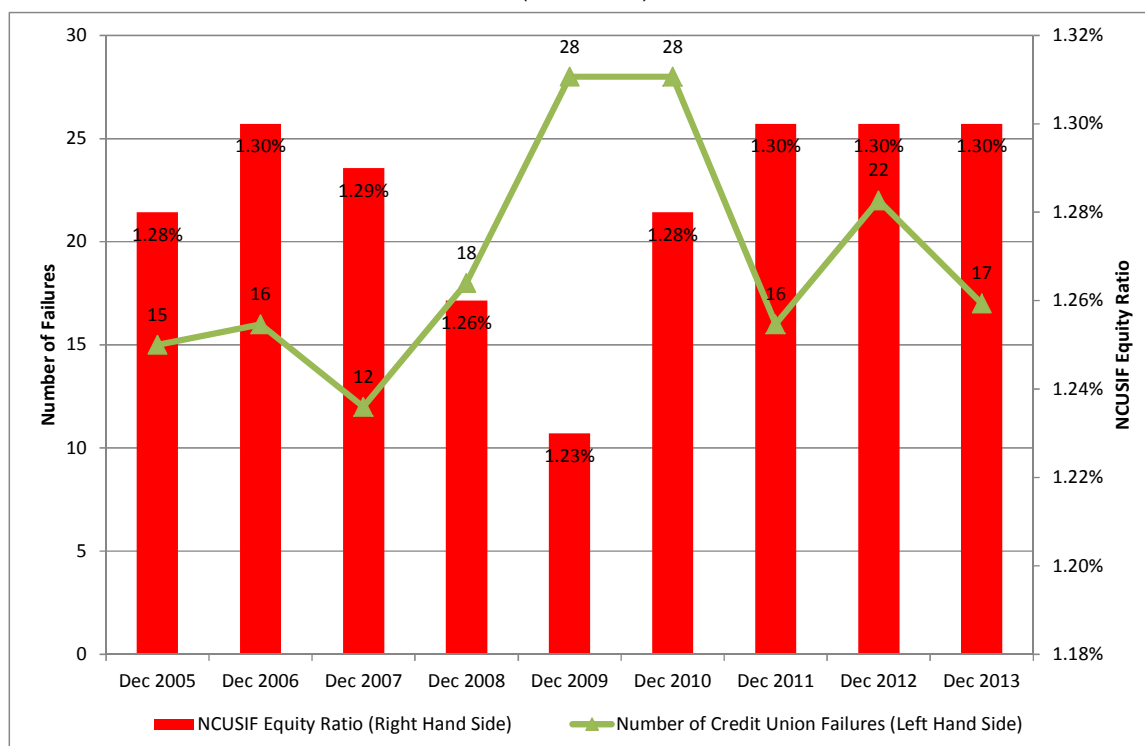
<sup>30</sup> See <http://www.ncua.gov/Legal/Documents/Reports/SI-Slides201312.pdf>. The NCUSIF's equity ratio does not reflect the total losses to the credit union system, given that it does not account for the corporate credit union conservatorships.

**Figure 3. Total NCUA-Insured Share Deposits and NCUSIF Equity Ratio  
(2005-2013)**



Source: NCUA.

**Figure 4. NCUSIF Equity Ratio and Annual Credit Union Failures**  
(2005-2013)



**Source:** NCUA.

**Note:** Figures are annual or cumulative for the given year.

## The Resolution Process for Insolvent Depository Institutions

If an insured depository institution fails to maintain sufficient levels of capital or net worth to meet safety and soundness requirements, it is closed, and the assets of the institution are generally sold to another qualified depository institution. The FDIC and NCUA resolution procedures are described below.

### Bank Failures and the FDIC

Bank assets include the consumer and commercial loans that banks originate and hold in portfolio; bank liabilities include the funds that banks borrow to provide loans to consumers and businesses. Whenever customers (depositors) make savings or checking deposits into a bank, the bank is effectively borrowing from them and using their funds to originate loans. A bank typically borrows the funds from its depositors for shorter periods of time with the expectation that these short-term borrowings must be continuously renewed until its longer-term loans held in portfolio have been fully repaid. For example, suppose a bank originates a consumer loan that a customer is expected to repay in full over two years. During those two years that the customer is borrowing, the bank will simultaneously “fund the loan,” meaning that it will treat its depositors’

funds as a sequence of quarterly (for a total of eight quarters) or monthly (for a total of 24 months) short-term loans and make periodic interest payments to depositors. In other words, banks (and credit unions) make loans to their customers for longer periods of time while they simultaneously borrow from their depositors in sequences of loans having shorter maturities.

