CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

May 16, 2002

H.R. 3717

Federal Deposit Insurance Reform Act of 2002

As ordered reported by the House Committee on Financial Services on April 17, 2002

SUMMARY

H.R. 3717 would amend provisions of banking and credit union law to reform the deposit insurance system. Specifically, the bill would increase insurance coverage for insured accounts from $100,000 per account to $130,000 for most accounts (with higher levels of coverage for retirement accounts and municipal deposits). Over time, the coverage limit for insured deposits would increase to account for inflation. Those provisions of the bill would affect deposits held by banks and thrifts, which are insured by the Federal Deposit Insurance Corporation (FDIC), as well as those held by credit unions, which are insured by the National Credit Union Administration (NCUA). In addition, the bill would merge the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) to create a new Deposit Insurance Fund (DIF), to pay the claims of depositors of failed banks and thrifts. Finally, H.R. 3717 would amend the conditions under which banks and thrifts would pay insurance premiums to the FDIC, which administers the funds.

CBO estimates that H.R. 3717 would increase both the costs of resolving failed financial institutions and the income from premiums paid by financial institutions. During the 2003-2012 period, the additional premiums that would be collected under the bill would more than offset the added spending. On balance, CBO estimates that H.R. 3717 would reduce net direct spending by $700 million over the 2003-2012 period. Because H.R. 3717 would affect direct spending, pay-as-you-go procedures would apply.

H.R. 3717 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the costs, if any, to comply with the requirement would not exceed the threshold established in UMRA ($58 million in 2002, adjusted annually for inflation).

The bill also contains private-sector mandates as defined by UMRA. CBO estimates that the direct cost of those mandates would be well above the annual threshold specified in UMRA

($115 million in 2002, adjusted annually for inflation), but we do not have sufficient information to provide a precise estimate of the aggregate cost.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3717 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Millions of Dollars				
	2003	2004	2005	2006	2007
DIRECT SPENDING					
FDIC and NCUA Spending Under Current Law					
Estimated Budget Authority	-31	-33	-34	-35	-36
Estimated Outlays	1,662	1,337	1,544	1,746	1,694
Proposed Changes to FDIC Spending					
Estimated Budget Authority	0	0	0	0	0
Estimated Outlays	-1,000	-400	0	-50	200
Proposed Changes to NCUA Spending					
Estimated Budget Authority	0	0	0	0	0
Estimated Outlays	-500	25	25	-125	25
Total Changes Under H.R. 3717					
Estimated Budget Authority	0	0	0	0	0
Estimated Outlays	-1,500	-375	25	-175	225
FDIC and NCUA Spending Under H.R. 3717					
Estimated Budget Authority	-31	-33	-34	-35	-36
Estimated Outlays	162	962	1,569	1,571	1,919

BASIS OF ESTIMATE

Two federal agencies are primarily responsible for the deposit insurance system. The FDIC insures the deposits in banks with the BIF and the deposits of thrifts with the SAIF. The National Credit Union Administration insures the deposits in credit unions (referred to as shares) with the Share Insurance Fund. When a financial institution fails, the FDIC and the NCUA use the insurance funds to reimburse the insured depositors of the failed institution. These agencies then sell the assets of the failed institution and deposit any money recovered into the insurance funds. CBO estimates that H.R. 3717 would increase both the cost of resolving failed banks and the premiums paid by financial institutions. Over the 2003-2012 period, we estimate that the added premiums paid by financial institutions would more than offset the increase in outlays to resolve failed financial institutions. Adding these effects together, we estimate that enacting H.R. 3717 would result in a net decrease in direct spending of about $700 million over the 2003-2012 period. The major components of this estimate are explained below.

Increase in the Cost of Resolving Failed Financial Institutions

H.R. 3717 would increase deposit insurance coverage from $100,000 to $130,000 for most accounts, and to $260,000 for employee benefit plans. Coverage for in-state municipal deposits would be the lesser of $5 million or 80 percent of any deposits above $130,000. Such increases would apply to deposits held by credit unions as well as banks and thrifts. In addition, the bill would require the FDIC and NCUA to increase deposit insurance coverage every five years beginning January 1, 2006, to account for inflation. (According to committee staff, the intent of section 3 of H.R. 3717 is to increase deposit insurance coverage in 2006 and 2011 to account for inflation. Despite a drafting error in this section, CBO assumes that such increases would occur.)

