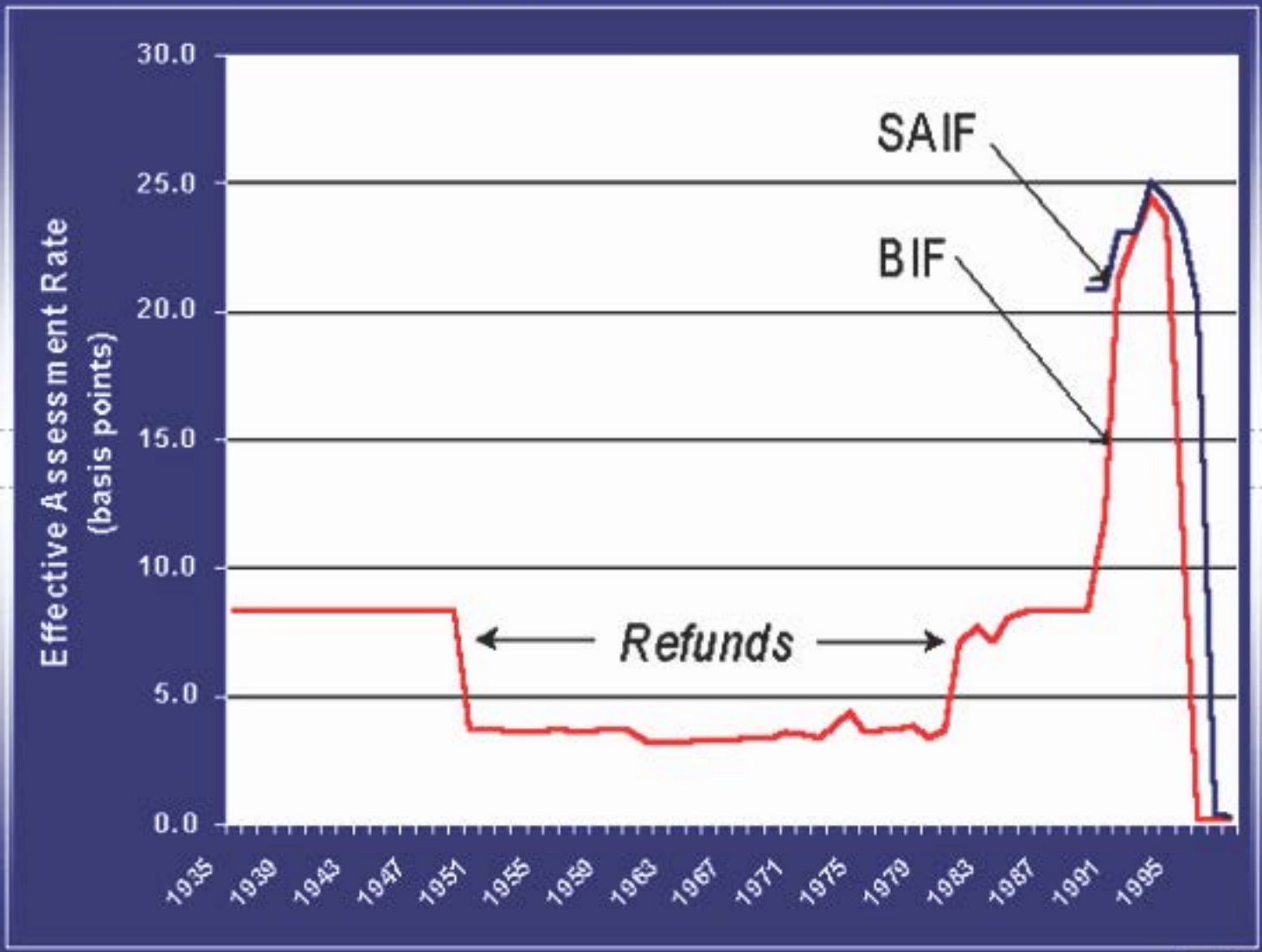
# Deposit Insurance Reform Roundtable

April 25, 2000

FDIC

# Pricing

# Premium rates are at historic lows.




FDIC

# The Deposit Insurance Fund Act of 1996

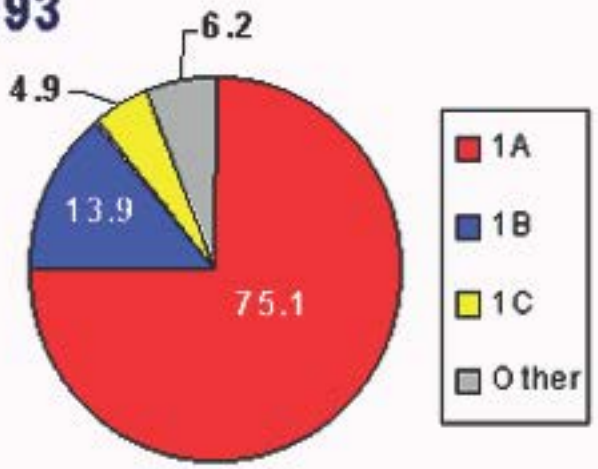
- The DIFA imposes a zero premium for most institutions that are well-capitalized.
- FDIC has limited flexibility to charge well-capitalized institutions unless they are rated CAMELS 3, 4, or 5.