Although banks may fund loans from creditors who are not depositors, deposits have traditionally been considered the most stable and inexpensive funding source, in particular for the smaller community banks, because depositors typically are the least sensitive to short-term interest rate fluctuations.<sup>31</sup> Nevertheless, banks can also borrow funds via participation in the federal funds market, by using repurchase agreements, by obtaining advances (loans) from the Federal Home Loan Bank System (FHLB); in addition, some of the larger banks may issue short-term commercial paper. Given that the short-term borrowings of a financial institution are refinanced more frequently, the composition of its liabilities (i.e., the ratio of deposit to non-deposit creditors) changes more frequently than the composition of its longer-term, less liquid assets (portfolio of loans). Hence, the total amounts of federally insured deposits are estimates at any point in time and are not known with certainty until an institution fails.<sup>32</sup>

A variety of financial ratios (e.g., total risk-based capital, tier 1 risk-based capital, tier 1 leverage, tangible equity ratios) are computed to determine whether a bank has sufficient reserves to act as buffers against default and liquidity risks.<sup>33</sup> If a bank's lending activities fail to generate enough income to maintain these buffers, then it will become insolvent.<sup>34</sup> A bank failing to meet the minimum required ratio thresholds would be considered insolvent, and its regulator (chartering authority and examiner) is likely to shut it down before the losses grow so large that it becomes unable to repay most of the principal and interest accruing to depositors. The regulator would also appoint the FDIC as the receiver of the failed institution.

As the receiver of a failed bank, the FDIC determines the resolution transaction that is least costly to the DIF by evaluating all 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 the DIF.<sup>35</sup> The least-costly transaction typically will involve some form of the purchase and assumption process, generally referred to as "P&A."<sup>36</sup> A P&A is a resolution

<sup>31</sup> 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>.

<sup>32</sup> 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*, February 12, 2007, [http://www.fdic.gov/deposit/insurance/initiative/Denominator\\_Board.pdf](http://www.fdic.gov/deposit/insurance/initiative/Denominator_Board.pdf).

<sup>33</sup> For more information on bank regulatory capital and liquidity ratios, see CRS Report R42744, *U.S. Implementation of the Basel Capital Regulatory Framework*, by (name redacted).

<sup>34</sup> 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 if there is an unusual demand for cash by depositors.

<sup>35</sup> 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>.

<sup>36</sup> 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 (name redacted) and (name redacted); Federal Deposit (continued...)

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).<sup>37</sup> The FDIC seeks bids from qualified institutions for the failed bank's assets.<sup>38</sup> The FDIC accepts the bid that is judged to be the least-costly option to the DIF and closes the failed bank. The transfers of assets and liabilities are typically completed over a weekend to minimize any disruptions to bank customers' access to their funds.

The total losses to the DIF may exceed any costs to reimburse depositors because additional costs associated with resolving a bank failure also apply. For example, some of the bank creditors may require repayment ahead of depositors. If a bank borrowed funds from the FHLB, the FDIC must repay the FHLB immediately because the FHLB's "super lien" status gives it priority over depositors.<sup>39</sup> In addition, the FDIC often provides assistance typically by entering into loss-sharing agreements with acquirers of a failed bank's assets. This assistance limits the amount of potential losses that may arise from loans transferred to an acquiring institution's balance sheet, which may threaten its solvency. Furthermore, any assets not purchased by an acquirer must still be liquidated by the FDIC.<sup>40</sup> Hence, the inability to know the amount of insured deposits until the bank failure occurs, when also considered with the additional costs associated with administration of the P&A process, increases the difficulty to predict the costs to the DIF.