By 2003, we expect that insured deposits will total more than $3.2 trillion under current law. Based on information from the FDIC and the experience of past increases in deposit insurance coverage, CBO estimates that H.R. 3717 would increase the deposits insured by the FDIC by about $325 billion—or around 10 percent. CBO estimates that about $33 billion of that amount would result from new deposits attracted to banks and thrifts as a result of the expanded coverage, an increase of about 1 percent. We expect that the assets of failed banks and thrifts would increase correspondingly—by about 1 percent. In 2003, we expect assets of failed banks and thrifts to be $3.65 billion under current law; such assets would increase slightly under the bill.

By insuring deposits that are currently uninsured, the bill would increase the liability of the FDIC and NCUA without significantly increasing the assets of institutions that will fail in the future. Under current law, we expect the FDIC's net losses on failed institutions to total about $12.6 billion over the 2003-2012 period. (We project that gross losses of $51.0 billion would be offset, in part, by recoveries of $38.4 billion from disposition of the institutions' assets.) Based on historical patterns of losses from failed institutions, CBO estimates that increasing insured deposits by about 10 percent would increase losses by about 10 percent over the long term. But over the next 10 years outlays would grow more rapidly because disposal of the assets of failed banks often takes many years. As a result, CBO estimates

H.R. 3717 would increase the FDIC's net outlays to resolve failed banks and thrifts by about $2.7 billion over the 2003-2012 period. Similarly, we estimate that enacting H.R. 3717 would increase NCUA's net outlays to resolve failed credit unions by about $100 million over the 2003-2012 period.

By increasing deposit insurance coverage, H.R. 3717 could reduce incentives of depositors to monitor the behavior of financial institutions. Over the long term, this could lead to increased risk-taking by those institutions and ultimately to higher losses. On the other hand, if the DIF incurs larger losses to resolve failed banks and thrifts, H.R. 3717 would give the FDIC the flexibility to set premiums so as to restore the balances in the fund over a few years, thus allowing the agency to recover from large losses without imperiling other institutions. This new authority could reduce future losses. CBO has no basis for estimating the magnitude of either of these effects. We expect, however, that any changes in the costs of resolving failed institutions would eventually be borne by banks and thrifts through premiums.

Increase in Premiums Paid to the FDIC By Financial Institutions

Several provisions of H.R. 3717 would affect the total amount of premiums collected by the FDIC. Increasing the size of insured accounts would lead to increased collections. Considered separately, merging the BIF and SAIF and providing the FDIC with increased discretion to set regulations for premium assessments would tend to reduce collections relative to CBO's baseline assumptions. Finally, establishing credits that certain institutions could use to pay the FDIC assessments in lieu of cash would also reduce collections.

The amount of additional premiums that banks and thrifts would pay through the combined effects of all these provisions of H.R. 3717 would depend on the DIF's balance in each year, which in turn would depend on the costs of resolving failed institutions. To estimate the effects of the bill's provisions on premium collections, CBO considered several thousand scenarios of the magnitude and timing of possible losses to the FDIC and resulting premiums collected under the bill. Because the fund balance in any given year depends on the losses of all prior years, each scenario included an estimate of losses over the entire 2003-2012 period. Applying a probability distribution to those loss scenarios, CBO estimated premium income to the government under H.R. 3717 reflecting the wide range of uncertainty about future costs of resolving failed financial institutions.

Overall, CBO estimates that the net effect of these provisions on deposit insurance premiums would be an increase in collections of about $2.8 billion over the next 10 years, slightly more than our projected increase in the FDIC's costs to resolve failed financial institutions. (We estimate that the FDIC will collect about $12 billion in premiums from members over the 2003-2012 period under current law.) Each of the bill's provisions that would have an impact on premium assessments is described below.

Increasing Deposit Insurance Coverage. Expanding deposit insurance coverage would result in increased premiums for the FDIC because premiums are based on the amount of insured deposits. CBO estimates that the increase in coverage would raise the amount of insured deposits by about 10 percent. But the bill would also give the FDIC more discretion in assessing premiums, which CBO expects would offset part of the impact of the increased coverage.

Increasing the FDIC's Regulatory Discretion. Under current law, the FDIC determines when to assess insurance premiums by calculating a figure known as the designated reserve ratio (DRR) for the BIF and SAIF. The DRR represents the ratio of the fund's balances to total insured deposits. Under current law, the FDIC is required to assess premiums so as to maintain the DRR at all times, but under the bill, the agency would be authorized to establish a restoration plan of up to three years to gradually collect sufficient premiums to maintain the DRR at the desired level.

