Federal Deposit Insurance Corporation

Fund Management: Historical View and Recent Changes

DICJ Roundtable: March 12, 2019

Presented by:

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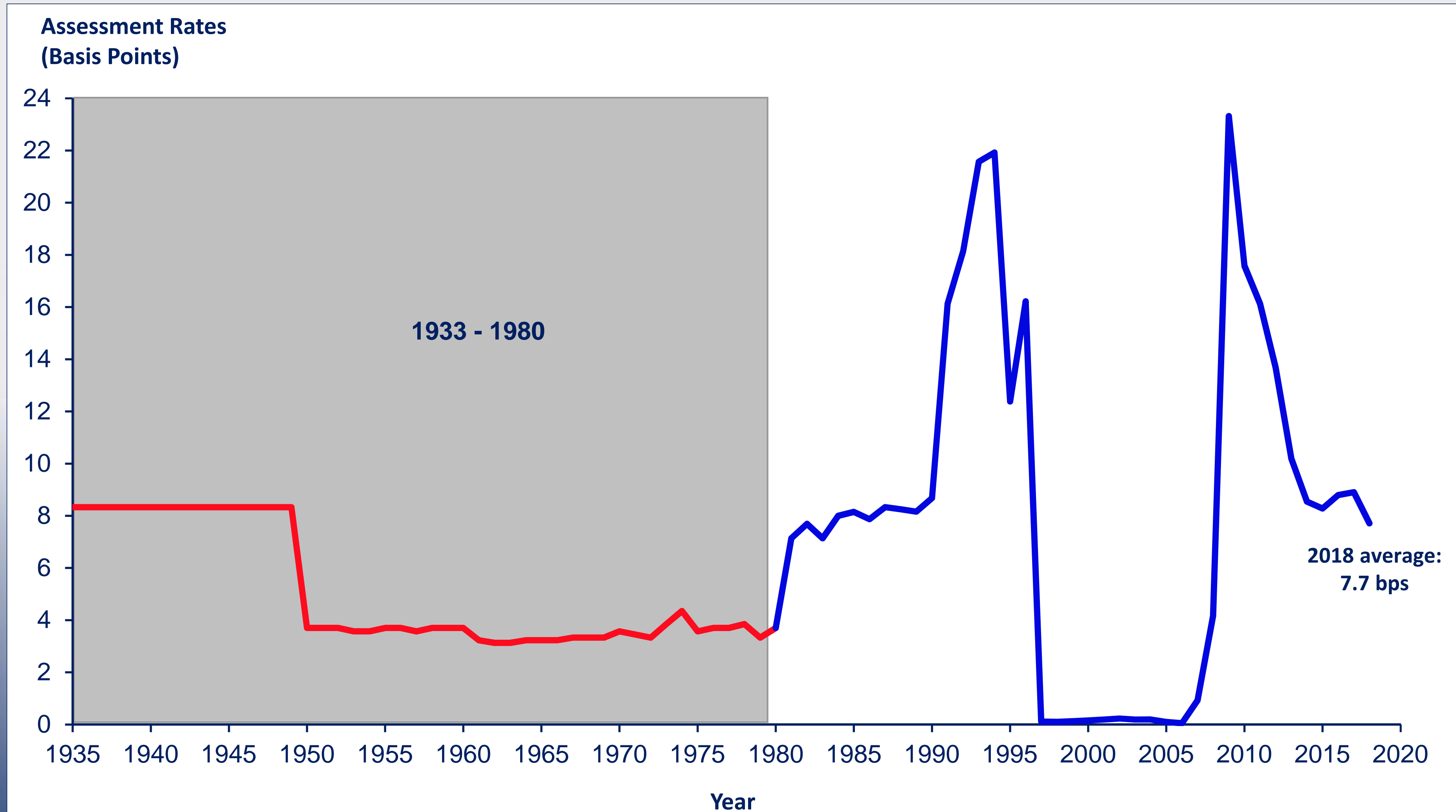
1933 – 1980: Fixed Nominal Rate and Fluctuating Reserve Ratio

- Target Fund Size: Through 1980, there was no target for the insurance fund.
- Initial Funding: Capital provided by the U.S. Treasury and 12 Federal Reserve Banks; all Federal Reserve member banks required to become members, assessed one-half of 1% of insurable deposits
- Premium Rates: Until the end of the 1980s, the nominal premium rate was 8.33 basis points of domestic deposits.

1933 – 1980: Fixed Nominal Rate and Fluctuating Reserve Ratio



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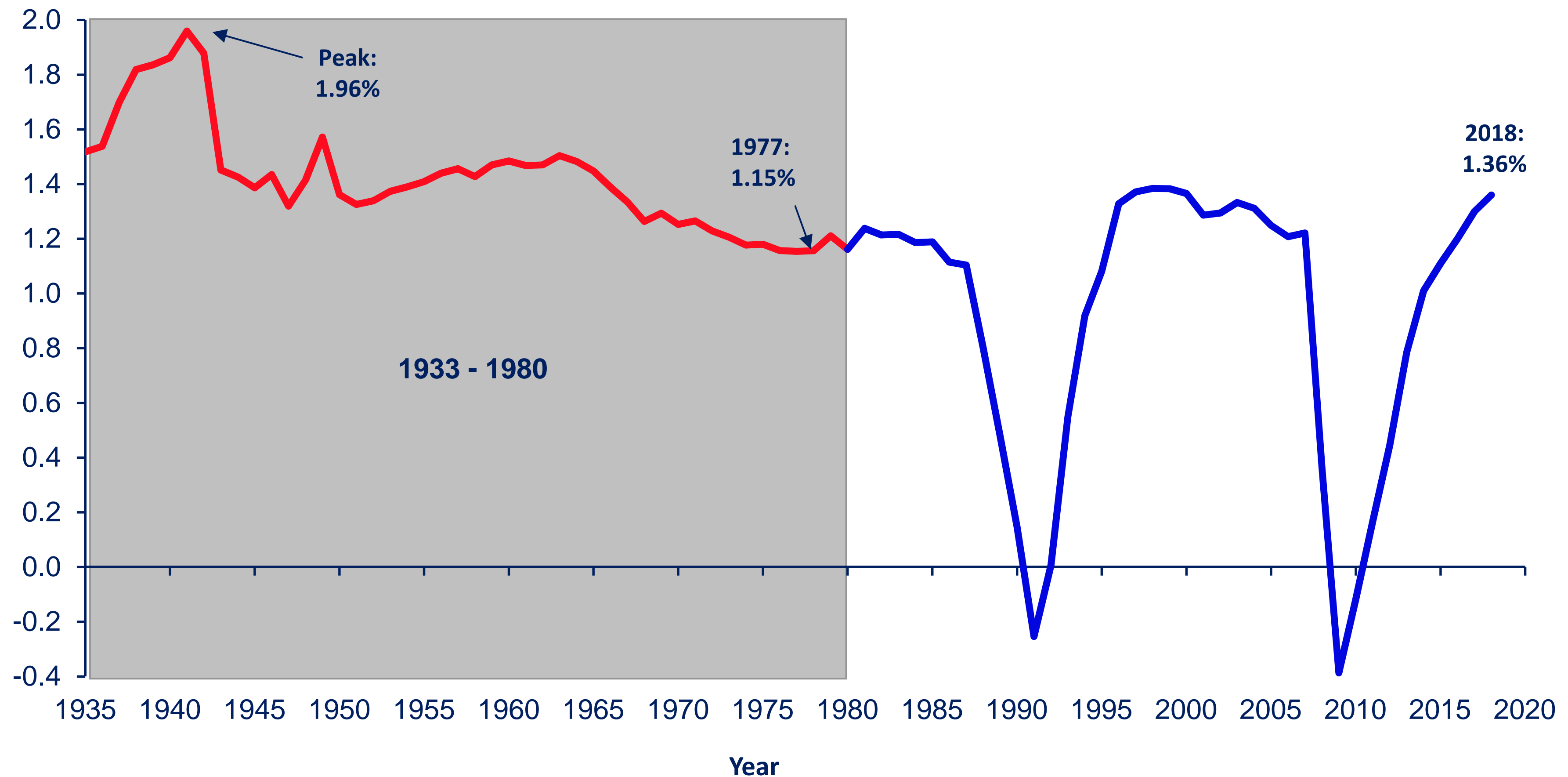