## Credit Union Failures and the NCUA

The NCUA, similar to the FDIC, uses a net worth-asset ratio to determine the solvency of a credit union.<sup>41</sup> The NCUA computes a credit union's net worth-asset ratio by dividing its net worth by its assets.<sup>42</sup> Under-capitalized credit unions, which typically have capital-asset ratios below the NCUA's minimum thresholds, would be considered insolvent.<sup>43</sup> If a credit union lacks sufficient

(...continued)

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.

<sup>37</sup> See Chapter 3 of the FDIC's *Resolution Handbook* at <http://www.fdic.gov/bank/historical/reshandbook/ch3pas.pdf>.

<sup>38</sup> 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.

<sup>39</sup> 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/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 (name redacted) and (name redacted). 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>. The FHLB may also assess prepayment fees that might be costly to the DIF when resolving a bank failure.

<sup>40</sup> 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/>.

<sup>41</sup> The difference between assets minus liabilities is referred to as "capital" in connection with banks, which issue preferred and common equity shares. For credit unions, the difference between assets minus liabilities is referred to as "net worth" given that they do not issue equity shares.

<sup>42</sup> The assets are also assigned risk-weights prior to computation of the net worth ratio.

<sup>43</sup> For a table that summarizes the net worth-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](http://www.ncua.gov/resources/RegulationsOpinionsLaws/rules_and_regs/NCUA%20R%20&%20R%20Book%201%20May%208%202008.pdf).

net worth, the NCUA, which is often the primary federal regulator, will shut down the institution and then act 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 the NCUSIF 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.<sup>44</sup> The total losses to the NCUSIF, as in the case of bank failures, are not limited to any costs to reimburse insured share deposit holders. The NCUSIF would also absorb the administrative costs associated with resolving a credit union failure (i.e., repayment of FHLB loans that have priority over share depositors, loss sharing agreements entered with acquiring institutions, the liquidation of any remaining assets not purchased by acquirers).<sup>45</sup>

## Insurance Fund(s) Insolvency and Taxpayer Risk

The risk to U.S. taxpayers to bear the losses of failed institutions increases when one or both of the insurance funds become depleted or insolvent. Insolvency of the insurance funds may occur after a systemic risk event (or an unexpected economic downturn or financial market collapse), which may generate numerous institutional failures. For example, a sudden decline in residential or commercial real estate values can cause the loan portfolios of numerous banks to deteriorate. In addition, an economic downturn that affects a particular industry or geographic area may be particularly devastating to the asset portfolios of smaller institutions. For instance, given their membership restrictions, credit unions with members consisting primarily of construction workers who experienced large job losses in the recent recession would be more likely to see a multitude of loan defaults.<sup>46</sup> Similarly, small banks or credit unions operating within a defined geographic region that experienced relatively large home value declines would see widespread mortgage defaults. Consequently, a sudden financial downturn that affects the portfolios of numerous depository institutions can drain deposit insurance funds just as quickly as the failure of a large financial institution. Hence, a systemic risk event, along with a procyclical bias in the pricing of deposit assessments (discussed in **Appendix A**), increases the risk of insurance fund insolvency.

Depletion of either or both deposit insurance funds may result in borrowings from the U.S. Treasury to protect depositors, with the taxpayer bearing the costs if those borrowings are not repaid. The DIF became insolvent by the third quarter of 2009, but the FDIC has been able to avoid having to borrow from the U.S. Treasury despite the numerous bank failures. On the other hand, the NCUSIF remained solvent; however, corporate credit union losses that may have been charged to the fund were placed onto an off-balance sheet account that has been funded by a line of credit from the U.S. Treasury. Consequently, the credit union system via the NCUA must repay the U.S. Treasury to prevent taxpayers from bearing any losses. The following appendixes discuss in more detail the efforts by legislators and the federal regulators to protect the DIF, NCUSIF, and ultimately, the taxpayers.

<sup>44</sup> See <http://www.ncua.gov/letters/2010/CU/10-CU-11.pdf> for more details regarding the NCUA's P&A process.

<sup>45</sup> 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](http://www.ncua.gov/news/press_releases/2010/MA10-1117NCUAINitiatesPilotLossShareProgram.pdf).

