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Statement of the Shadow Financial Regulatory Committee

FDIC Replenishing of the Deposit Insurance Fund

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In early January, Congress passed the Deficit Reduction Act of 2005, which contained several reforms of the deposit insurance system. While the Shadow Financial Regulatory Committee commented on this legislation as it moved through Congress and supported much of it, the final legislation contained a new provision on which we believe it is necessary to comment.

For several years, Congress has been wrestling with the issue of when and how quickly the deposit insurance fund should be replenished when it suffers losses. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) required the FDIC to take action to replenish the funds whenever the amount in a deposit insurance fund fell below 1.25 percent of estimated insured deposits, and that such replenishment should occur within one year by levying or increasing deposit insurance premiums on insured banks.

Both banks and the FDIC believe that FDICIA gave fund managers insufficient flexibility to take account of industry conditions when a premium levy or increase might be necessary, and the new legislation grants the FDIC some leeway in doing so in two respects. First, the agency now has authority to levy or raise premiums whenever the amount in the merged deposit insurance fund falls between 1.15 percent and 1.35 percent of estimated insured deposits. Second—in language that was introduced in the final legislation—the FDIC is required to bring the fund back into that range within five years. This greatly relaxes the former one year deadline.

The Shadow Committee has in the past expressed concern about granting the FDIC additional leeway in replenishing the deposit insurance fund. Any opportunity for forbearance, in the Committee's view, is not good policy. The tendency of all regulatory agencies, generally abetted by Congress, is to avoid the tough decisions or defer them to a later time. Extending to five years the period during which replenishment must occur and allowing the FDIC to extend it further in "extraordinary circumstances" opens the possibility that the FDIC will be able to defer tough decisions on premiums almost indefinitely.

The Committee believes that the banking industry was short-sighted in encouraging the adoption of this provision. Banks seem not to realize that FDICIA puts the capital of the banking industry—and not that of taxpayers—behind the FDIC's insurance obligations. As a result, the banks are better served by a regular replenishment of the fund rather than deferral into the future. If the FDIC, through forbearance, allows the deposit insurance fund to decline to very low levels, the entire industry would be hit suddenly with a massive premium increase. The safer policy for the industry would be to encourage the FDIC to replenish the fund quickly whenever it falls below the minimum percentage required, so that a larger premium increase will not be required when, for whatever reason, there has been a massive loss to the consolidated depository-institution insurance fund.