CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

March 28, 2003

H.R. 522
Federal Deposit Insurance Reform Act of 2003

As reported by the House Committee on Financial Services on March 27, 2003

SUMMARY

H.R. 522 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. 522 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. 522 would increase the net cost of resolving failed financial institutions by $2.1 billion over the next 10 years. Under the bill, the FDIC and NCUA would offset some of that cost through increased insurance premiums paid by financial institutions. Because H.R. 522 would allow institutions to pay FDIC premiums with credits in lieu of cash, the additional cost of resolving failed financial institutions under the bill would exceed the cash receipts from additional premiums. Consequently, we estimate that the FDIC would bear nearly all of the increased costs of resolving failed institutions during the next five years, when most of the credits would be used. As a result, CBO estimates that H.R. 522 would increase net direct spending by $1.9 billion over the 2004-2013 period.

H.R. 522 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the mandate would impose no costs on state, local, or tribal governments and, therefore, that its costs would not exceed the threshold established in UMRA ($59 million in 2003, adjusted annually for inflation).

The bill contains private-sector mandates as defined by UMRA, primarily because it would necessitate the payment of increased deposit insurance premiums. CBO estimates that the direct cost of those mandates would be below the annual threshold specified in UMRA ($117 million in 2003, adjusted annually for inflation) during the first five years after enactment because the bill would provide credits to certain institutions that would largely offset their insurance premium assessments over the 2004-2008 period. We do not have sufficient information to provide a precise estimate of the aggregate cost of all the mandates in the bill.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 522 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Billions of Dollars									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
DIRECT SPENDING										
FDIC and NCUA Spending Under Current Law										
Estimated Budget Authority	*	*	*	*	*	*	*	*	*	*
Estimated Outlays	1.1	1.5	0.9	0.7	0.7	0.8	0.6	0.3	0.1	0.3
Changes in Costs to Resolve Failed Institutions Insured by FDIC and NCUA										
Estimated Budget Authority	0	0	0	0	0	0	0	0	0	0
Estimated Outlays	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.2
Changes to FDIC and NCUA Premium Collections										
Estimated Budget Authority	0	0	0	0	0	0	0	0	0	0
Estimated Outlays	0.5	0.4	1.1	0.4	*	-0.3	-0.4	-0.5	-0.6	-0.9
Total Changes Under H.R. 522										
Estimated Budget Authority	0	0	0	0	0	0	0	0	0	0
Estimated Outlays	0.7	0.6	1.3	0.6	0.2	*	-0.1	-0.3	-0.4	-0.7
FDIC and NCUA Spending Under H.R. 522										
Estimated Budget Authority	*	*	*	*	*	*	*	*	*	*
Estimated Outlays	1.8	2.1	2.2	1.3	0.9	0.8	0.5	*	-0.3	-0.4

NOTE: * = Between 0 and -$50 million.

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 NCUA insures the deposits in credit unions (referred to as shares) with the Share Insurance Fund. When a financial institution fails, the FDIC or 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. 522 would increase both the cost of resolving failed financial institutions and the premiums paid by financial institutions. Over the 2004-2013 period, we estimate that the cost of resolving failed institutions would increase by $2.1 billion and premiums paid by financial institutions would increase by $200 million. Thus, we estimate that enacting H.R. 522 would result in a net increase in direct spending of $1.9 billion over the 2004-2013 period. The major components of this estimate are explained below.

Increase in the Cost of Resolving Failed Financial Institutions

H.R. 522 would increase deposit insurance coverage from $100,000 to $130,000 for most accounts, with higher coverage levels for employee benefit plans and in-state municipal deposits. 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 adjust deposit insurance coverage every five years beginning January 1, 2006, to account for inflation. Because H.R. 522 would require that coverage levels be rounded to the nearest $10,000, CBO estimates that coverage would remain at $130,000 in 2006 and would increase to $150,000 in 2011.

