Wall Street lauds FDIC plan to replenish bank deposit insurance fund

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1 October 2009

The US Federal Deposit Insurance Corporation (FDIC) announced Tuesday that its deposit insurance fund, which guarantees the bank deposits of millions of American consumers up to $250,000, would fall into the red this week. The agency proposed that its insurance fund, which has effectively gone broke as a result of 115 bank failures since January of 2008, receive a $45 billion cash infusion in the form of prepayments of quarterly fees that banks are required to pay into the fund.

Following a meeting of the FDIC board, the agency proposed that banks pay their fees for the rest of this year as well as 2010, 2011 and 2012 by December 31. Even with this stopgap cash infusion, the FDIC estimated that its deposit insurance fund would remain technically in the red into 2012 and would not return to "comfortable" levels until 2017.

The insurance fund's liabilities include $32 billion which the FDIC has set aside to account for expected bank failures in 2010. Government officials on Tuesday projected that bank failures from 2009 through 2013 will cost the FDIC $100 billion, up from an estimate several months ago of $70 billion.

Even these projections are highly optimistic. The International Monetary Fund on Wednesday released its latest "Global Financial Stability Report," which estimates that losses from the global financial crisis stand at $3.4 trillion for the 2007-10 period, less than half of which has so far been realized. Banks in the US and internationally are concealing massive losses by refusing to write down bad loans, and a new wave of defaults are anticipated in commercial real estate and consumer credit.

Ninety five US banks have failed so far this year, up from 25 in 2008. In addition, the FDIC had 416 banks on its "problem" list at the end of June, the highest number in 15 years, and the list is certain to grow.

Before the financial crisis erupted last autumn, the FDIC insurance fund had over $50 billion. By the end of June, that figure had fallen to $10.4 billion to back $6.2 trillion in total deposits.

The *Wall Street Journal* on Wednesday quoted Gerard Cassidy, a bank analyst at RBC Capital, as saying, "Though some of our largest bank failures have already taken place, there are still hundreds and hundreds of banks that are going to fail in this cycle."

This is only the second time in the FDIC's 76-year history that its deposit insurance fund has been depleted. Its net worth turned negative in 1991 during the savings and loan crisis.

The FDIC was established in 1933 to provide a measure of government backing for deposits and arrest a wave of bank runs that had tipped the United States into the Great Depression. The limit on insured deposits was raised at the height of the financial crisis last year from $100,000 to $250,000—a measure chiefly designed to reassure the wealthy and protect the deposits of big investors.

FDIC officials insisted Tuesday that despite the insurance fund's problems, depositors would not be affected because federally insured bank deposits are backed by the "full faith and credit" of the US government. The FDIC is able at any time to tap into a $100 billion Treasury line of credit, and earlier this year Congress passed legislation allowing it to borrow up to $500 billion from the federal Treasury.

However, the de facto insolvency of the FDIC fund can only fuel international concerns over the credit-worthiness of the United States and further erode confidence in the US dollar, whose value has fallen sharply on global currency markets in recent months. Under conditions of federal budget deficits estimated at $9 trillion over the next decade, a doubling of the potential liabilities of the Federal Reserve in the course of the past year, and a massive rise in the national debt, the FDIC's troubles raise the specter of state bankruptcy.

One reason the FDIC chose to address its crisis by having banks prepay their insurance fund fees, rather than tap its credit line with the Treasury, is that the government is rapidly approaching the statutory limit on the national debt. Treasury Secretary Timothy Geithner warned last month that the $12.1 trillion cap will likely be reached later this year. The Obama administration has been pressing Congress to raise the debt limit.

An even more decisive consideration was opposition by the major banks. They lobbied fiercely against both the Treasury loan option and the alternative of a special fee being levied by the FDIC on the banks to bolster the insurance fund. Either plan would result in higher premiums being imposed on the banks. The banks fear, moreover, that a Treasury loan could bring with it new attempts to rein in the banks, including limits on executive compensation.

In May, the FDIC imposed a special fee, netting $5.6 billion for the insurance fund. This time the banks—despite receiving trillions of dollars in government cash, cheap loans and debt guarantees backed by the FDIC—dug in their heels.

In a letter sent September 21 to FDIC Chairman Sheila Bair, American Bankers Association CEO Ed Yingling endorsed borrowing from the banks (which would net them handsome profits in interest payments) or collecting regular premiums early as an alternative to charging another fee.

At a hearing last week of the House of Representatives Financial Services Committee, the chairman, Massachusetts Democrat Barney Frank, ever attentive to the interests of Wall Street, told Bair, "This is not the time to raise assessments on the banks."

Testifying before the House panel, the comptroller of the currency John Dugan, who oversees national banks and is an FDIC board member, said he was "very concerned" about a second special assessment.

Bank officials pushed for the prepayment plan last week and lauded the FDIC announcement after it was made Tuesday. In an email to *Bloomberg News* last week, James Chessen, chief economist at the American Bankers Association, said, "The prepayment option provides the FDIC cash up front to easily handle future failures without imposing significant costs on the industry all at once."

Michael Feroli, an economist at JPMorgan Chase, told *Bloomberg*, "Pre-paid assessments would allow the FDIC to replenish the deposit insurance fund in a way that does not permanently damage banks' financial viability."

And following Tuesday's announcement, JPMorgan Chase Chief Executive James Dimon, in an interview with the *Wall Street Journal*, praised the FDIC's plan as "an elegant way for them to do it."

The banks are all the more pleased because the FDIC proposal allows them to count their prepayments as assets and not write them off until they would normally come due. In addition, it allows troubled banks to request waivers.

In making the announcement, FDIC Chairman Bair cynically sought to portray the prepayment plan as a boon to taxpayers, saying, "In choosing this path, it should be clear to the public that the industry will not simply tap the shoulder of the increasingly weary taxpayer."

In fact, a major reason for the collapse of the deposit insurance fund is the policy of the FDIC—and the Obama administration—of giving massive subsidies to banks that agree to take over failing institutions seized by the agency. The *Wall Street Journal* reported last month that the FDIC has been subsidizing the purchase of distressed banks by larger institutions by guaranteeing virtually all of the potential losses of the bigger banks.

The article reported that the FDIC has assumed up to 95 percent of the risk on $80 billion in assets of failed banks bought by other banks. As the *Journal* noted, the FDIC's policy of engineering bank takeovers at public expense "amounts to a subsidy for dozens of hand-picked banks."