FDIC

# Most institutions pay nothing for deposit insurance.

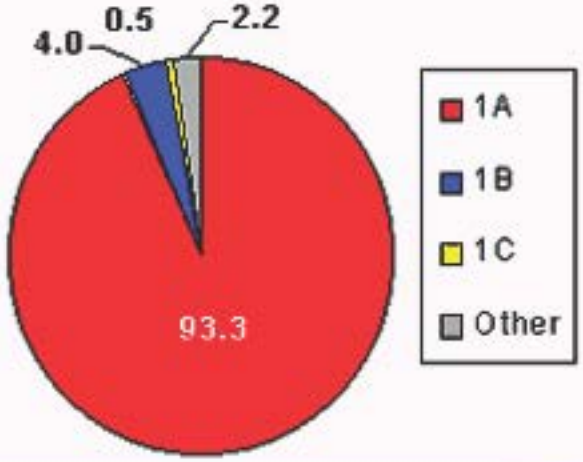
## January, 1993

| | | Supervisory Subgroup | | |
|---|---|---|---|---|
| | | A | B | C |
| Capital | 1 | 23 | 26 | 29 |
| | 2 | 26 | 29 | 30 |
| | 3 | 29 | 30 | 31 |




## Today

| | | Supervisory Subgroup | | |
|---|---|---|---|---|
| | | A | B | C |
| Capital | 1 | 0 | 3 | 17 |
| | 2 | 3 | 10 | 24 |
| | 3 | 10 | 24 | 27 |



# Concerns Raised by DIFA

- Fairness in sharing the costs of deposit insurance
- Is the pricing system sufficiently forward-looking?
- Do premiums adjust appropriately to reflect emerging risks and changes in industry structure?

# Pricing Discussion Topics

- *Deposit Growth*
- *Risk Differentiation*

# *Deposit Growth*

- Sudden deposit growth could significantly dilute the reserve ratio. This scenario is increasingly realistic with blending of financial services and advances in technology.
- $100 billion increase in insured deposits would reduce the BIF reserve ratio from 1.37 to 1.31.
- $100 billion increase in insured deposits would reduce the SAIF reserve ratio from 1.45 to 1.27

# *Deposit Growth:* Disparities among institutions

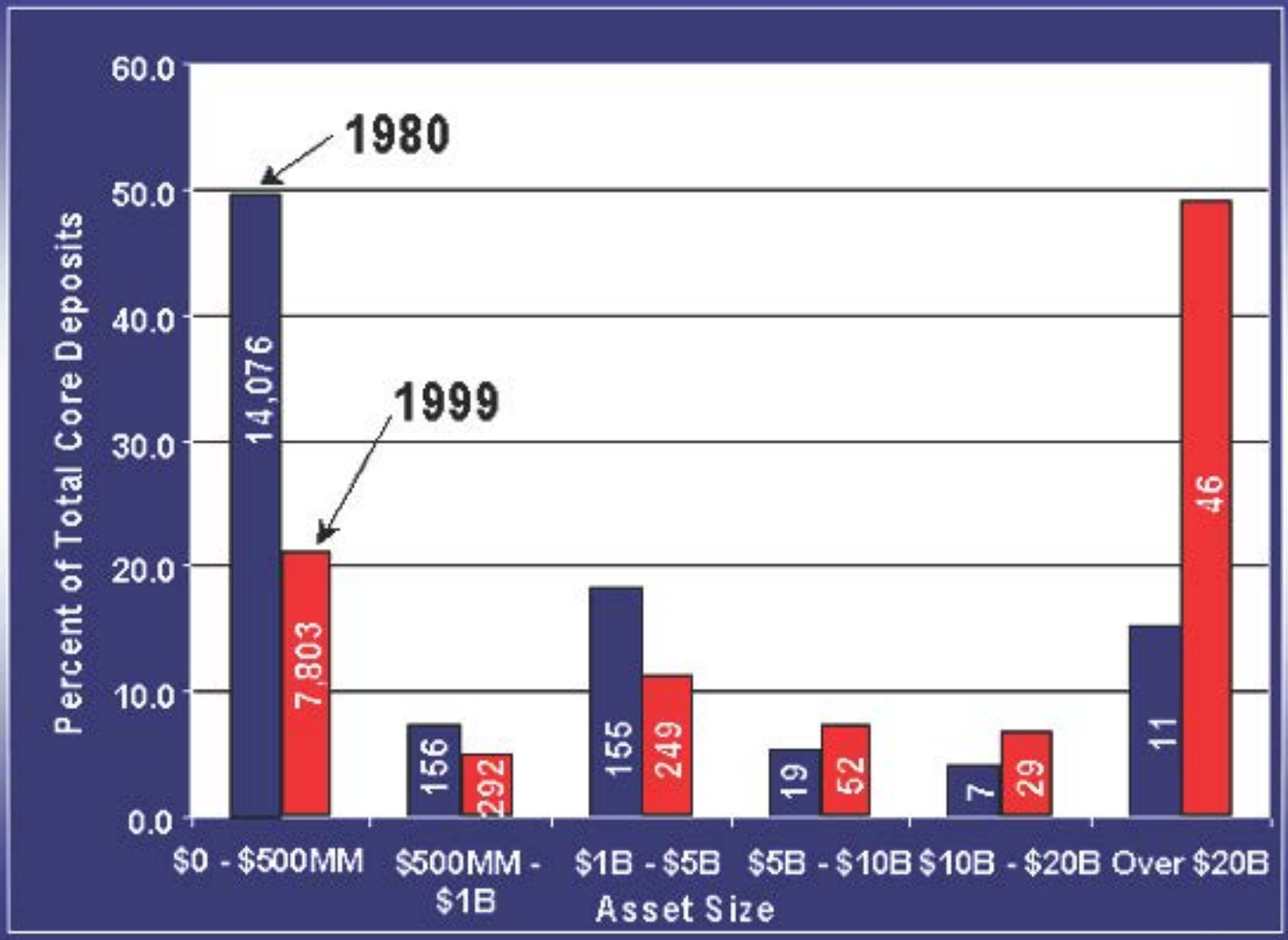
- The top 25% in terms of deposit growth have added $178 billion since the funds were capitalized.
- Since 1996, 814 new banks, now with $44 billion of insured deposits, have never paid insurance premiums.
- Based on experience, we can expect some of these new banks to fail without having contributed to the BIF or the SAIF.
- The lowest 25% in terms of deposit growth have lost $69 billion since the funds were capitalized.