By 2004, we expect that insured deposits will total more than $3.5 trillion under current law. Based on information from the FDIC and the experience of past increases in deposit insurance coverage, CBO estimates that the increased insurance coverage under H.R. 522 would increase the deposits insured by the FDIC by about $300 billion—or around 8 percent.

By insuring current deposits that are now uninsured, the bill would increase the liability of the FDIC and NCUA when institutions fail without significantly increasing the assets of those institutions. Under current law, we expect the FDIC's net losses on failed institutions to total about $12.2 billion over the 2004-2013 period. (We project that gross losses of $56.3 billion would be offset, in part, by recoveries of $44.1 billion from selling the assets of the failed institutions.) CBO estimates that the bill would lead to an increase in net losses of $1 billion over the next 10 years. Outlays for resolving failed institutions would increase by a larger amount over the next 10 years, however, because selling the assets of failed banks often takes many years. As a result, CBO estimates H.R. 522 would increase the FDIC's net outlays to resolve failed banks and thrifts by about $2.1 billion over the 2004-2013 period. Similarly, we estimate that enacting H.R. 522 would increase NCUA's net outlays to resolve failed credit unions by about $10 million over the 2004-2013 period.

By increasing deposit insurance coverage, H.R. 522 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. 522 would give the FDIC the flexibility to set premiums to restore the balances in the fund over several 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.

Effects on Premiums Paid to the FDIC By Financial Institutions

Three general provisions of H.R. 522 would affect the total amount of premiums collected by the FDIC. The bill would provide the FDIC with increased discretion to set premiums. Financial institutions would be given credits that could be used to pay the FDIC assessments in lieu of cash. Finally, the bill would require the FDIC to merge the BIF and SAIF.

The amount of premiums that banks and thrifts would pay through the combined effects of the three major provisions of H.R. 522 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 the subsequent impact on premiums that would be collected under the bill. Because the fund balance in any given year depends on the losses in all prior years, each scenario included an estimate of losses over the entire 2004-2013 period. Applying a probability distribution to those loss scenarios, CBO estimated premium income to the government under H.R. 522, 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 $100 million over the next 10 years, considerably less than our projected increase in the FDIC's costs to resolve failed financial institutions ($2.1 billion). Each of the bill's three major provisions that would affect premium assessments is described below.

Increased FDIC Discretion Over Premiums. Under current law, the FDIC is required to assess premiums so as to maintain reserves equal to 1.25 percent of insured deposits in the BIF and the SAIF. H.R. 522 would give the FDIC broad discretion to set premiums paid by insured financial institutions. As a result, the total amount collected would depend on how the FDIC chooses to exercise that discretion. Specifically, the bill would charge the FDIC with assessing premiums based on the degree of risk for each institution, it would authorize the FDIC to assess other premiums if it considers the DIF's reserves to be inappropriately low, and it would require the FDIC to implement a 10 year restoration plan if the DIF reserve ratio falls below 1.15 percent. It is possible that the FDIC could use its broad discretion differently than we have assumed and that could result in either fewer or greater premium collections than CBO has estimated. The following sections describe how CBO expects that the FDIC would exercise its discretion under the bill.

Premiums Based on the Risk of Each Institution. For this estimate CBO assumes that when setting premiums, the FDIC will consider all of the bill's criteria. Specifically, H.R. 522 would authorize that the FDIC charge premiums based on each institutions' risk of failure. CBO expects that the FDIC would choose to charge all institutions some premiums all of the time because even the strongest institutions pose some risk. (Under current law, the vast majority of institutions do not pay any premiums if the BIF or the SAIF are above 1.25 percent of insured deposits.) The bill, however, would limit the amount of premiums the strongest institutions could pay to 0.01 percent of their deposits. Based on information from the FDIC, CBO expects that the risk posed by the strongest institutions will not be much less than that of the next strongest institutions. Therefore, we do not expect that the FDIC would charge those groups vastly different premiums.