<sup>46</sup> For additional information on large job losses during the recent recession, see CRS Report R43476, *Returning to Full Employment: What Do the Indicators Tell Us?*, by (name redacted).



## Appendix A. Recent Efforts to Support the Deposit Insurance Fund

As noted in **Figure 1** and **Figure 2**, the DIF began declining in 2008, and it became negative by the third quarter of 2009. The designated reserve ratio (DRR) was -0.16 during the third quarter of 2009, and reached a low of -0.39 during the fourth quarter of 2009. The DRR rose to 0.06 during the second quarter of 2011 and has so far remained positive. The decline in the DRR was due to both an increase in deposit insurance coverage during the crisis and the increase in bank failures. Congress and the FDIC took actions to support the DIF, which are discussed in this appendix.

### 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.<sup>47</sup> 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.<sup>48</sup> 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 permanent borrowing authority from the U.S. Treasury.<sup>49</sup>

### 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, which was implemented on January 1, 1993.<sup>50</sup> 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 risk. The Deposit Insurance Funds Act of 1996, however, mandated that institutions that are both well-capitalized and have received high examination ratings shall not be charged premiums when the DIF is at or above the statutorily set DRR.<sup>51</sup> Some economists have argued that this limitation injected a procyclical bias into the pricing of deposit insurance.<sup>52</sup> 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.

<sup>47</sup> 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>.

<sup>48</sup> 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 (name redacted) and (name redacted).

<sup>49</sup> P.L. 111-22, 123 Stat. 1632, Section 204.

<sup>50</sup> P.L. 102-242, 105 Stat. 2236 See "Assessment Rate Cases" at [http://www.fdic.gov/deposit/insurance/assessments/rate\\_cases.html](http://www.fdic.gov/deposit/insurance/assessments/rate_cases.html).

<sup>51</sup> P.L. 104-208, 110 Stat. 3009.

<sup>52</sup> 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>.



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.<sup>53</sup> 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 to individual banks, after notice and comment rulemaking, based upon the riskiness of the institutions, regardless of the level of the DRR.<sup>54</sup> On July 16, 2006, the FDIC then proposed new risk-based deposit premium assessments, which were approved on November 2, 2006.<sup>55</sup> 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 apparently remained.<sup>56</sup>

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.<sup>57</sup> This provision allows the FDIC to continue collecting assessments regardless of the DRR level. This authority in principle enhances 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.<sup>58</sup>

## Changes to the Pricing of Deposit Insurance

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.<sup>59</sup> On November 10, 2010, the FDIC made further revisions to the system in light of the Dodd-Frank Act.<sup>60</sup> On February 7, 2011, the FDIC approved a final rule on assessments, dividends, the assessment base,

<sup>53</sup> 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>.

<sup>54</sup> See <http://www.fdic.gov/deposit/insurance/initiative/index.html> for highlights regarding coverage of the law and a link to the Reform Act.

<sup>55</sup> 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>.

<sup>56</sup> See "Assessment Dividends" at <http://www.fdic.gov/deposit/insurance/reform.html#drr>.

<sup>57</sup> P.L. 111-203, 124 Stat. 1376, Section 332.

<sup>58</sup> For more information regarding the elimination of the procyclicality in the existing risk-based assessment system, see "Designated Reserve Ratio" at <https://www.federalregister.gov/articles/2010/12/20/2010-31829/designated-reserve-ratio> and <http://www.gpo.gov/fdsys/pkg/FR-2010-12-20/pdf/2010-31829.pdf>.

<sup>59</sup> 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.

<sup>60</sup> 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.

and the pricing of deposit insurance for large banks, with an effective date of April 1, 2011.<sup>61</sup> The new system takes a formal risk analysis approach, similar to methodologies used in credit underwriting.<sup>62</sup> This approach attempts to more accurately capture risk at the time the institution assumes the risk and, therefore, to better predict when an institution's risk profile may change.<sup>63</sup>

The assessment system has separate assessment structures for large depository institutions, highly complex institutions, and small depository institutions, respectively. A large depository institution is defined as one having \$10 billion or more in total assets for at least four consecutive quarters. A highly complex institution is 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.<sup>64</sup> Small institutions, which do not fit into the other categories, are assessed separately.

