Bank Insurance Fund Reserve Ratio Above Statutory Minimum - For Now

September 12, 2002

The Federal Deposit Insurance Corporation reported today in the Quarterly Banking Profile that the Bank Insurance Fund (BIF) reserve ratio rose to 1.26 percent at the end of June, just slightly above the statutorily mandated Designated Reserve Ratio (DRR) target of 1.25 percent. At March 31, the BIF reserve ratio stood at 1.23 percent.[1]

The increase in the BIF reserve ratio in the second quarter resulted from both an increase in the BIF balance and a decrease in BIF-insured deposits. (The BIF reserve ratio is determined by dividing the BIF balance by the estimated amount of deposits insured by the BIF.) The BIF balance grew by 1.6 percent ($490 million) during the second quarter of 2002, ending the quarter with a balance of $31.19 billion (unaudited). The strong second quarter growth in the BIF, as compared to the first quarter growth of $258 million, was primarily due to higher interest income from investments and greater unrealized gains on securities. BIF-insured deposits decreased by 0.1 percent during the second quarter.

The BIF reserve ratio figures significantly in setting BIF deposit insurance premium rates. Under current law, if the BIF reserve ratio is below 1.25 percent, the FDIC's Board of Directors must charge premiums that are sufficient to restore the reserve ratio to the DRR within a year, or it must charge premiums that average at least 23 basis points until the reserve ratio meets the DRR. Currently, most institutions do not pay premiums for deposit insurance.

When the FDIC's Board meets later this year to set deposit insurance premium rates for the first half of 2003, the June 30, 2002, BIF reserve ratio may be the most current available ratio. Estimated insured deposits are calculated from Call Reports that are filed up to 45 days after the end of each quarter. Editing the Call Reports and calculating estimated insured deposits can take an additional two to three weeks. Therefore, estimated insured deposits—and, hence, the reserve ratio—for the end of September may not be finalized when the FDIC's Board meets.

The FDIC's Board will not be limited solely to looking at the June BIF reserve ratio, however. Although the September 30 reserve ratio may not be final, the Board will have data available on the factors that go into determining the reserve ratio. The September 30 BIF balance will be available and the FDIC is working to enhance its estimates of insured deposit growth.

Predicting how the reserve ratio will change from one quarter to the next is difficult. The trend in the BIF reserve ratio over the past few years has been downward (see Chart 1), but fluctuations in the reserve ratio from quarter to quarter are not uncommon. These quarterly changes in the reserve ratio have varied between -4.5 percent and 2.4 percent over the past few years.

This volatility stems from fluctuations in the factors that determine the reserve ratio. Estimated insured deposits, which by definition are inversely related to the reserve ratio, are one of the major determinants of the reserve ratio. BIF-insured deposits have generally been growing, but the level has been volatile over the past few years. Growth rates of insured deposits have varied between -0.5 percent and 3.4 percent per quarter. The volatility in the growth rate of insured deposits has contributed to fluctuations in the BIF reserve ratio (see Chart 2).

Fluctuations in the BIF balance can also lead to fluctuations in the reserve ratio. Several factors determine changes in the BIF balance from quarter to quarter, including changes in the contingent loss reserve—the amount set aside to cover losses from probable failures; actual losses resulting from insured institution failures when they are different from the amounts set aside in the loss reserve; assessment income; interest income; and changes in the value of Treasury securities in the BIF's available-for-sale portfolio. On balance, these factors have interacted to produce a fluctuating BIF balance over the past few years (see Chart 3).

Under current law, because the BIF ratio is near the DRR, even small fluctuations in the reserve ratio can have financial consequences for BIF-insured institutions. For example, large insured deposit growth during the third quarter or losses from bank failures that exceed expectations could result in the BIF ratio falling below 1.25 percent. In that event, the FDIC Board may determine that premiums are necessary to maintain the target DRR.

To keep small fluctuations in the reserve ratio from greatly affecting premiums, and to solve other problems with the current system, the FDIC published Recommendations for Deposit Insurance Reform in April 2001. Among other things, the FDIC is seeking greater discretion from Congress to establish a range for the reserve ratio and to set risk-based deposit insurance premium levels to reflect actual risk in the industry and to the insurance funds. The House acted on the FDIC's recommendations by passing legislation, H.R. 3717, on May 22. Another reform bill, S. 1945, was introduced in the Senate earlier this year. Both bills would grant the FDIC significantly greater discretion to set the DRR. H.R. 3717 would allow the FDIC to set the DRR between 1.15 and 1.40 percent; S. 1945 would allow the FDIC to set the DRR between 1.0 and 1.5 percent. Both bills would allow the FDIC to determine the factors it considers important when setting risk-based premium levels, and would end the hard-and-fast rule that premiums for all institutions must increase when the reserve ratio falls below 1.25 percent.

In the absence of new legislation, however, existing law combined with the volatility of the BIF reserve ratio could force the FDIC to increase premiums for BIF-insured institutions in the near future.

FDIC Chairman Donald Powell addresses the need for deposit insurance reform and discusses the current adequacy of the BIF in a speech today before the Fall Conference of the Financial Services Roundtable.

The full text of Chairman Powell's remarks will be available immediately following the speech at http://www.fdic.gov/news/news/speeches/archives/2002/sp12sep02.html.

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[1] The March 31 BIF reserve ratio was revised from 1.24 percent, as a result of amendments to the amount of insured deposits reported by BIF-insured institutions.

Chart 1

The BIF Reserve Ratio Has Generally Been Declining Over the Past Few Years

	Percent of Insured Deposits
9/98	1.41
12/98	1.39
3/99	1.41
6/99	1.4
9/99	1.39
12/99	1.37
3/00	1.36
6/00	1.33
9/00	1.35
12/00	1.35
3/01	1.33
6/01	1.33
9/01	1.32
12/01	1.26
3/02	1.23
6/02	1.26

Source: FDIC

Chart 2

The Volatility of Insured Deposit Growth Has Contributed to Fluctuations in the BIF Reserve Ratio

	Insured Deposits Quarterly Change, in %	Reserve Ratio Quarterly Change, in %
12/98	3.4	-1.4
3/99	-0.5	1.4
6/99	0.3	-0.7
9/99	0.0	-0.7
12/99	1.0	-1.4
3/00	1.9	-0.7
6/00	2.2	-2.2
9/00	1.3	1.5
12/00	1.4	0.0
3/01	3.1	-1.5
6/01	0.5	0.0
9/01	0.9	-0.8
12/01	0.2	-4.5
3/02	3.2	-2.4
6/02	-0.1	2.4

Source: FDIC

Chart 3

The BIF Balance Has Fluctuated Over the Past Few Years

	Billions of Dollars
9/98	$29.1
12/98	$29.6
3/99	$29.9
6/99	$29.8
9/99	$29.5
12/99	$29.4
3/00	$29.7
6/00	$29.8
9/00	$30.6
12/00	$31.0
3/01	$31.4
6/01	$31.7
9/01	$31.8
12/01	$30.4
3/02	$30.7
6/02	$31.2

Source: FDIC