First U.S. Banking Crisis
1980 – 1991: Evolving Fund Target

- Target Fund Size: In 1980, Congress created a target range for the insurance fund of 1.10 to 1.40 percent of insured deposits. In 1989, Congress set the designated reserve ratio at 1.25 percent.
- Premium Rates: The nominal premium rate remained at 8.33 basis points of domestic deposits throughout the 1980s. Congress increased the statutory rate to 12 basis points in 1990 and authorized further increases. Rates rose to 19.5 basis points and then 23 basis points in 1991 in an effort to maintain an adequate fund balance.
- Rebates: Between 1980 and 1985, the rebate (credit) mechanism was linked to the level of the reserve ratio in addition to net assessment income. In 1985, rebates (credits) were suspended because of an increase in bank failures.

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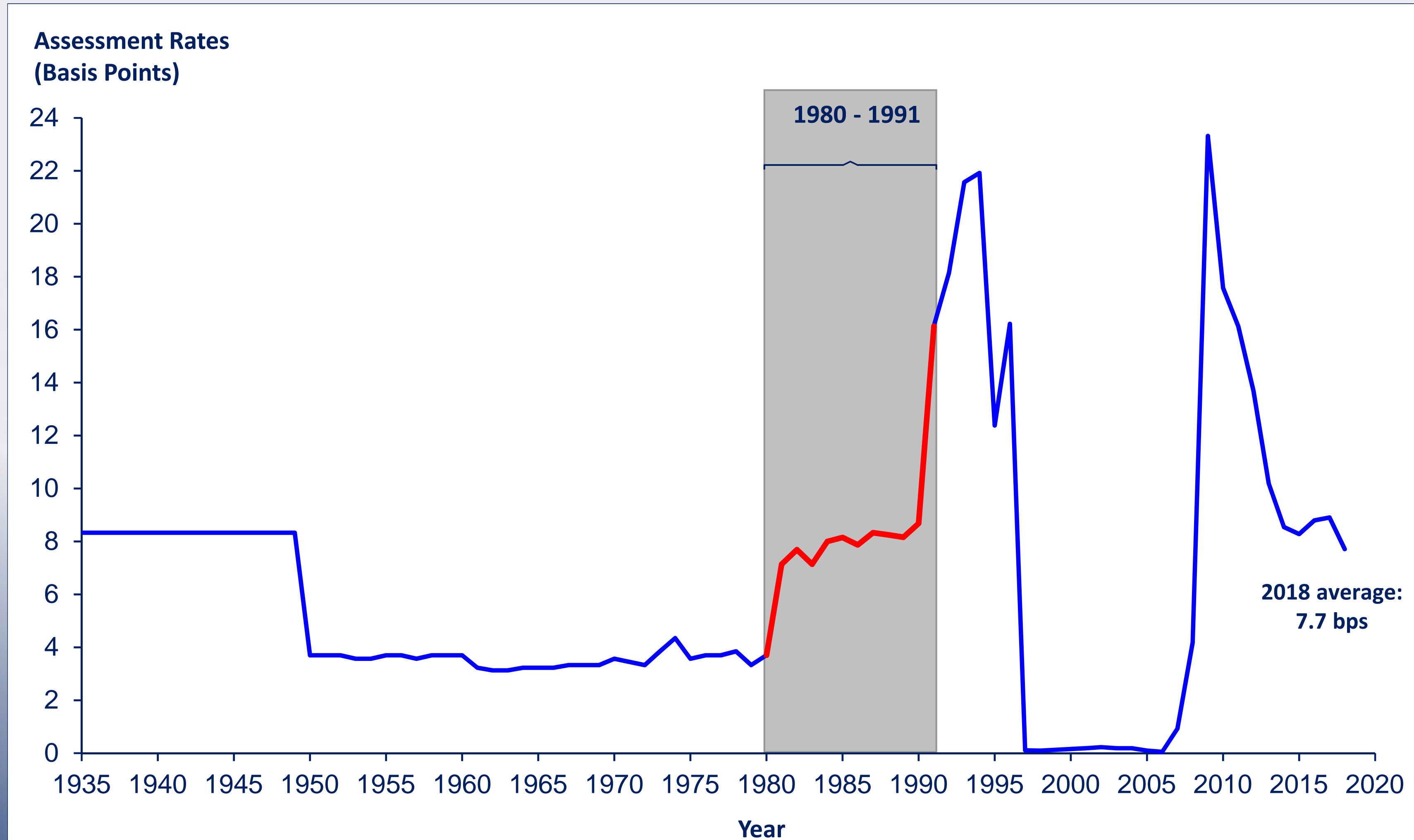