Data for the large depository institutions and the highly complex institutions,<sup>65</sup> which are collected during examinations, are evaluated using a scorecard with variables from the following categories:

- a weighted average CAMELS<sup>66</sup> rating;
- 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;
- variables that represent the ability to withstand an increase in liquidity or funding risk, such as the ratio of core deposits to total liabilities; and
- 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.

After the data have been entered, the scorecard would compute a performance score and a loss severity score between 0 and 100. 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

<sup>61</sup> 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>.

<sup>62</sup> 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.

<sup>63</sup> The FDIC provides a complete description of the assessment system at <http://www.fdic.gov/deposit/insurance/11RuleAD35.pdf>.

<sup>64</sup> For a more precise definition of a highly complex institution, see <http://www.fdic.gov/news/board/april05.pdf>.

<sup>65</sup> 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."

<sup>66</sup> 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>.

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 is still 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).

The final assessment rate for each of the risk categories is computed using a predetermined initial base assessment rate followed by adjustments made based upon the bank's holdings of unsecured debt, secured liabilities, and brokered deposits.

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.<sup>67</sup> Under the previous assessment structure, banks may have been able to select non-deposit short-term funding options, thus reducing the amount of deposit insurance assessments they would have to pay. With an expanded assessment base, deposit premiums for the DIF would be collected regardless of the funding strategies pursued. The additional funds could potentially cover more of the additional costs that must be incurred to resolve a bank failure.

## **Increase in Deposit Insurance Assessments**

On October 7, 2008 (with a DRR at 0.76 for the third quarter), the FDIC announced a plan to restore the DIF to its statutory requirement by the end of 2013.<sup>68</sup> Under the plan, deposit insurance assessments increased by seven basis points (or 0.07 percentage points) beginning January 1, 2009. The FDIC announced modifications to its original restoration plan on February 27, 2009.<sup>69</sup> 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 also

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<sup>67</sup> P.L. 111-203, 124 Stat. 1376, §331. See Financial Institutions Letter (FIL-78-2010) at <http://www.fdic.gov/news/news/financial/2010/fil110078.html>, which defines the assessment base as "average consolidated total assets minus average tangible equity," as required by the Dodd-Frank Act.

<sup>68</sup> See "FDIC Board Adopts Restoration Plan—Proposes Higher Assessments on Insured Banks" at <http://www.fdic.gov/news/news/press/2008/pr08094.html>.

<sup>69</sup> See "FDIC Extends Restoration Plan; Imposes Special Assessment" at <http://www.fdic.gov/news/news/press/2009/pr09030.html>.

imposed an emergency special assessment of 5 basis points (0.05%) on member banks on June 30, 2009, to be collected on September 30, 2009.<sup>70</sup> Hence, the FDIC's response during the banking crisis appears to have been consistent with academics' earlier warnings of a procyclical bias in the deposit assessment pricing system.

## Prepaid Insurance Assessments

On November 12, 2009, the FDIC approved a final rule requiring 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.<sup>71</sup> The assessment *rate* was calculated using the institution's rate as of September 30, 2009, and the rate applied to 2011 and 2012 was 3 basis points (0.03%) higher. The assessment *base* or amount of deposits was calculated using the institution's third quarter assessment base, and the base was estimated to grow at 5% annually through the end of 2012. The FDIC announced that it would consider requests to be exempted from the prepayment requirement on a case-by-case basis.<sup>72</sup>

The FDIC has other options for reducing its liquidity needs. The FDIC could impose additional special assessments or exercise its authority to borrow from the U.S. Treasury or the Federal Financing Bank. 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 could, however, 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.<sup>73</sup> One component of the program guarantees senior unsecured debt issued before October 31, 2009.<sup>74</sup> Such debt structures include commercial paper, interbank funding debt, promissory notes, and any unsecured portion of secured debt. The guarantee remained in effect until June 30, 2012. Also, a surcharge was imposed on any debt issued on or after April 1, 2009, with a maturity date of one year or more.<sup>75</sup> The Transaction

<sup>70</sup> 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*.

