CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

April 29, 2005

H.R. 1185
Federal Deposit Insurance Reform Act of 2005

As ordered reported by the House Committee on Financial Services on April 27, 2005

SUMMARY

H.R. 1185 would amend provisions of laws governing banks and credit unions 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). The coverage limit for insured deposits would subsequently increase every five years 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 federal Bank Insurance Fund (BIF) and the federal 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. 1185 would amend the conditions under which banks and thrifts would pay insurance premiums to the FDIC, which administers the funds.

CBO estimates that provisions in H.R. 1185 increasing insurance coverage would increase the net cost of resolving failed financial institutions by about $1.4 billion over the next 10 years. The bill also would expand the FDIC's discretion to determine the timing and amounts of insurance premiums that financial institutions would be required to pay. CBO expects that the FDIC would use this new authority to collect net assessments about $3.8 billion higher than CBO estimates would be collected under current law. Over the same period, we estimate NCUA would increase its net assessments by $0.1 billion under the bill. As a result, CBO estimates that H.R. 1185 would reduce net direct spending of the FDIC and NCUA by $2.5 billion over the 2006-2015 period.

H.R. 1185 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that enacting the bill would impose minimal costs, if any, on state, local, or tribal governments and therefore would not exceed the threshold established in UMRA ($61 million in 2005 adjusted annually for inflation).

H.R. 1185 contains private-sector mandates as defined in UMRA, primarily because it would require certain depository institutions to pay higher premiums for federal deposit insurance. Although CBO cannot determine the aggregate cost of all of the private-sector mandates in the bill, we expect that the direct cost of those mandates would exceed the annual threshold established by UMRA ($123 million in 2005, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 1185 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									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
DIRECT SPENDING										
FDIC and NCUA Net Spending Under Current Law										
Estimated Budget Authority	*	*	*	*	*	*	*	*	*	*
Estimated Outlays	1.1	1.1	1.3	1.0	0.7	0.8	0.9	0.9	1.0	0.8
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	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3
Changes to FDIC and NCUA Premium Collections										
Estimated Budget Authority	0	0	0	0	0	0	0	0	0	0
Estimated Outlays	0	-0.2	-0.3	0.1	-0.2	-0.7	-0.7	-0.7	-0.7	-0.5
Total Changes Under H.R. 1185										
Estimated Budget Authority	0	0	0	0	0	0	0	0	0	0
Estimated Outlays	0	-0.1	-0.2	0.2	-0.1	-0.6	-0.5	-0.5	-0.5	-0.2
FDIC and NCUA Spending Under H.R. 1185										
Estimated Budget Authority	*	*	*	*	*	*	*	*	*	*
Estimated Outlays	1.1	1.0	1.1	1.2	0.6	0.2	0.4	0.4	0.5	0.6

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 (financed through the BIF) and the deposits of thrifts (financed through the SAIF). The NCUA insures the deposits in credit unions (referred to as shares) with the Share Insurance Fund. When financial institutions fail, the FDIC and NCUA use the insurance funds to reimburse the insured depositors of the failed institutions. These agencies then sell the assets of the institutions and deposit any money recovered into the insurance funds.

Because H.R. 1135 would increase the amount of federally insured deposits, CBO estimates that the bill would increase the future costs of resolving failed financial institutions. We also expect that the FDIC and NCUA would increase the amount of premiums collected from financial institutions under the bill. Over the 2006-2015 period, we estimate that the cost of resolving failed institutions would increase by $1.4 billion and that premiums paid by financial institutions would increase by $3.9 billion. Thus, we estimate that enacting H.R. 1185 would result in a net reduction in direct spending by the FDIC and NCUA of $2.5 billion over the 2006-2015 period. The major components of this estimate are explained below.

Increase in the Cost of Resolving Failed Financial Institutions

H.R. 1185 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, banks, and thrifts. In addition, the bill would require the FDIC and NCUA to adjust deposit insurance coverage every five years beginning January 1, 2008, to account for inflation. Because H.R. 1185 would require that coverage levels be rounded to the nearest $10,000, CBO estimates that coverage would remain at $130,000 in 2008 and would increase to $150,000 in 2013.

By 2006, we expect that insured deposits will total $3.8 trillion under current law. Based on information from the FDIC and the experience from past increases in deposit insurance coverage, CBO estimates that the increased insurance coverage under H.R. 1185 would increase the deposits insured by the FDIC by about $330 billion—or around 8 percent by 2007.