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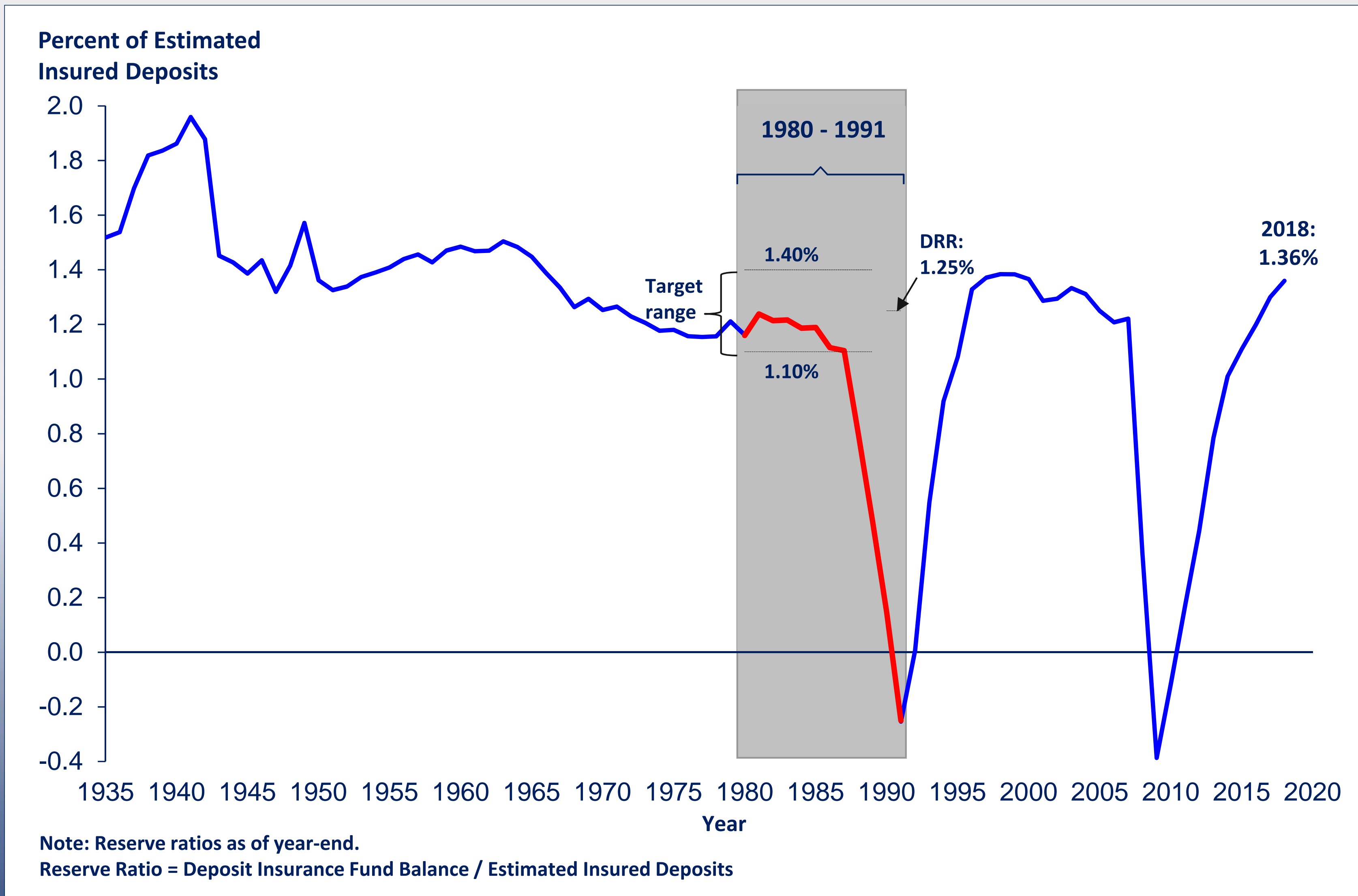
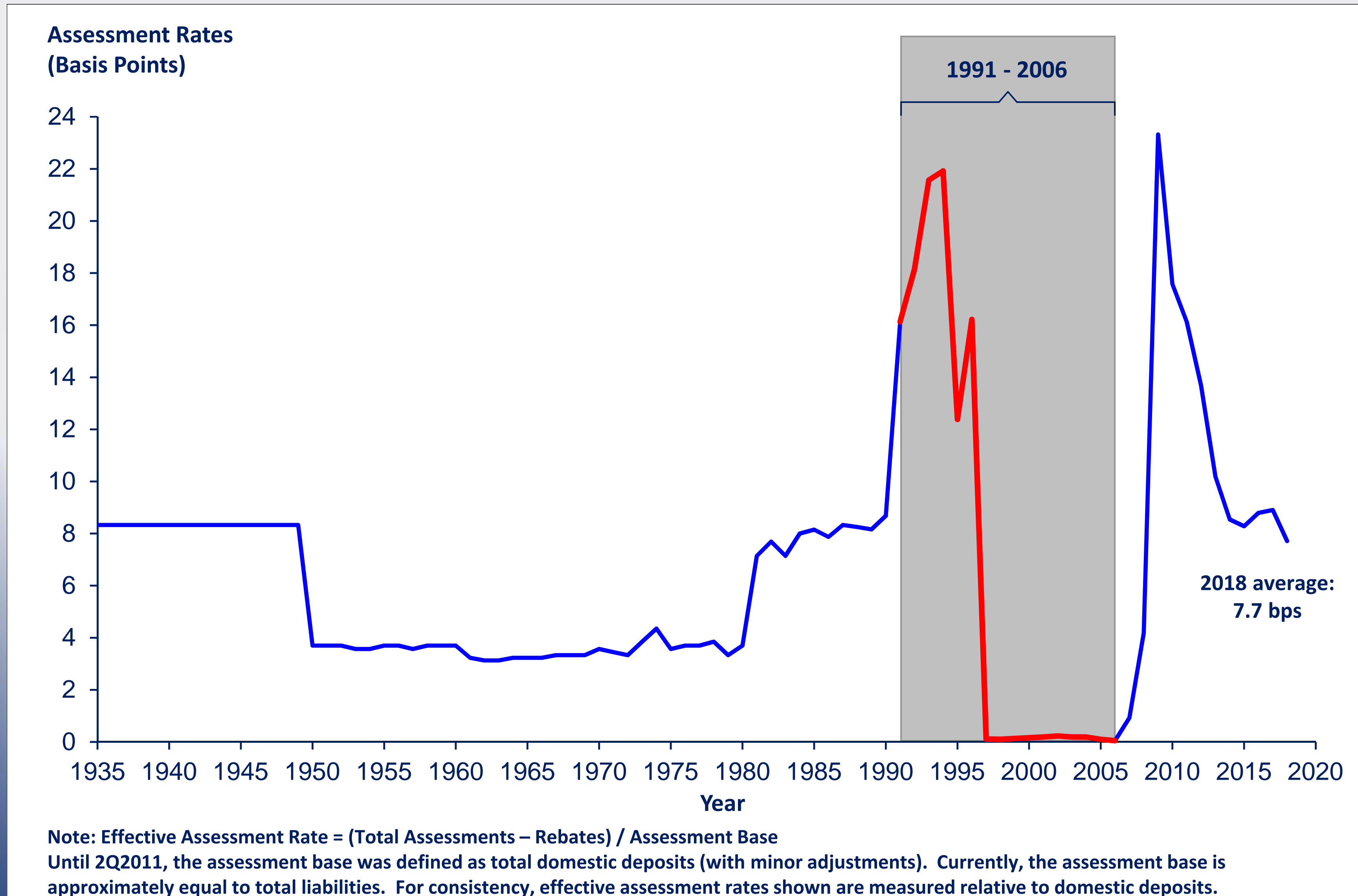