Authority to Set Other Premiums. Based on information from the FDIC, CBO expects that the FDIC would increase premiums above the amount required by risk only when the FDIC determines that the DIF's reserves are inappropriately low. For this estimate, CBO assumes the FDIC would charge additional premiums if the DIF's reserves are between 1.15 percent and 1.20 percent of insured deposits. However, there may be limits on the amount by which the FDIC could increase premiums as the DIF nears 1.15 percent. For instance, the increased premiums would not apply to the least risky group of institutions because of the bill's limitation on assessments. Furthermore, we expect that the FDIC would attempt to charge similar premiums to banks with similar risks. Even if the fund were smaller than the FDIC would prefer, we expect that the FDIC would not significantly raise premiums charged to more risky institutions. Finally, CBO expects that the FDIC would attempt to limit volatility in premiums charged and avoid increases in premiums for temporary reductions in the fund. For these reasons, CBO assumes that, when the DIF reserve ratio is between 1.15 percent and 1.2 percent, the FDIC would charge all institutions other than the least risky group only an extra two basis points in premiums.

Ten-Year Restoration Plans. If the DIF's reserves fall below 1.15 percent of insured deposits, then H.R. 522 would require the FDIC to devise and implement a restoration plan to bring the reserve ratio back to 1.15 percent within 10 years. This flexibility to set restoration plans could reduce assessment income of the FDIC because it could spread the necessary premiums over 10 years. On the other hand, this provision of H.R. 522 might provide the FDIC the discretion necessary to recover from a large loss in the fund without imperiling other institutions. For this estimate, CBO assumes that the FDIC would charge all institutions premiums at least two basis points above their risk premiums and, under some conditions, would attempt to return the fund's reserve ratio to 1.15 percent in fewer than 10 years.

Credits for Future Assessments. H.R. 522 would require the FDIC to provide certain banks and thrifts with one-time credits against future assessments, based on their payments to the BIF or SAIF prior to 1997. FDIC's income from premiums would decline to the extent such credits are used. CBO estimates that financial institutions would use credits worth nearly $5.4 billion during the 2004-2013 period. Therefore, FDIC's collections would fall by an equivalent amount over the next 10 years. CBO expects most of the credits would be used over the 2004-2008 period.

The 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. They 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 these one-time credits against their future assessments.

H.R. 522 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 only use credits worth no more than the average assessment on all depository institutions for that period. In addition, if the DIF's reserves fall below 1.15 percent of insured deposits, institutions would be prohibited from using more than three basis points worth of credits in that year. Even with those limitations, CBO expects that all of the credits awarded would be used during the 2004-2013 period.

H.R. 522 also would give the FDIC broad authority to award additional credits on an ongoing basis. For the purposes of this estimate, CBO assumes that the FDIC would award those ongoing credits only when DIF reserve ratio approaches 1.35 percent. Based on the growth of insured deposits, increased losses, and the impact that one-time credits would have on premium income, CBO estimates that it is very unlikely the fund balance would approach 1.35 percent of insured deposits.

Merging BIF and SAIF. H.R. 522 would require the FDIC to merge the Bank Insurance Fund and the Savings Association Insurance Fund and create a new Deposit Insurance Fund. By 2004, CBO expects the net worth of the combined fund would be about $45 billion. Considered separately from the other reforms in the bill, merging the funds would delay the collection of premiums on institutions now insured by the BIF for a few years and would have a minor impact on net outlays from the fund over the 2004-2013 period.

Increase in Premiums Paid to NCUA By Financial Institutions

Under current law, credit unions must pay NCUA 1 percent of the net change in deposits each year. NCUA provides rebates to credit unions if the balance in the share insurance fund exceeds 1.3 percent of insured deposits. Under current law, CBO estimates that NCUA will collect net premiums of about $3.3 billion from its members over the 2004-2013 period.