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 $8.4 billion over the 2006-2015 period. (We project that gross losses of

$38.6 billion would be offset, in part, by recoveries of $30.2 billion from selling the assets of the failed institutions over the 10-year period.) CBO estimates that the bill would lead to an increase in losses of roughly $1.4 billion over the next 10 years. Similarly, we estimate that enacting H.R. 1185 would increase NCUA's net outlays to resolve failed credit unions by less than $10 million over the 2006-2015 period.

By increasing deposit insurance coverage, H.R. 1185 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 FDIC incurs larger losses to resolve failed banks and thrifts, H.R. 1185 would give the agency the flexibility to set premiums to restore the balances in the insurance fund over several years—rather than immediately—thus allowing the agency to recover from large losses without imperiling other institutions. In this way, the new authority under the bill could reduce future losses from failed institutions. 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. 1185 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 premium 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. 1185 would depend on the DIF's balance in each year, which in turn would depend on the costs of resolving failed institutions and on the growth in insured deposits. Overall, CBO estimates that the net effect of these provisions on deposit insurance premiums would be an increase in collections of about $3.8 billion over the next 10 years, considerably more than the projected increase in the FDIC's costs to resolve failed financial institutions ($1.4 billion). The major provisions that would affect premium assessments are 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. 1185 would give the FDIC broad discretion to set premiums paid by insured financial institutions and would allow the reserve ratio to range from between

1.15 percent of insured deposits to 1.4 percent. 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 additional premiums if it considers the DIF's reserves to be inappropriately low, and it would require the FDIC to implement a 10-year plan to restore the fund's reserve balances if the DIF reserve ratio falls below 1.15 percent. It is possible that the FDIC could use its broad discretion under H.R. 1185 differently than CBO assumes for this estimate, resulting in either smaller or greater premium collections than CBO estimates. The following sections describe how CBO expects that the FDIC would exercise its discretion under the bill.

Basic Premiums Based on the Risk of Each Institution. For this estimate, CBO assumes that when setting premiums, the FDIC would consider all of the bill's criteria. Specifically, H.R. 1185 would authorize the FDIC to charge premiums based on each institution's 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 reserves are greater than 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 existing category of least risky banks would be subdivided into three groups, and that the lowest-risk group would be assessed at a rate of 0.01 percent. Banks and savings associations in higher-risk categories would pay correspondingly higher rates, CBO estimates. CBO also expects that the risk posed by the strongest institutions would not be significantly different from that of the next strongest institutions. Therefore, we expect that the FDIC would not charge those groups substantially different premiums.

Likewise, CBO expects that the FDIC would attempt to limit volatility in premiums and avoid increases in premiums for temporary reductions in the fund. As a result, CBO assumes that the FDIC would try to set premiums at levels considered likely to achieve the desired reserve ratio over several years. By expanding insurance coverage, H.R. 1185 also would affect the FDIC's decision about the reserve target, because increasing insured deposits would reduce the DIF's reserve ratio from about 1.3 percent to less than 1.2 percent. For this estimate, CBO assumes that the FDIC would opt to rebuild the reserve gradually following enactment of the bill, resulting in a reserve ratio of close to 1.20 percent over the 10-year period. Setting a higher target would require correspondingly higher assessments and would yield higher receipts to the DIF.

Under such assumptions, CBO estimates that the FDIC's premium assessments—before the use of premium credits—would total $18.1 billion over the 2006-2015 period, compared to about $9.1 billion under current law. The amounts paid by most banks and savings associations would be reduced by the availability of one-time premium credits authorized by the bill (premium credits are described in the next section). Because of the time needed to implement these changes, CBO assumes the new premium levels would not take effect until fiscal year 2007.

Other Provisions Affecting Assessments. H.R. 1185 also sets parameters for changing premiums and using credits if the DIF's reserves fall below or above the 1.15 percent to 1.4 percent range. While those provisions would affect the amounts collected under such conditions, they would not have a significant effect under CBO's current baseline assumptions.

For example, if the DIF's reserves were to fall below 1.15 percent of insured deposits, H.R. 1185 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. 1185 might provide FDIC the discretion necessary to recover from a large loss in the fund without imperiling other institutions.

H.R. 1185 also would give the FDIC broad authority to grant additional premium credits on an ongoing basis. For this estimate, CBO assumes that the FDIC would grant additional credits only when the DIF reserve ratio approaches 1.35 percent. Based on our estimates of the growth of insured deposits, increased losses, and the impact that one-time credits would have on premium income, CBO estimates that it is unlikely the fund balance would approach 1.35 percent of insured deposits over the next 10 years.