U.S. Banking Recovery and Growth Period
1991 – 2006: Hard Target for Reserve Ratio and Fluctuating Rates

- Target Fund Size: In 1991, Congress made the 1.25 percent target for the fund reserve ratio the basis for setting assessment rates.
- Premium Rates:
  - In 1991, Congress required that the FDIC:
    - Set assessments at rates that are sufficient to increase the fund reserve ratio to 1.25 percent within a year, or
    - Set rates so that the reserve ratio would reach 1.25 percent within 15 years, with a minimum average rate of 23 basis points of domestic deposits.
    - Risk-based pricing was established for the first time after the crisis to create better risk incentives.
  - From 1996 – 2006, Congress prohibited the FDIC from charging well capitalized, highly rated banks an insurance premium when the reserve ratio remained at or above 1.25 percent.
  - Rebates: None

1991 – 2006: Hard Target for Reserve Ratio and Fluctuating Rates



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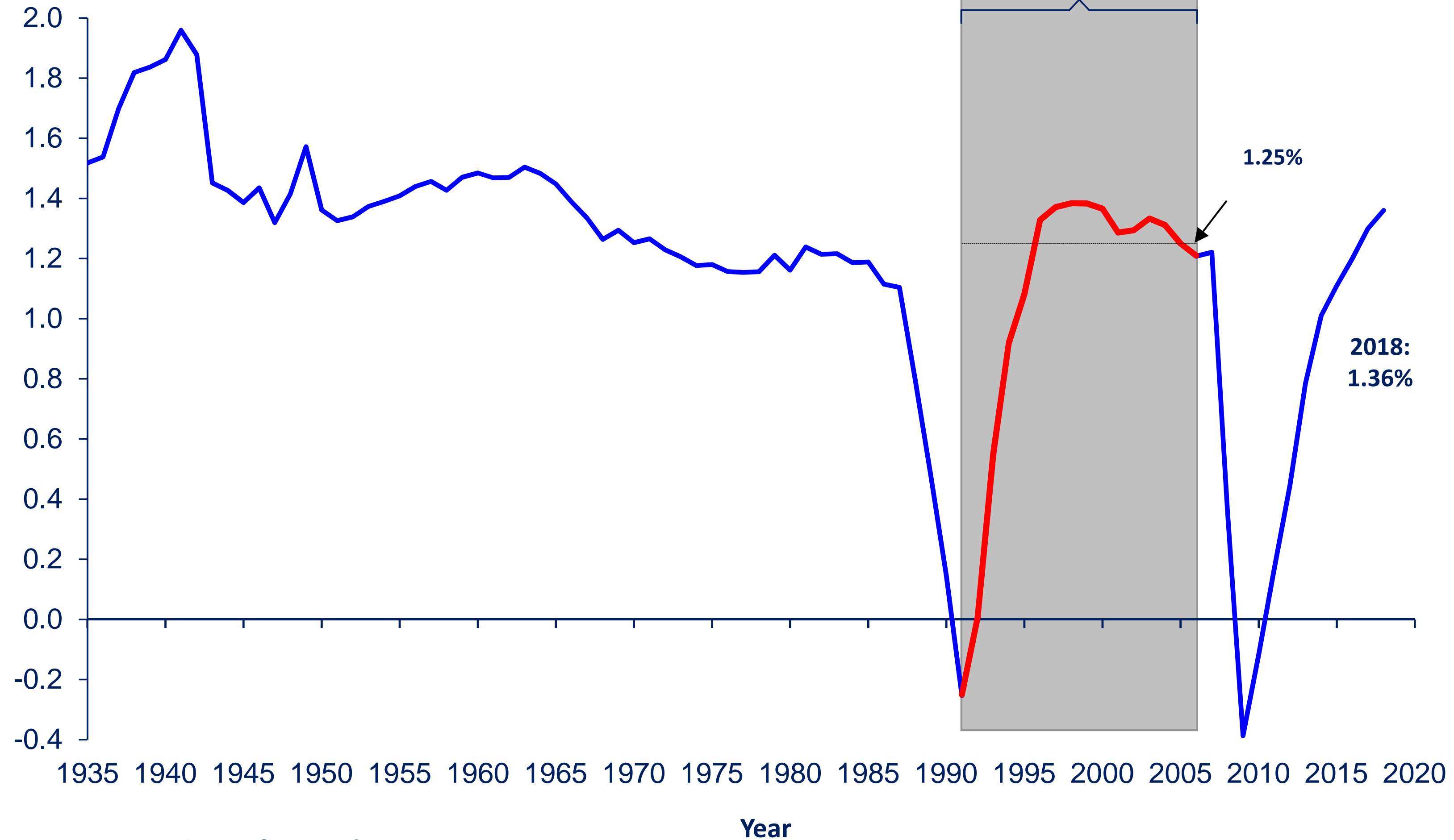