Based on information from NCUA, CBO expects that H.R. 522 would extend insurance coverage to about $6 billion in currently uninsured deposits in 2004 and that the higher insurance levels would attract about $50 million in new deposits that year. CBO estimates that, under the bill, the net premiums collected by NCUA would increase by $100 million over the 2004-2013 period. About $60 million of that amount would be realized in 2004. The premiums collected for the expanded insurance coverage would more than offset the estimated additional costs to NCUA of $10 million over the next 10 years.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 522 contains an intergovernmental mandate as defined in UMRA. A provision in section 3 would preempt New York state laws that bar savings banks and savings and loan associations from accepting municipal deposits. Enacting this provision would impose no costs on state, local, or tribal governments and, therefore, the costs of the mandate would not exceed the threshold established in UMRA ($59 million in 2003 adjusted annually for inflation). Enacting the bill could benefit municipalities in New York to the extent that more depository institutions may compete for their deposits and offer more favorable terms as part of that competition.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

The bill contains private-sector mandates as defined by UMRA, primarily because it would necessitate the payment of increased deposit insurance premiums. CBO estimates that the direct cost of those mandates would be below the annual threshold specified in UMRA

($117 million in 2003, adjusted annually for inflation) during the first five years after enactment because the bill would provide credits to certain institutions that would largely offset their insurance premium assessments over the 2004-2008 period. We do not have sufficient information to provide a precise estimate of the aggregate cost of all the mandates in the bill.

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. Because premiums are based in part on the amount of insured deposits, that increase in coverage would require banks and savings associations to pay more in deposit insurance premiums.

Three provisions of H.R. 522 would affect the total amount of premiums collected by the FDIC. The bill would require the FDIC to merge the BIF and the SAIF. The bill would provide the FDIC with greater discretion to set premiums. The FDIC would grant credits to some financial institutions that could be used to pay deposit insurance premiums in lieu of cash.

CBO estimates that as a result of the merger of the deposit insurance funds, increased deposit insurance coverage, and the greater discretion given to the FDIC to set premiums for banks and savings associations, banks and savings associations would be assessed about $200 million less in premiums in fiscal year 2004 (largely because of the savings provided by the merger of the BIF and the SAIF) but would be assessed about $1 billion more in 2005 when compared with current law. The additional assessments would total about $2.4 billion over the five-year period from 2004 to 2008.

However, H.R. 522 would require the FDIC to award credits to certain banks and savings associations that may be used to offset future deposit insurance premium assessments. The credits would amount to about $5.4 billion. Only banks and savings associations that paid deposit insurance premiums prior to 1997 would be eligible to receive credits. CBO expects that institutions that are awarded credits would use them as soon as they are available. For example, CBO estimates that in 2005, the industry would use about $1.5 billion of these credits towards the $1.7 billion of deposit insurance assessments. Although some institutions would have to pay more in premiums, the industry as a whole would pay about $400 million less in 2005 than it would have to pay under current law because of the use of the credits.

Over the 2004-2007 period, CBO expects that the industry would pay less in premiums than it would under current law due to the credits. However, as the industry exhausts its credits, it would have to pay more in premiums than under current law. By 2008, CBO expects that the industry would have to pay premiums of about $50 million more. In 2009, the industry would pay additional premiums of about $300 million, and the amount of additional premiums paid would increase in subsequent years.

Credit Unions

Because the bill would increase the coverage of insured accounts for federally insured credit unions, those credit unions would have to contribute more to the National Credit Union Insurance Fund. CBO estimates that those institutions would contribute an additional $60 million in fiscal year 2004. The additional contributions would total about $100 million over the 2004-2008 period.

Employee Benefit Plan Deposits

The bill would also prohibit banks, savings associations, and credit unions that are not well capitalized or adequately capitalized from accepting employee benefit plan deposits. CBO does not have sufficient information to assess the cost of this mandate.

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