# *Risk Differentiation:* Characteristics of 1A-rated banks may differ significantly.

| | First Decile Avg | Tenth Decile Avg |
|---|---|---|
| Non-Performing Loans/ Loans & Leases | 0.0% | 3.2% |
| Charge-Offs / Loans & Leases | 0.0% | 10.2% |
| Loan Yield | 5.1% | 11.1% |
| Commercial Loan Growth | -42.1% | 565.7% |
| Volatile Liability Growth | -41.4% | 721.0% |
| Total Equity / Assets | 23.0% | 6.0% |

* Growth rates are 3 year merger adjusted

# Deposit concentrations have shifted.



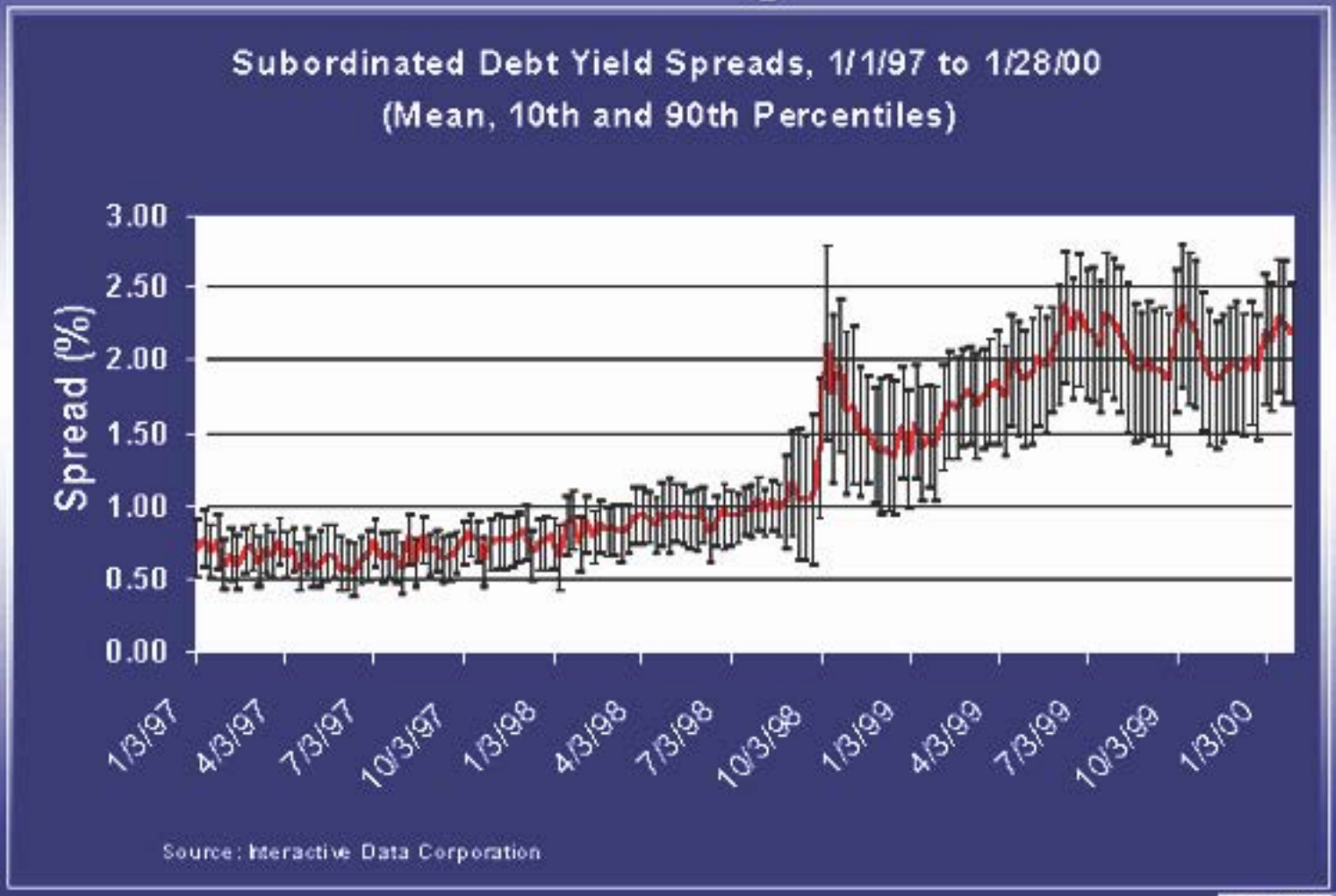

FDIC

# *Risk Differentiation:* Large institutions are engaged in more diverse activities.

| | Top 10% By Asset Size | All Others |
|---|---|---|
| Number | 847 | 7,624 |
| Off-Balance Sheet Derivatives / Total Assets | 23.8% | 0.1% |
| Core Deposits / Total Liabilities | 67.3% | 81.2% |
| Average Subordinated Debt ($ million) | $82 | $0 |