<sup>71</sup> See <http://www.fdic.gov/news/board/2009nov12no4.pdf> for the official announcement of the final rule in the *Federal Register*.

<sup>72</sup> See "FDIC Board Approves Final Rule on Prepaid Assessments" <http://www.fdic.gov/news/news/press/2009/pr09203.html>.

<sup>73</sup> 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.

<sup>74</sup> On March 17, 2009, the FDIC extended the original deadline from June 30, 2009, to October 31, 2009.

<sup>75</sup> 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>.

Account Guarantee (TAG) component insured all non-interest-bearing deposit accounts, primarily payroll processing accounts used by businesses, which often exceed the \$250,000 deposit insurance limit.<sup>76</sup>

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 was a voluntary program, eligible financial institutions were automatically registered to participate unless they had requested to be excluded 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.<sup>77</sup> 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, almost 7,000 of 8,300 FDIC-insured institutions opted in to the transaction account guarantee program, and nearly 7,100 banks and their holding companies opted into the debt guarantee program.<sup>78</sup>

On April 13, 2010, the FDIC adopted a final rule extending the TAG portion of the TLGP for six months through December 31, 2010.<sup>79</sup> 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.<sup>80</sup> TAG was allowed to expire on December 31, 2012.

The FDIC has reported that losses from the TAG program to date have not been large enough to materially affect the goal to reach the statutory DIF reserve ratio (the DRR) requirement of 1.35 by September 30, 2020.<sup>81</sup> The TAG deposits represented a small percentage of failed bank deposits because a greater share of them was held in larger institutions.<sup>82</sup> Now that the TAG program has expired, TAG deposits are no longer used in the calculation of the DRR, which arguably moves the ratio more quickly toward its statutory requirement.

<sup>76</sup> P.L. 111-203, 124 Stat. 1376, Section 627 repeals the prohibition of payment of interest on demand deposit accounts beginning one year after enactment.

<sup>77</sup> The list of institutions requesting not to participate in the TLGP program is available at <http://www.fdic.gov/regulations/resources/TLGP/optout.html>.

<sup>78</sup> Statement of John F. Bovenzi, deputy to the chairman and chief operating officer, Federal Deposit Insurance Corporation, "Promoting Bank Liquidity and Lending Through Deposit Insurance, Hope for Homeowners, and Other Enhancements before the Committee on Financial Services," before U.S. House of Representatives, February 3, 2009, <http://www.fdic.gov/news/news/speeches/archives/2009/spfeb0309.html>.

<sup>79</sup> See CRS Report R42787, *An Overview of the Transaction Account Guarantee (TAG) Program and the Potential Impact of Its Expiration or Extension*, by (name redacted); and <http://www.fdic.gov/news/news/financial/2010/fil10015.html>.

<sup>80</sup> P.L. 111-203, 124 Stat. 1376, Section 343.

<sup>81</sup> See Letter from Martin J. Gruenberg, FDIC acting chairman, to Honorable Shelley Moore Capito, chairman, Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, House of Representatives, June 29, 2012, <http://www.aba.com/Issues/Index/Documents/FDICResponsetoCapitoonTAG.pdf>.

<sup>82</sup> Ibid. Banks that failed since the existence of the TAG programs had an average asset size below \$1 billion. TAG costs were approximately 3% of the estimated total costs of bank failures under the original TAG program that ended in 2010 and approximately 3% to date under the extended TAG program.

## Appendix B. Recent Efforts to Support the NCUSIF

As noted in **Figure 3** and **Figure 4**, the NCUSIF began to decline after 2006. The 2006 equity ratio was 1.30% and fell to 1.18% by August 2010, which was below the statutory minimum of 1.2%. Congress and the NCUA took actions to support the NCUSIF, which are discussed in this appendix.

### Temporary Corporate Credit Union Stabilization Fund

HFSTHA established the Temporary Corporate Credit Union Stabilization Fund (TCCUSF, or the 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.<sup>83</sup> 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.<sup>84</sup> 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.<sup>85</sup>

### Enhancement of the Central Liquidity Facility

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.<sup>86</sup> 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.<sup>87</sup>

### The National Credit Union Authority Clarification Act of 2010

The National Credit Union Authority Clarification Act of 2010 (NCUACA; P.L. 111-382, 124 Stat. 4134) made the following statutory changes that would help reduce losses to the NCUSIF:<sup>88</sup>

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<sup>83</sup> See <http://www.ncua.gov/Resources/OIG/Files/Reports/2010/OIG-10-13FY2009FSATCCUSF.pdf>.