2006 – 2010: Hybrid Approach

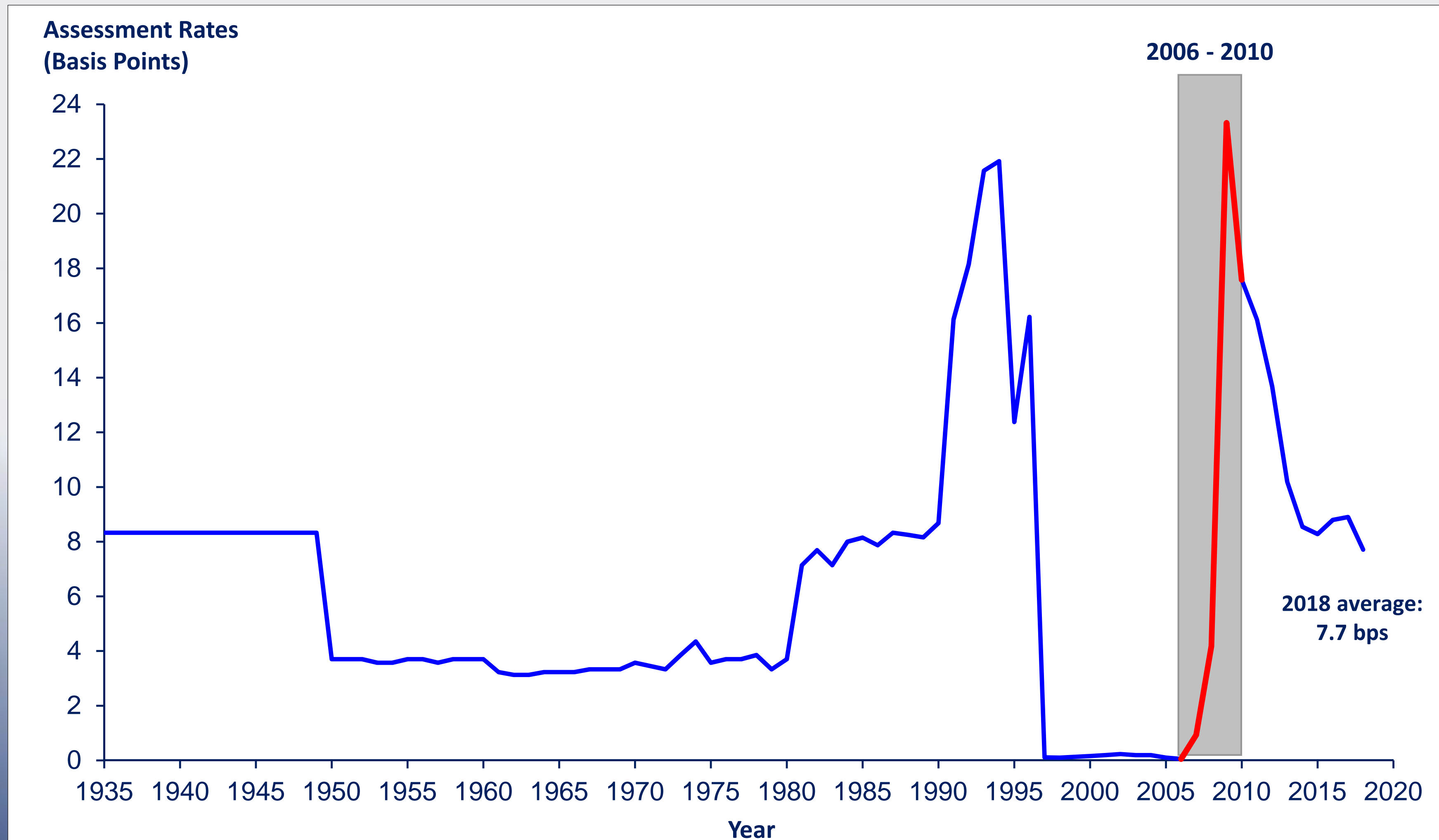
- Target Fund Size:
  - Congress permitted the FDIC to set the Designated Reserve Ratio (DRR) each year between 1.15 percent and 1.50 percent.
- Premium Rates:
  - Congress ended the prohibition against charging most banks a premium when the reserve ratio was at or above the DRR. The FDIC could charge all banks a risk-based premium regardless of the level of the reserve ratio.
- Rebates:
  - If the reserve ratio was between 1.35% and 1.50%, the FDIC had to pay "dividends" (with a limited exception) equal to half of the excess above 1.35%.*
  - If the reserve ratio exceeded 1.50%, the FDIC had to pay dividends equal to 100% of the excess, creating a hard cap of 1.50% for the fund.

*Because the reserve ratio never reached 1.35%, no dividends were actually paid.

Recent Crisis: Fund Balance and Reserve Ratio Begin Rapid Decline

- 2008:
- The Deposit Insurance Fund (DIF) and reserve ratio began a two year decline as the cost of bank failures rapidly depleted the fund.
- Jan 1, 2009:
- Premium rates for all risk categories increased.
- Jun 30, 2009:
- A special assessment was levied.
- Dec 30, 2009:
- A 3-year prepaid assessment was collected.

2006 – 2010: Hybrid Approach and Recent Crisis



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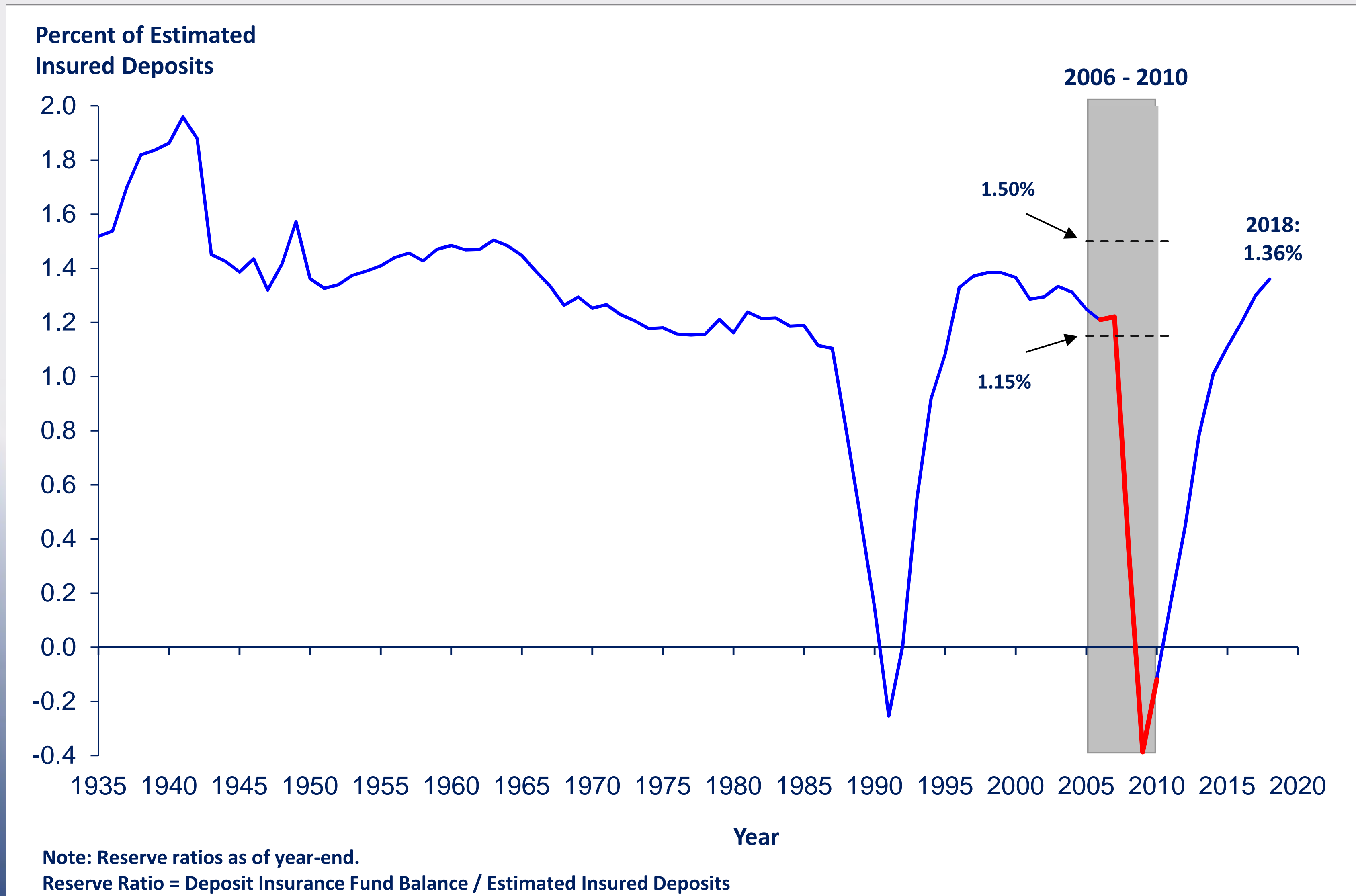
2006 – 2010: Hybrid Approach and Recent Crisis