Designated Reserve Ratio (DRR). The DRR is statutorily set at 1.25 percent of insured deposits. If the reserve ratio of either fund falls below that point, the FDIC assesses institutions that are covered by that fund until the reserve ratio reaches at least 1.25 percent. H.R. 3717 would eliminate the requirement that the DRR be 1.25 percent for the FDIC's insurance funds and, instead, allow the FDIC the discretion to set the DRR between 1.15 percent and 1.4 percent, inclusive. The bill would require the FDIC to set the DRR at least annually and at other times as it deems appropriate. The bill also would require the board of directors of the FDIC to consider increasing the DRR during more favorable economic conditions and reducing the DRR during less favorable economic conditions, notwithstanding the risk of loss that may occur under such conditions.

Based on the actions of the NCUA when it was given discretion to set such a ratio, CBO expects that the FDIC would set the DRR at 1.25 percent for 2003 and adjust it annually as conditions warrant. To maintain stability in the banking system, we expect the FDIC would set the DRR within a relatively narrow range around 1.25 percent, except under extreme conditions. In fact, the bill would require the FDIC to return some collections (referred to in the bill as dividends) if the reserve ratio of the DIF exceeds 1.35 percent. In this event, the FDIC would be required to refund half of the amount in the fund that is above the amount necessary to maintain 1.35 percent. If the DRR were to exceed 1.4 percent, the FDIC would be required to refund enough to institutions to reduce the ratio below 1.4 percent.

Restoration Plans. Under current law, the FDIC must charge assessments to return the funds to a level above the DRR within one year. H.R. 3717 could delay some of those assessments by allowing the FDIC to return the fund to a level above the DRR within three years.

If the FDIC projects that the reserve ratio of the DIF will fall below the DRR, H.R. 3717 would require it to establish a restoration plan to return the reserve ratio to the DRR within three years. If the FDIC projects that the reserve ratio of the DIF will fall below 1 percent, H.R. 3717 would require the FDIC to establish a restoration plan to return the reserve ratio to 1 percent within two years and return the reserve ratio to the DRR within three years thereafter. The flexibility to set restoration plans would reduce the assessment income of the FDIC because it could take up to five years to return to the DRR, and government collections would be below baseline levels during this period. On the other hand, this provision of H.R. 3717 might provide the FDIC the discretion necessary to recover from a large loss in the fund without imperiling other institutions.

Allowing the FDIC discretion over when premiums are charged would reduce total collections below the level that would be experienced without that discretion. However, CBO estimates that such reductions would be more than offset by the premium increases resulting from the increase in deposit insurance coverage.

Merging BIF and SAIF. H.R. 3717 would require the FDIC to merge the Bank Insurance Fund and the Savings Association Insurance Fund and create a new Deposit Insurance Fund. By 2003, CBO expects the net worth of the combined fund will be about $42 billion. By itself, merging the funds would delay the collection of premiums on institutions insured by the BIF. Although the BIF is much larger than the SAIF, the reserve ratio of the BIF is lower—1.26 percent—due to rapid growth in insured deposits and the costs of recent bank failures. Under current law, we expect the FDIC to begin charging fees to institutions insured by the BIF in 2003. The reserve ratio of the combined fund would be about 1.3 percent, and in the absence of other changes made by the bill, the FDIC would not have to assess higher premiums in 2003 to maintain the reserve ratio at the designated level.

Credits for Future Assessments. The bill would require the FDIC to provide certain banks and thrifts with credits against future assessments, based on their payments to the BIF or SAIF prior to 1997. CBO expects that the use of those credits would reduce the amount of future collections by the DIF.

Under the bill, credits would equal 12 basis points (0.12 percent) of the combined assessment base of the BIF and SAIF as of December 31, 2001. Based on information from the FDIC, CBO estimates that the credits would total nearly $5.4 billion. The credits would be allocated to each institution based on their market share as of December 31, 1996.

Institutions established after that date would be ineligible for credits against their future assessments. The bill would prohibit institutions from using credits whenever the reserve ratio of the fund is less than the DRR or when the DRR is less than 1.25 percent.

H.R. 3717 also would limit the use of credits by institutions that are not well capitalized, or that exhibit financial, operational, or compliance weaknesses that range from moderately severe to unsatisfactory. Under the bill, such institutions could use no more in credits than the average assessment on all depository institutions for that period. In addition, because the least risky institutions (i.e., those that are well capitalized and do not exhibit those weaknesses) would be assessed no more than one basis point, their use of credits would be effectively constrained. Hence, CBO estimates that more than half of the credits would not be used during the 2003-2012 period and would be available to reduce collections by the FDIC in subsequent years.

