

FDIC proposes multi-year billing for late 2009 to raise ready cash

Rejecting further special assessments, FDIC seeks to handle today's failures with tomorrow's assessments

By Steve Cocheo, executive editor, scocheo@sbpub.com

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FDIC has taken a page from the traditional magazine publisher's circulation promotion, where readers are encouraged, through discounts, to pay up front for multi-year subscriptions. But in the new FDIC proposal approved for public comment on Sept. 29, there were key distinctions: The payments won't be voluntary, and instead of discounts there will be built-in increases.

"Pre-paid assessments," as the approach has been dubbed, represent a new approach in a crisis that has stretched the inventiveness of agency and industry to new lengths. In discussing the proposal prior to the FDIC board's official vote, Chairman Sheila Bair stated that FDIC's commitment to depositors "is absolute," and that the pending proposal was about methodology, not outcome. Portraying an industry awash in liquidity, FDIC positioned its new concept as a means of using banks' current cash without affecting ability to lend, as loan demand is down.

"The decision today is really about how and when the industry fulfills its obligation to the insurance fund," said Bair. "It's clear that the American people would prefer to see an end to policies that look to the federal balance sheet as a remedy for every problem. In choosing this path, it should be clear to the public that the industry will not tap the shoulder of the increasingly weary taxpayer. This proposal is a vote of confidence for the banking industry's resilience and will continue to recover its strength as we work through the significant challenges ahead."

A senior staffer, briefing board members, stated that, "Liquidity needs will exceed liquid assets [of the FDIC's Deposit Insurance Fund] sometime early next year." FDIC holds many assets acquired in the course of closing banks and meeting insured depositors' needs. However, many such assets aren't readily convertible to cash, which is what the agency needs in order to meet current and anticipated resolution and cleanup requirements. In essence, FDIC requires "working capital." The proposed approach, built on the pre-paid assessments, is expected to raise \$45 billion.

Comptroller of the Currency John Dugan, a statutory member of the FDIC board, boiled matters down to essentials during the gathering. The insurance agency cannot meet its needs on a pay-as-you-go basis, he said, so, "we have to borrow." The agency's preference is to "borrow" from the banking industry, rather than use the expanded credit line at the Treasury Department that was obtained in May under the Helping Families Save Their Home Act.

“Treasury borrowing creates the perception that this [resolutions of failed banks] is being paid for by the taxpayer, even though that is not a correct perception,” Dugan added. He said that \$45 billion spread out over a multi-trillion-dollar banking industry was not an unreasonable amount.

“There may come a time when we want to tap our Treasury credit line,” said Bair. “But today is not that day.”

ABA Chief Economist Jim Chessen stated that, “The prepaid assessments represent money that the FDIC expects to receive from banks anyway over the next several years, but having the cash on hand sooner rather than later provides more flexibility for dealing with any contingencies over the foreseeable future. The bottom line is that customer deposits remain safe in banks and the FDIC has the resources needed to meet its responsibilities.”

In a phone interview, former FDIC Chairman William Isaac, now a private consultant and chairman of LECG Global Financial Services, called the matters before the FDIC Board “a tough choice.” But he said he would also have come down on the side of having banks pay the prepaid assessments, rather than going to Treasury for credit. He said he thought it would be bad for the industry to have Treasury backing up FDIC.

Details of FDIC’s action

FDIC’s Board adopted a notice of proposed rulemaking, with a 30-day comment period, that would require insured banks and savings banks to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. The prepayment and regular payment would be due on Dec. 30, 2009. FDIC anticipates that banks will draw on available cash and excess reserves.

FDIC addressed the accounting for these prepayments in its announcement. Initially, banks would record the prepayments as a prepaid expense, which is considered an asset. Quarterly payments that come due would be offset against the prepayments. That would occur either until a bank’s prepayment was exhausted, or until yearend 2014. Any monies left over of a bank’s prepayment would be returned, under the proposal.

As each quarter passes, a bank would record an expense for its regular quarterly assessment, and also a credit to the prepaid assessment, until that asset is exhausted.

The board also voted to adopt a uniform three-basis-point increase in assessment rates effective on Jan. 1, 2011.

The amount due will be based on each institution’s total base assessment rate in effect on Sept. 30, 2009. That would be increased by the 3 basis points mentioned above in 2011 and in 2012. Furthermore, each institution’s assessment base would be keyed to its third-quarter 2009 assessment base; for each quarter going forward, for purposes of calculating the prepayments, FDIC will assume a 5% annual growth rate through 2012.

A process has also been proposed to deal with institutions that would be endangered by prepayments, as determined by FDIC review. An appeals process for other institutions that believe they will be endangered is also anticipated under the proposal.

The agency plan and schedule for restoring DIF to statutorily required levels was extended to eight years from seven. (The plan had been extended to seven from five years in February 2009.) FDIC staff anticipates that the agency could face \$100 billion in failure costs over the 2009-2013 period, with \$25 billion of that already incurred in the course of 2009.

FDIC issued a FAQ on the prepaid assessments, in addition to its staff analysis and its proposal language. The FAQ notes that, "Prepayment of assessments would ensure that the deposit insurance system remains directly industry-funded and it preserves Treasury borrowing for emergency situations."

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