Credits for Future Premiums. H.R. 1185 would require the FDIC to provide certain banks and thrifts with one-time credits against future premiums, based on the amount of their payments to the BIF or SAIF prior to 1997. The 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 2006-2015 period. Therefore, the FDIC's collections would be reduced by an equivalent amount over the next 10 years. CBO expects that most of the credits would be used over the 2006-2008 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. They would be allocated to each institution based on its 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. 1185 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 credits worth no more than the average assessment on all depository institutions for that period. In addition, if the DIF's reserves were to 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.

Based on information from the FDIC, CBO expects that about $5.2 billion of the credits awarded would be used during the 2006-2015 period. After adjusting for such credits, CBO estimates that implementing this bill would increase net proceeds from premiums by a total of $3.9 billion relative to CBO's baseline over the next 10 years.

Merging BIF and SAIF. H.R. 1185 would require the FDIC to merge the Bank Insurance Fund and the Savings Association Insurance Fund and create a new Deposit Insurance Fund. By 2006, CBO expects the net worth of the combined fund would be about $50 billion. Together with the other reforms in the bill, CBO expects that merging the funds would have a negligible budgetary impact. 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 2006-2015 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 $3.6 billion from its members over the 2006-2015 period.

Based on information on the characteristics of credit union deposits, CBO expects that H.R. 1185 would extend insurance coverage to about $8 billion in currently uninsured deposits in 2006. CBO estimates that, under the bill, the net premiums collected by NCUA would increase by $100 million over the 2006-2015 period. About $60 million of that amount would be realized in 2007. The premiums collected for the expanded insurance coverage would more than offset CBO's estimate of the additional costs to NCUA of $10 million over the next 10 years to resolve failed institutions.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 1185 contains an intergovernmental mandate as defined in UMRA. A provision in section 3 would preempt New York state laws that limit savings banks and savings and loan associations from accepting municipal deposits. Complying with this mandate would impose minimal costs, if any, on the state of New York, and any such costs would not exceed the threshold established in UMRA ($61 million in 2005 adjusted annually for inflation). Enacting the bill could benefit municipalities in New York to the extent that more depository institutions could compete for their deposits and offer more favorable terms as part of that competition.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 1185 contains private-sector mandates as defined in UMRA, primarily because it would require certain depository institutions to pay higher premiums for federal deposit insurance. CBO estimates that the direct cost of those mandates would likely exceed the annual threshold in UMRA ($123 million in 2005, adjusted annually for inflation) in most of the first five years the mandates would be in effect. We do not have sufficient information to provide an 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, an increase in coverage would require banks and savings associations to pay more in deposit insurance premiums.

Three additional provisions of H.R. 1185 would affect the total amount of premiums collected by the FDIC. First, the bill would require the FDIC to merge the BIF and the SAIF insurance funds. Second, the bill would provide the FDIC with greater discretion to set premiums by allowing the agency to collect premiums from all banks and savings institutions regardless of their risk category. 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. Third, the bill would direct the FDIC to grant credits to some financial institutions that could be used to pay deposit insurance premiums in lieu of cash.

CBO estimates that banks and savings associations would pay (net of credits) about $1.1 billion more in premiums in fiscal years 2007 through 2011 relative to current law. The incremental cost to the industry would depend, in part, on how the FDIC uses its new discretion under the bill to set premium rates. CBO expects that the FDIC would begin to collect premiums from banks and savings associations that are not required to pay premiums under current law.

Credit Unions

Because the bill also 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 additional contributions would total about $100 million over the 2006-2010 period. All federally chartered and most state-chartered credit unions are required to have federal deposit insurance. According to the National Association of Federal Credit Unions, 17 states do not require their state-chartered credit unions to purchase federal deposit insurance. The cost of the mandate would amount to the incremental premiums paid by those institutions required to have federal insurance and thus may be less than the total additional contributions collected from all federally insured credit unions.

Employee Benefit Plan Deposits

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

ESTIMATE PREPARED BY:

Federal Costs: Kathleen Gramp and Judith Ruud
Impact on State, Local, and Tribal Governments: Sarah Puro
Impact on the Private Sector: Judith Ruud and Craig Cammarata

ESTIMATE APPROVED BY:

Robert A. Sunshine
Assistant Director for Budget Analysis