Increase in Premiums Paid to NCUA By Financial Institutions

Under current law, credit unions must pay the NCUA 1 percent of their net change in deposits each year. The NCUA provides rebates to credit unions if the balance in the share insurance fund exceeds 1.3 percent of insured deposits. CBO estimates that the NCUA will collect net premiums of about $2.4 billion from its members over the 2003-2012 period.

Based on information from the NCUA, CBO expects that H.R. 3717 would extend insurance coverage to about $38 billion in currently uninsured deposits in 2003 and that the higher insurance levels would attract another $4 billion in new deposits that year. Because these added amounts would reduce the ratio of insured deposits to fund balances below 1.3 percent in 2003, H.R. 3717 would reduce the amount of the rebate that the NCUA would otherwise provide that year.

CBO estimates that, under the bill, the net premiums collected by the NCUA would increase by $700 million over the 2003-2012 period. About $500 million of that amount would be realized in 2003. The premiums collected for the expanded insurance coverage would more than offset the estimated additional costs to the NCUA of $100 million over the next 10 years.

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in outlays that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects through fiscal year 2006 are counted.

Section 252 of the Balanced Budget and Emergency Deficit Control Act exempts from pay-as-you-go procedures any changes in outlays resulting from the "full funding of, and continuation of, the deposit insurance guarantee commitment in effect under current estimates." Increasing deposit insurance coverage is not part of the current guarantee commitment, and changing the premiums paid by banks and thrifts is not the type of change necessary for the continuation of the current guarantee commitment. Hence, CBO believes that the pay-as-you-go exemption for deposit insurance would not apply to H.R. 3717.

	By Fiscal Year, in Millions of Dollars										
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Changes in outlays	0	-1,500	-375	25	-175	225	325	325	275	-50	225
Changes in receipts	Not applicable										

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3717 would preempt certain state laws regarding statutes of limitation by shortening the time allowed for insured depository institutions or the FDIC to file claims related to overpayments or late payments of assessments. Such a preemption would be an intergovernmental mandate as defined in UMRA. Because the mandate imposes no duty on states that would result in additional spending, CBO estimates that the costs of complying with the mandate would not exceed the threshold established in UMRA ($58 million in 2002, adjusted annually for inflation).

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 3717 contains private-sector mandates as defined by UMRA. CBO estimates that the direct cost of those mandates would be well above the annual threshold established by UMRA for private-sector mandates ($115 million in 2002, adjusted annually for inflation). We do not have sufficient information to provide a precise estimate of the aggregate cost because of uncertainties about how certain regulations would be implemented.

Banks and Savings Associations

Commercial banks and savings associations must have federal deposit insurance. CBO, therefore, considers changes in the federal deposit insurance system that increase requirements on those institutions to be private-sector mandates under UMRA. Specifically, the bill would increase federal insurance coverage for insured depository accounts. That increase in coverage would require banks and savings associations to pay more in deposit insurance premiums.

H.R. 3717 also would change the conditions under which banks and savings associations would pay insurance premiums to the FDIC. Under current law, banks and savings associations in the lowest risk category do not have to pay any deposit insurance premiums when their deposit insurance fund (BIF or SAIF) is above the designated reserve ratio of 1.25 percent of insured deposits. The bill would require that all banks and savings associations pay premiums for deposit insurance regardless of the reserve ratio. In addition, the bill would authorize the FDIC to charge fees to banks and thrifts that increase their net deposits more rapidly than the FDIC determines to be appropriate. The FDIC has indicated that determining the criteria for deciding whether growth is inappropriate would be difficult. At this time, CBO has no basis for estimating the amount of such fees.

CBO estimates that, as a result of the increased deposit insurance coverage and the requirement that all banks and savings associations pay deposit insurance premiums regardless of the reserve ratio, those institutions would have to pay an additional $1 billion in premiums in fiscal year 2003. The additional premium payments would total about $2.1 billion over the first five years the mandate is in effect.

Credit Unions

Because the bill would increase the coverage of insured accounts for federally insured credit unions, those credit unions would pay higher premiums. CBO estimates that those institutions would pay an additional $500 million in fiscal year 2003. The additional premium payments would total about $600 million for the first five years the increased coverage is in effect.

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