FDIC

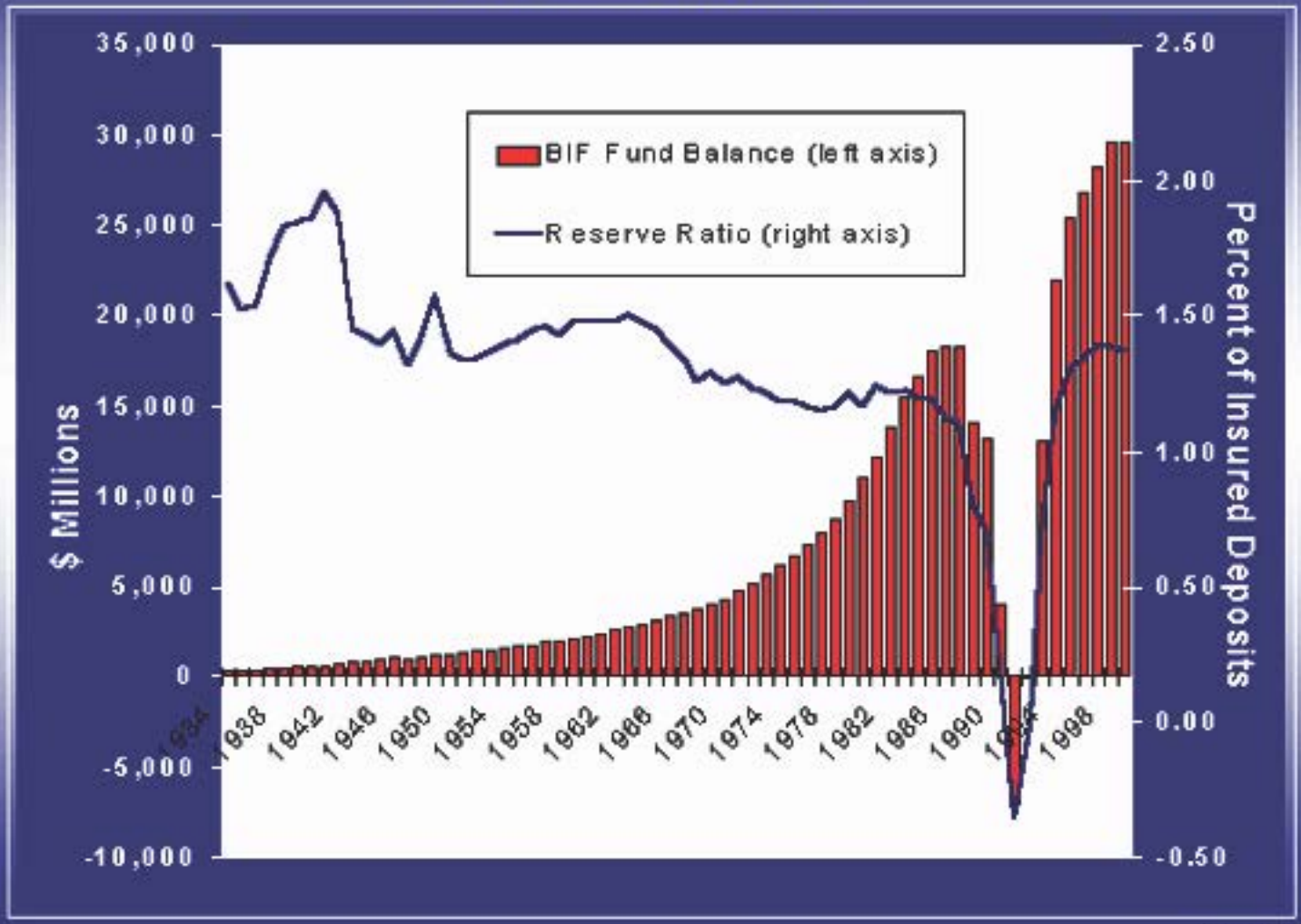
# Spreads have widened and become more volatile at the largest institutions.