Dodd-Frank Changes to Fund Management: Designated Reserve Ratio

- Raised the minimum designated reserve ratio (DRR), which the FDIC must set each year, from 1.15% to 1.35%
- Required that the fund reserve ratio reach 1.35% by September 30, 2020
- Required that banks with over $10 billion in assets pay for the cost of the change in the minimum target from 1.15% to 1.35%
- Removed the upper limit on the DRR and therefore on the size of the fund

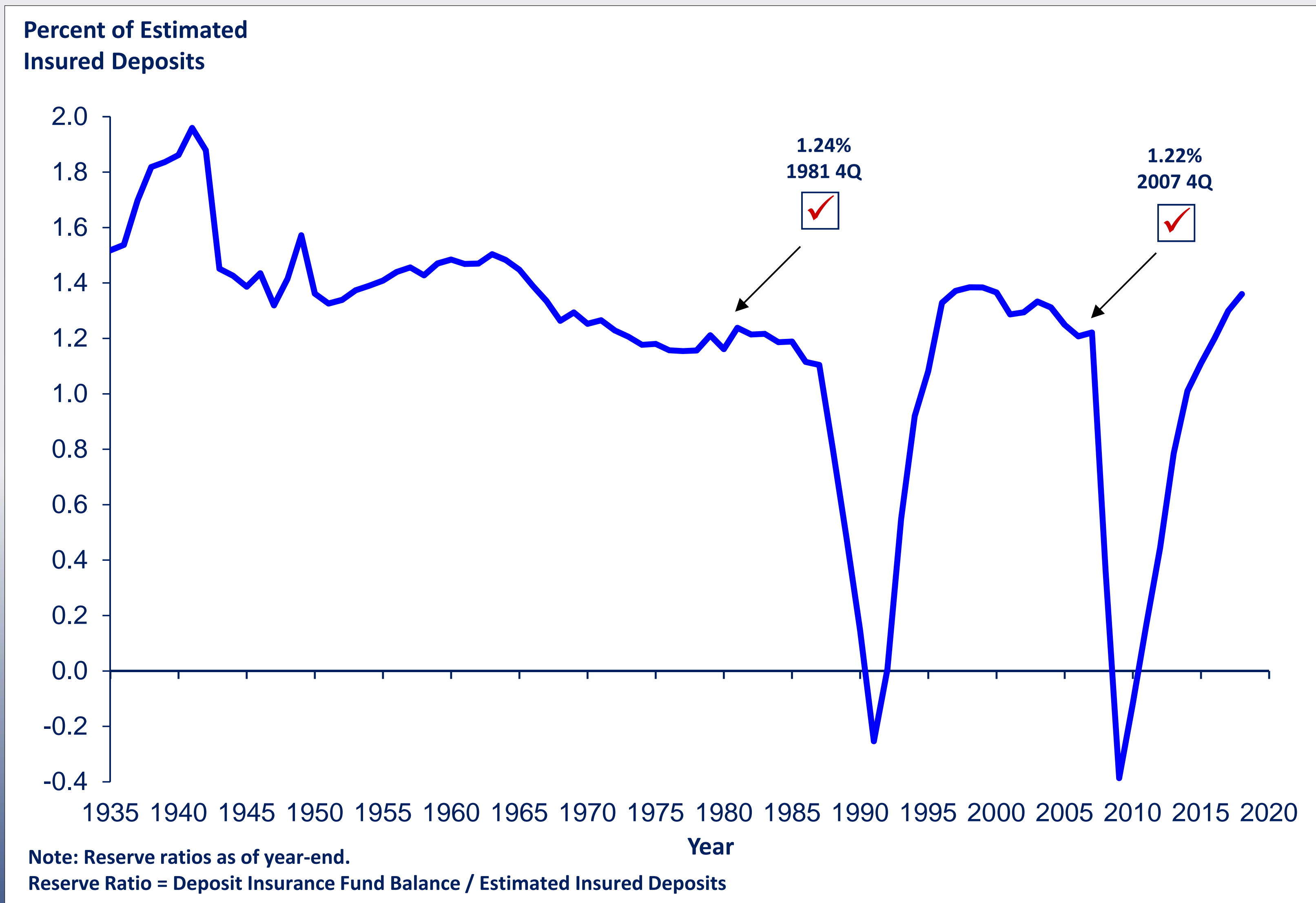
Dodd-Frank Changes to Fund Management: Assessments and Dividends

- Eliminated the requirement to pay dividends from the fund when the reserve ratio is between 1.35 and 1.50%
- Granted the FDIC sole discretion in determining whether to suspend or limit dividends when the fund is above 1.50%
- Changed the assessment base on which premiums are charged to make the largest banks responsible for a greater share of FDIC assessment revenue