<sup>84</sup> See <http://www.ncua.gov/Resources/CorporateCU/Files/CULetters/09-CU-14CorpStabilizationFundImplementation.pdf>.

<sup>85</sup> See Board Action Bulletin, May 20, 2010, at <http://www.ncua.gov/GenInfo/BoardandAction/reports/2010/BAB10-0520.pdf>.

<sup>86</sup> P.L. 95-630, 92 Stat. 3641. 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>.

<sup>87</sup> P.L. 110-329, 122 Stat. 3574. See <http://www.ncua.gov/Resources/Reports/NCUA2008-2009AnnualReport.pdf>, p. 9.

<sup>88</sup> For discussions of the issues that required amending, see <http://www.ncua.gov/newspublications/News/Newsletters/NCUARepFeb2011.pdf> and 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 in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, 111<sup>th</sup> Cong., 2<sup>nd</sup> sess., December 9, 2010.



- Changes in accounting definitions and standards, which are made by the Financial Accounting Standards Board (FASB), may indirectly affect the NCUSIF when its loans and account ledger definitions must remain the same by statute.<sup>89</sup> 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.<sup>90</sup> NCUACA gives the NCUA Board the authority to modify accounting definitions as accounting standards change, thus creating 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. Consequently, the equity ratio would likely fall below its statutory limit and thus 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 based solely 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 so 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.<sup>91</sup>

## **NCUA Restructuring of Corporate Credit Union Regulatory Framework**

On September 24, 2010, NCUA issued final amendments to its rule governing corporate credit unions.<sup>92</sup> Among the numerous revisions, corporate credit unions will now be regulated for safety and soundness under a risk-based capital scheme similar to FDIC insured banks. Rather than just

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<sup>89</sup> For more information about FASB, see <http://www.fasb.org/home>.

<sup>90</sup> 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](http://www.ncua.gov/resources/RegulationsOpinionsLaws/proposed_regs/Prompt%20Corrective%20Action%20Amended%20Definition%20of%20Post%20Merger%20Net%20Worth.pdf).

<sup>91</sup> 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.

<sup>92</sup> 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>.

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.<sup>93</sup> 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.

## 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.<sup>94</sup> 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 happened by December 2011.

## Temporary Guarantees

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.<sup>95</sup> 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.<sup>96</sup> For example, the Temporary Corporate Credit Union Liquidity Guarantee Program (TCCULGP), which is analogous to TLGP, was approved by NCUA on October 16, 2008.<sup>97</sup> Under TCCULGP, the NCUF provided a 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, and 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.<sup>98</sup> After passage of the Dodd-Frank Act, TCCUSGP was extended through December 31, 2012.<sup>99</sup>

<sup>93</sup> For definitions of these ratios as they apply to banking, see CRS Report R42744, *U.S. Implementation of the Basel Capital Regulatory Framework*, by (name redacted).

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

<sup>95</sup> See [http://www.ncua.gov/resources/CorporateStabilization/2009/samuelj@ncua.gov\\_20090618\\_105409.pdf](http://www.ncua.gov/resources/CorporateStabilization/2009/samuelj@ncua.gov_20090618_105409.pdf).

<sup>96</sup> See **Appendix A** for more information on the FDIC's TLGP and TAG programs.

<sup>97</sup> See [http://www.ncua.gov/news/press\\_releases/2008/MA08-1016.htm](http://www.ncua.gov/news/press_releases/2008/MA08-1016.htm).

<sup>98</sup> See [http://www.ncua.gov/letters/2009/CU/Enclosure\\_2TemporaryCorporateShareGuaranteeProgram.pdf](http://www.ncua.gov/letters/2009/CU/Enclosure_2TemporaryCorporateShareGuaranteeProgram.pdf).

<sup>99</sup> 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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