FDIC

# *Maintaining the Funds*

# History of the BIF Fund Balance and Reserve Ratio

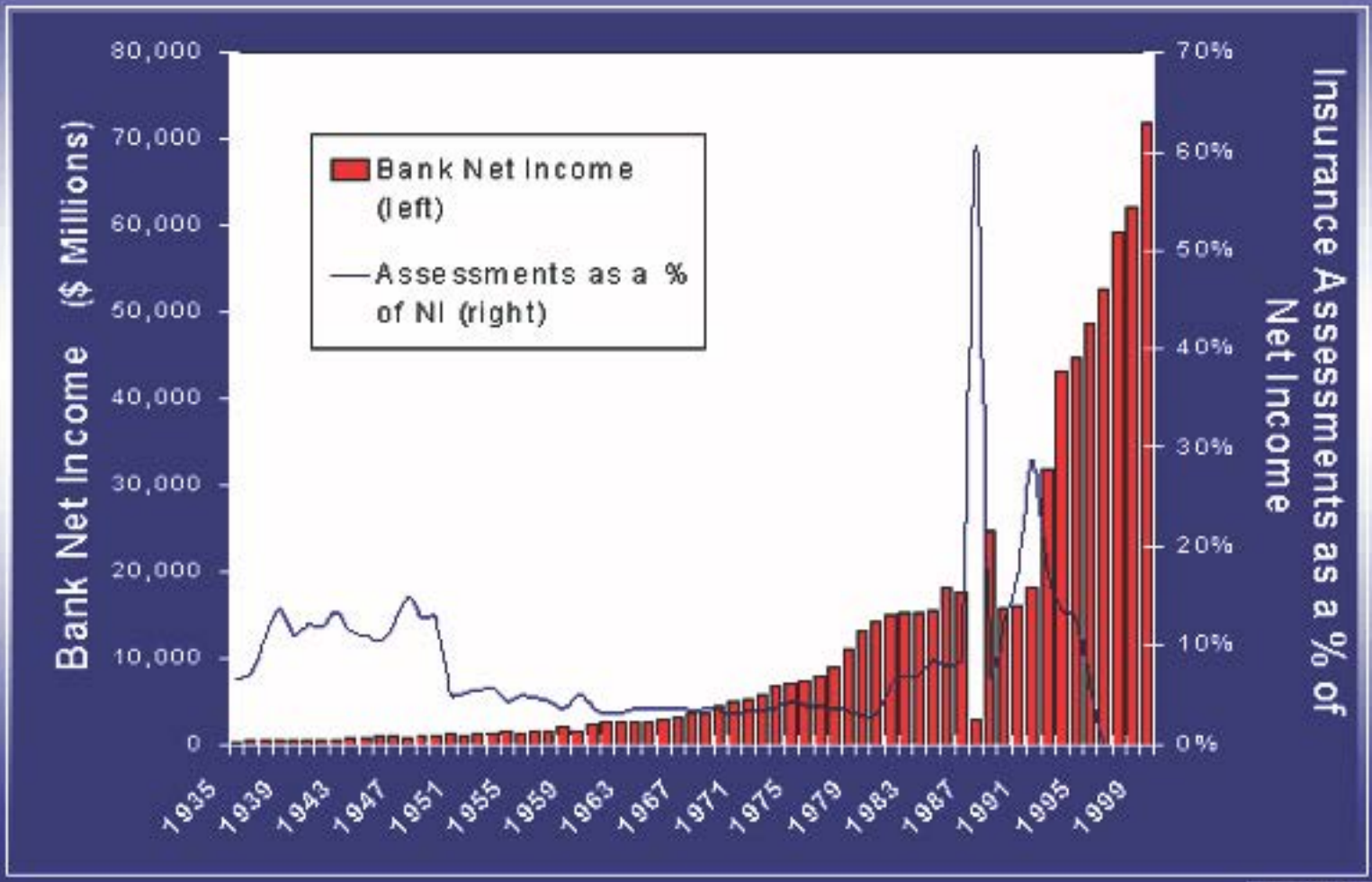



FDIC

# Why have insurance funds?

- Avoid delay in resolving failures
- Spread losses over time, and avoid charging institutions the most when they can least afford to pay.