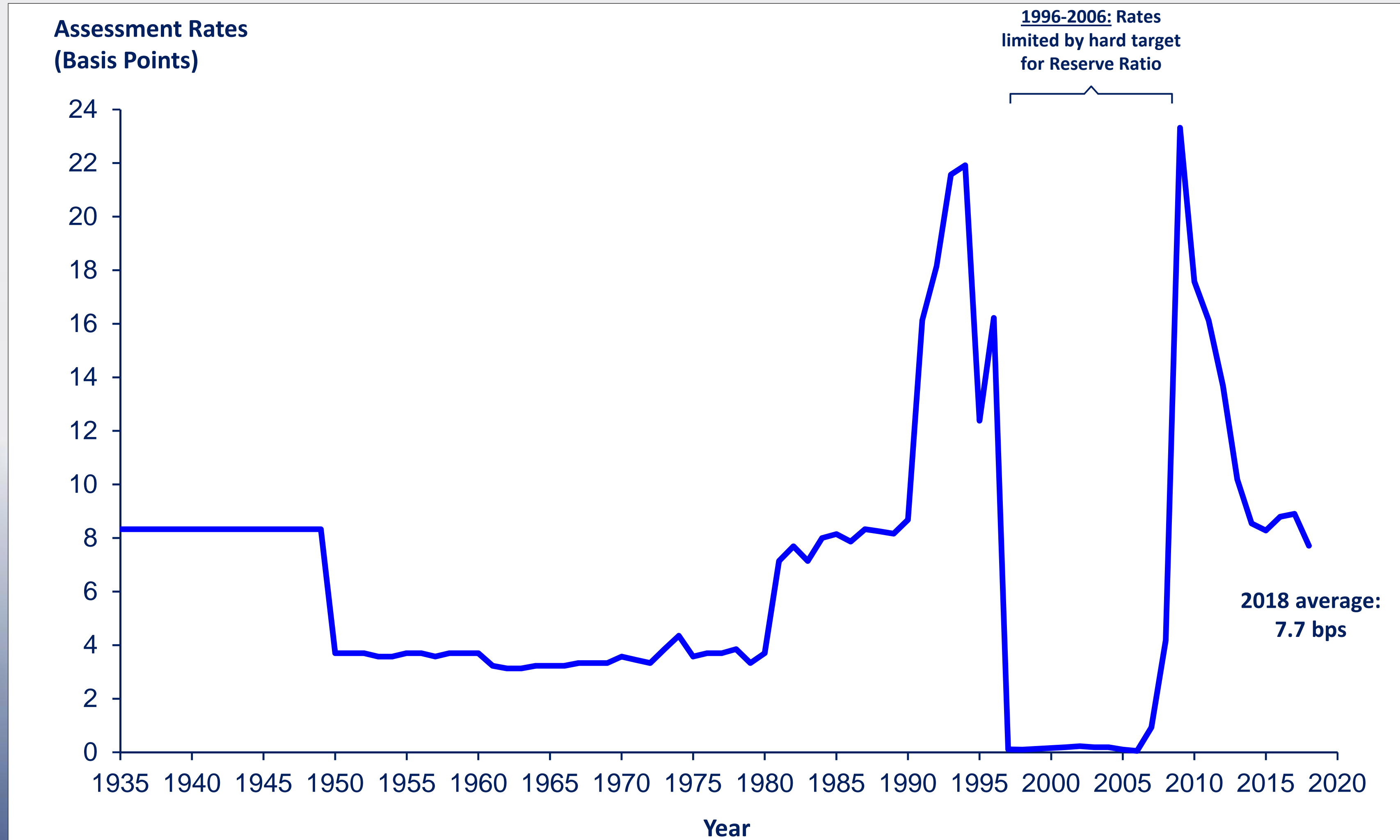
Implementing Dodd Frank:
Developing a Long-Term Plan for Fund Management

- Historical Analysis:
  - Using data from two banking crises, the FDIC conducted a historical analysis to determine how high the reserve ratio would have had to have been to have maintained:
    1. A positive fund balance
    2. Stable, moderate assessment rates
  - This analysis was used to develop a comprehensive, long-term management plan for the DIF that is designed to:
    - Reduce pro-cyclicality
    - Achieve moderate, steady assessment rates throughout economic and credit cycles
    - Maintain a positive fund balance

The reserve ratio peaked at about the same level before both crises.



Effective assessment rates have been volatile and pro-cyclical.