# Assessments as a Percentage of Bank Net Income

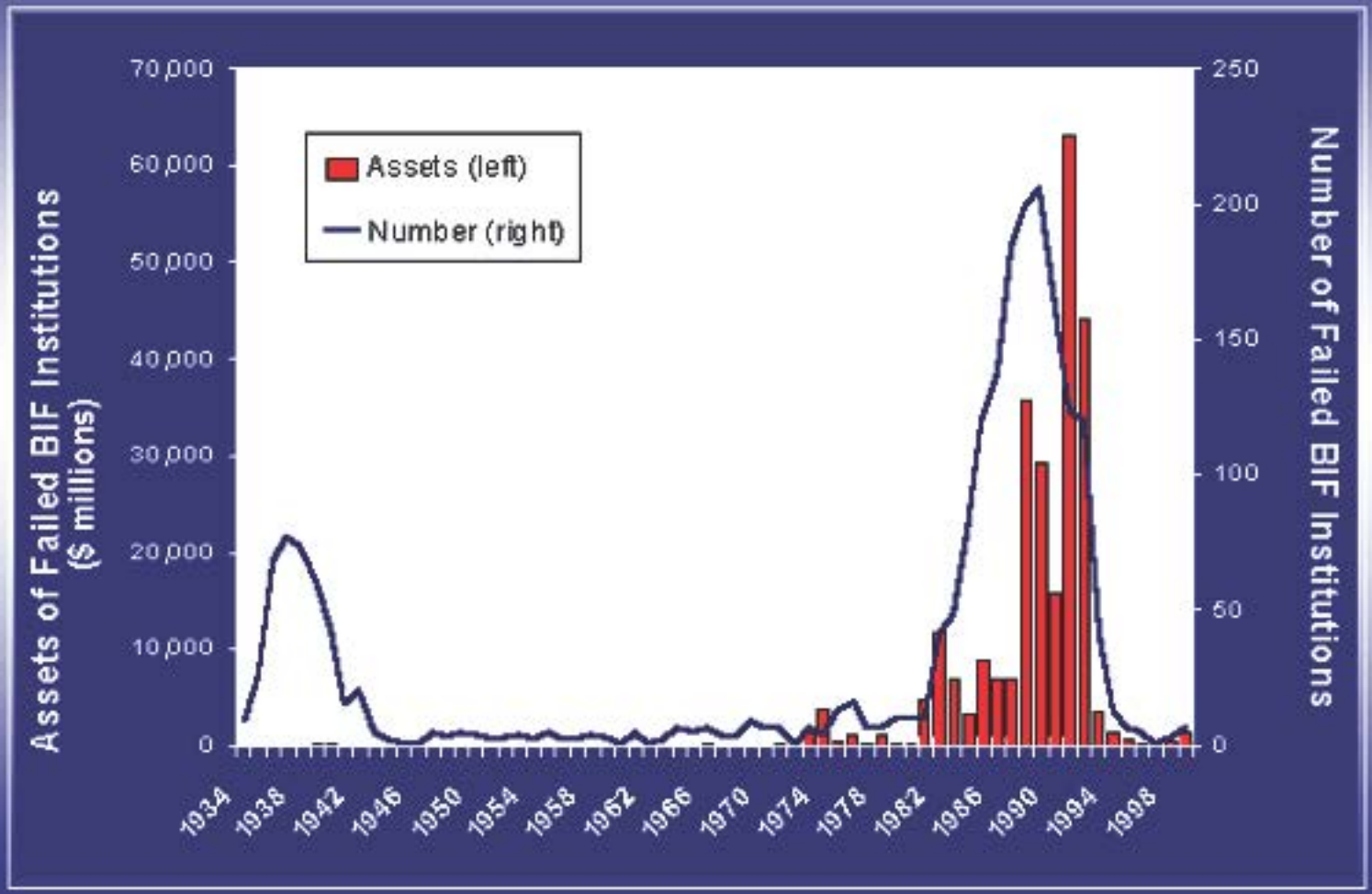



FDIC

# The Designated Reserve Ratio

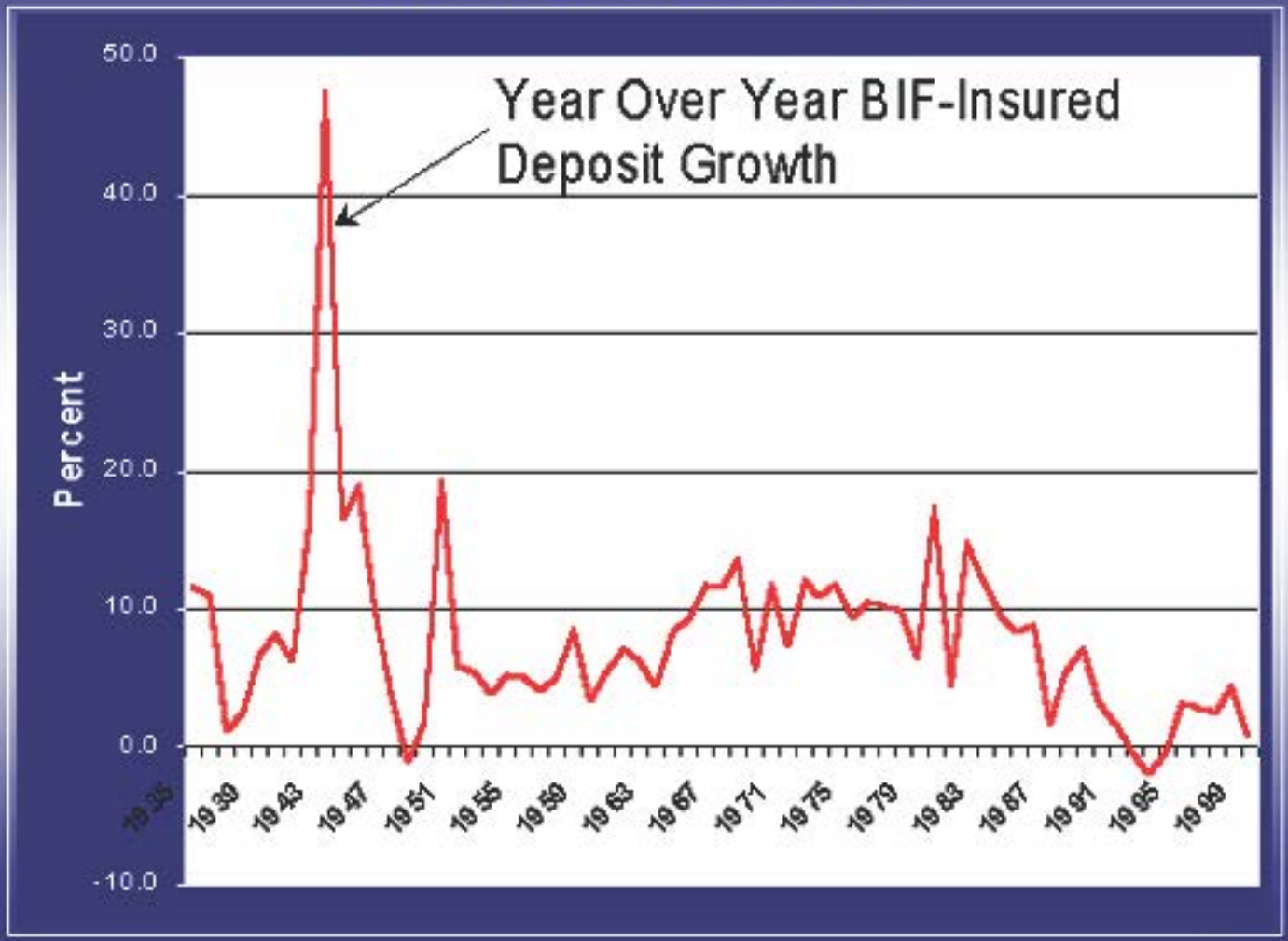
- The DRR sets a hard floor at 1.25, with a minimum premium of 23 bp if DRR cannot be achieved in one year.
- The DRR has a short-run focus. The FDIC can raise the DRR for a particular year by pointing to a "significant risk of substantial future losses."

# Annual bank failures have fluctuated significantly



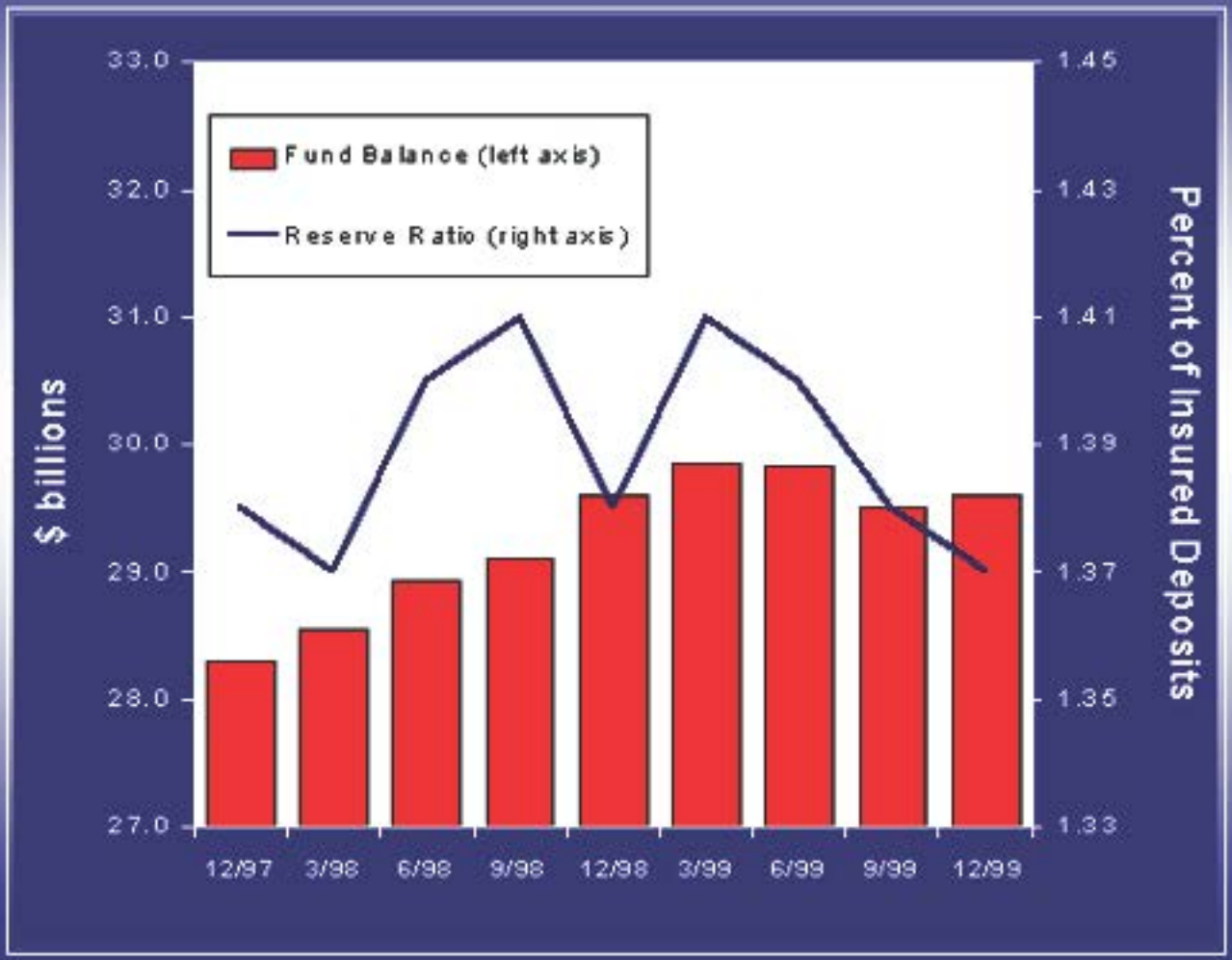

FDIC

# The volatility of deposit growth also affects the reserve ratio.




FDIC

# Recent Volatility of the BIF Reserve Ratio




FDIC

# Systemic Risk Exception

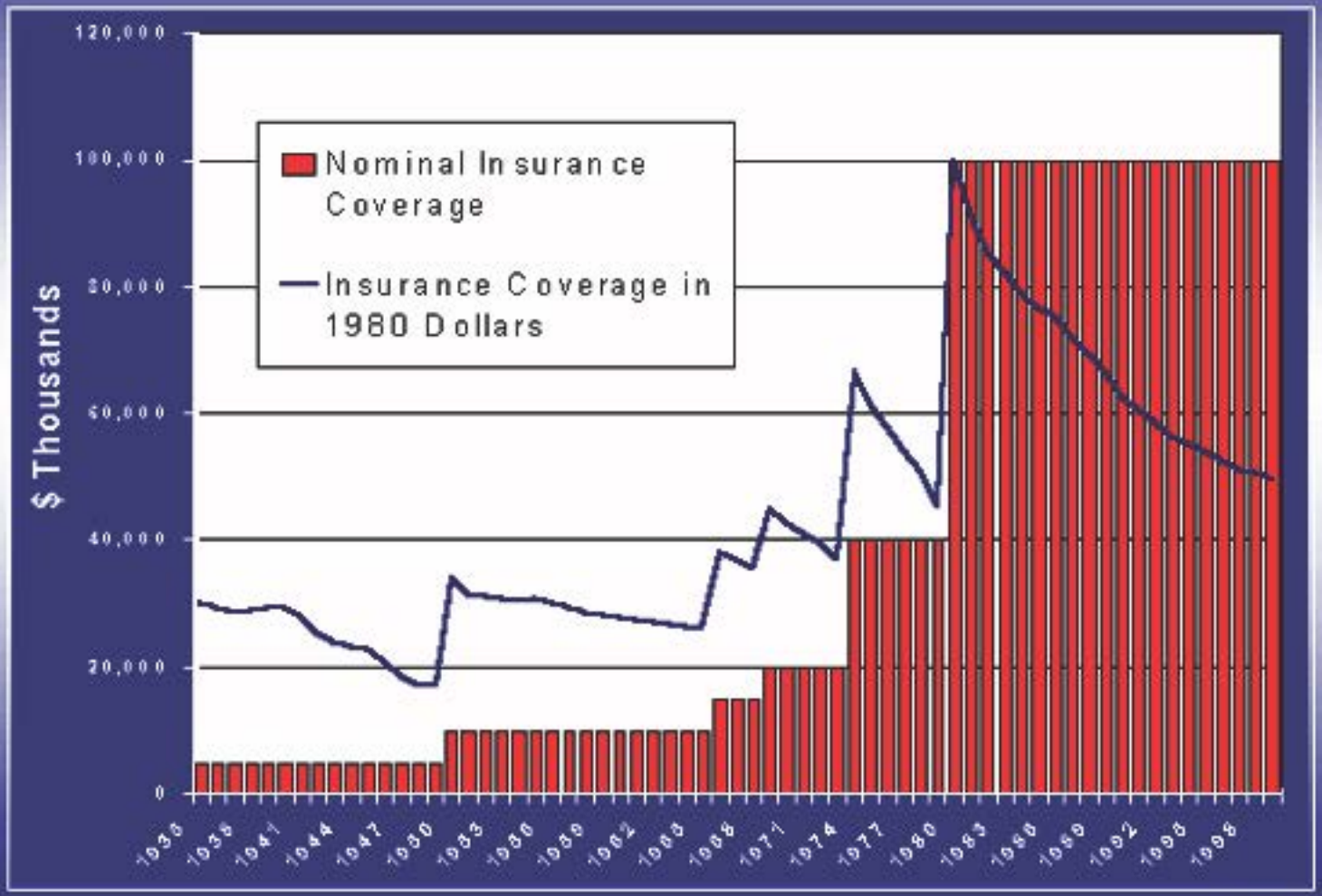
- Systemic risk assessments would be charged to all institutions and can come on top of regular assessments.

# Rebate Proposals

- Rebates directly from the fund or from current assessments
- Discretionary versus mandatory
- Rebates directly to banks and thrifts or to make FICO payments

# *Insurance Coverage*

# The real value of insured deposit coverage has declined.




FDIC

# The 1980 Increase to $100,000

- An inflation adjustment would have raised deposit insurance coverage to $60,000.
- Why $100,000?
  - Response to interest rates and changes in the financial industry
  - Draw funds into thrifts
- Some have cited the increased coverage as a contributing factor to the S&L crisis.
  - Additional liabilities increased resolution costs.
  - Exacerbated "Moral Hazard" problem
  - Removal of Reg Q ceilings

Source: FDIC," **History of the Eighties**", 1997

# Increasing Coverage to $200,000

- Current level of uninsured deposits = $1 trillion
- High-end estimate of the increase in insured deposits with $200,000 limit = $400 billion
- This would reduce the ratio of the combined fund from 1.38 to 1.22 percent.

# International Comparisons:
## Coverage Ratio to Per Capita GDP in 1999

- Average coverage ratio = 3X per capita GDP
- Africa has the highest coverage: 6.2X per capita GDP
- Europe has the lowest coverage: 1.6X per capita GDP
- U.S. deposit coverage = 3.2X per capita GDP
- IMF Rule of Thumb: 1 to 2X per capita GDP

Source: Garcia, Gillian, 1999, "**Deposit Insurance: A Survey of Actual and Best Practices**," IMF Working Paper No. 99/54 (Washington: International Monetary Fund)

FDIC