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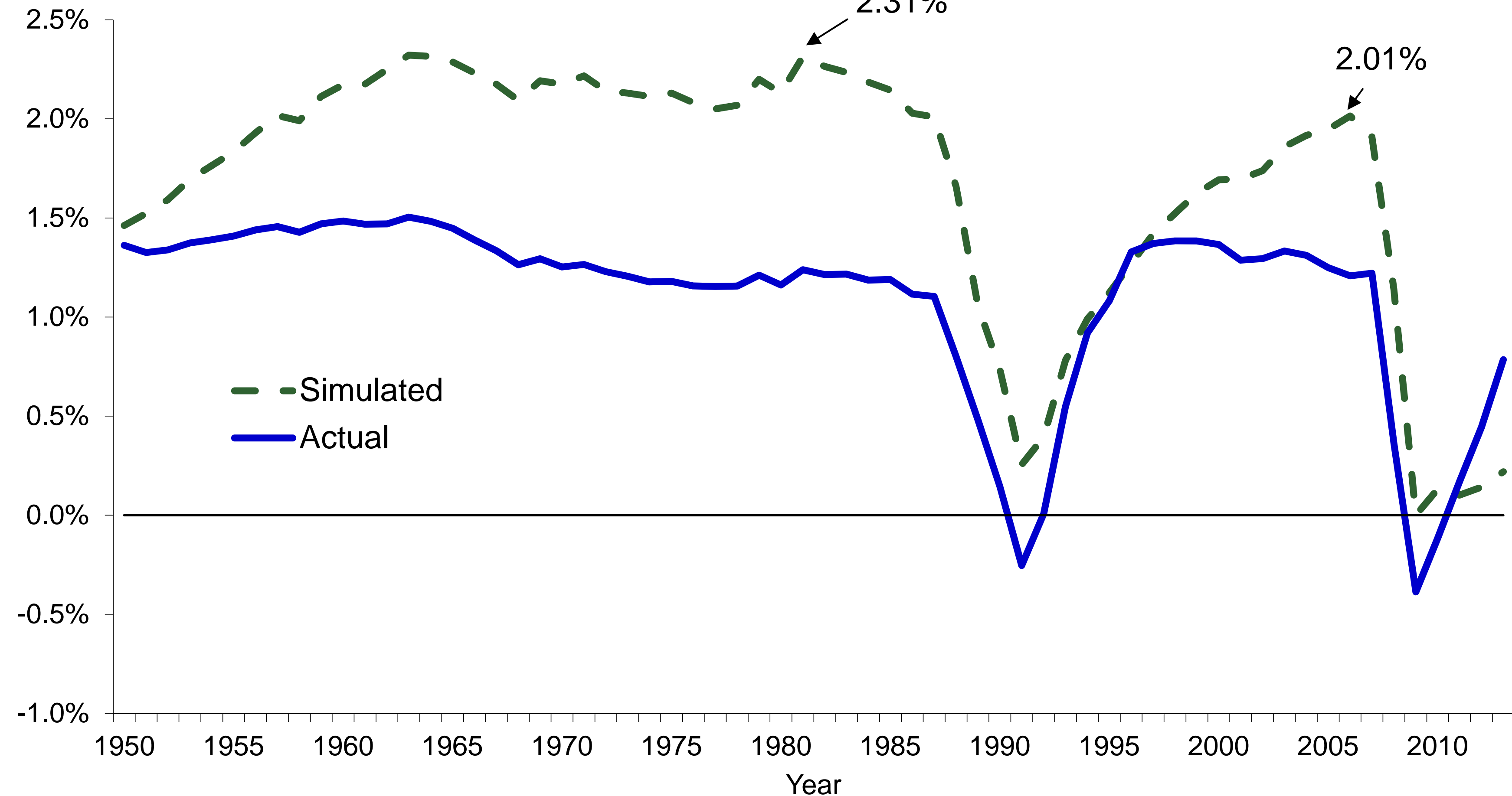
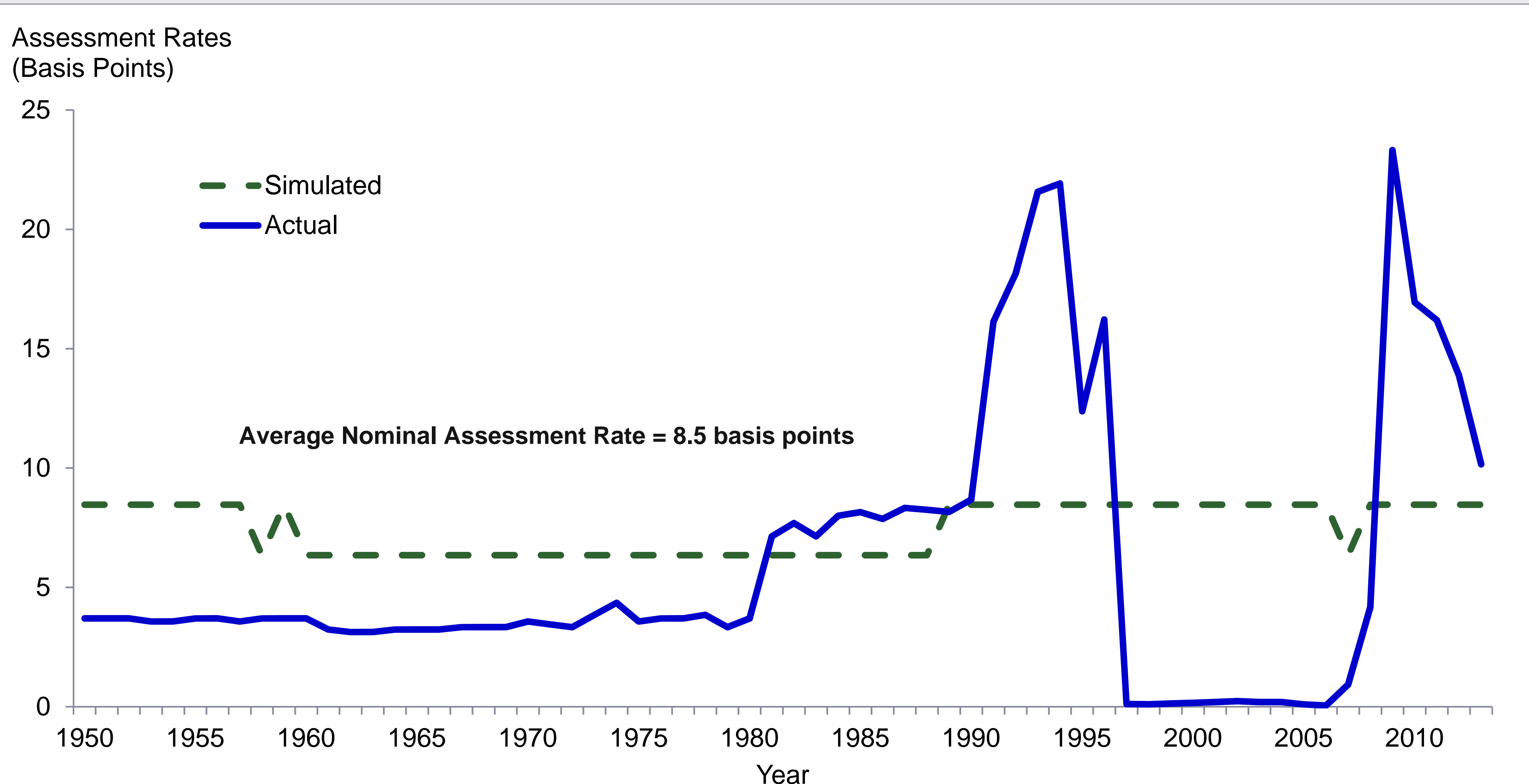
A minimum target of 2 percent would have helped avoid negative fund balances in the early-1990s and late-2000s crisis periods.



A target of 2 percent will help allow rates to remain steady under good and bad conditions while maintaining a positive fund balance.



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2010 – Present: More Stable and Less Procyclical Premiums

- Target Fund Size: In December 2010, the FDIC adopted a final rule setting the DRR at 2%.
- Premium Rates:
  - In February 2011, the FDIC adopted a final rule that put into place moderate assessment rates when the fund reserve ratio exceeds 1.15 percent. The rate schedule is based on the long-term average rate needed to maintain a positive fund balance throughout banking and credit cycles.
  - There will be progressively lower assessment rates if the reserve ratio exceeds 2 percent and 2.5 percent.
- Rebates: The final rule adopted by the FDIC suspends dividends indefinitely. In lieu of dividends, the FDIC will gradually lower assessment rates.