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CURRENT ISSUES IN DEPOSIT INSURANCE

HEARING

BEFORE THE

SUBCOMMITTE ON FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

ON

STRENGTHENING DEPOSIT INSURANCE AND REVIEWING INCREASING THE FDIC AND NCUA'S BORROWING AUTHORITY FROM TREASURY

MARCH 19, 2009

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THURSDAY, MARCH 19, 2009

WITNESSES

CURRENT ISSUES IN DEPOSIT INSURANCE

THURSDAY, MARCH 19, 2009

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 2:05 p.m., in room SD–538, Dirksen Senate Office Building, Senator Tim Johnson (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR TIM JOHNSON

Senator JOHNSON. As we all know, the economic landscape has undergone significant change since the Committee last looked at deposit insurance. In these times of economic instability, it is increasingly important that we have a strong and stable deposit insurance fund and that our regulators have the tools they need to wind down failed institutions while at the same time guaranteeing that Americans' savings and retirement remain safe. I am pleased to hold this hearing today to take a closer look at deposit insurance issues that the FDIC, the National Credit Union Administration, and our Nation's banks and credit unions currently face. I would also like to welcome our panel of witnesses, and thank them for their time and for their thoughtful testimony.

We are waiting for Ranking Member Senator Crapo to show up. I have some urgency in that Harry Reid has announced that we will have a vote around 4 o'clock, and so we intend to wrap up about then.

I would like to welcome our first panel of witnesses. Our first witness is Mr. Art Murton, Director of the Division of Insurance and Research at the Federal Deposit Insurance Corporation. Welcome.

Our second witness is Mr. David Marquis. Mr. Marquis is the Executive Director of the National Credit Union Administration and the former head of NCUA's Examination and Insurance Division. Welcome.

I will ask that the witnesses please limit their testimony to as close to 5 minutes as possible. Your full statement and any additional materials you may have will be entered into the record.

Mr. Crapo, do you have any comments?

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman. Sorry for being late. I am out of breath from running to get here.

First of all, I want to welcome our witnesses and everyone here today. Thank you, Mr. Chairman, for holding this hearing.

Looking at today's economic climate and the threats that face us in the financial industry, we have to consider the possibility that we could have one or more major financial institution failures. This is not an acknowledgment that it will happen, but it is an acknowledgment that there is a threat or a risk present.

The FDIC and the NCUA protect against the loss of insured deposits if a Federal insured bank, savings association, or a credit union fails. It is important to note that the depositors who have accounts at failed banks or credit unions are made whole by the insurance fund at either FDIC or NCUA that banks and credit unions pay into. It is essential that this remains the case, and I am going to oppose any efforts to change that.

In order to make sure that the FDIC and the NCUA can immediately access the necessary resources to resolve failing banks and credit unions and provide timely protection to insure depositors, I support increasing the borrowing authority of both the FDIC and the NCUA.

I am a cosponsor of S. 541 with Senator Dodd and others that would permanently increase the FDIC authority to borrow from the Treasury, increase that authority from $30 billion to $100 billion. I note that it has been a long time since that borrowing level has been increased.

In addition, the bill would temporarily authorize an increase in borrowing authority of about $100 billion, but not to exceed $500 billion, based on a process that would require the concurrence of the FDIC, the Federal Reserve Board, and the Treasury Department, in consultation with the President.

I look forward to hearing today from our witnesses about what would be the appropriate parallel authority to provide to NCUA. It is my hope that we will decide not to try to add controversial items like the bankruptcy cram-down provisions or others into this effort, which will only delay our ability to provide the additional necessary resources to address future contingencies.

Again, Mr. Chairman, I appreciate your holding this hearing. I look forward to working with you and hearing from our witnesses.

Senator JOHNSON. Mr. Murton, please begin.

STATEMENT OF ART MURTON, DIRECTOR, DIVISION OF INSURANCE AND RESEARCH, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. MURTON. Thank you. Chairman Johnson and Ranking Member Crapo, I appreciate the opportunity to testify today on behalf of the FDIC.

By protecting deposits, the FDIC protects the most important source of funding available to banks—funds that can be used to provide credit to communities and the broader economy.

While many sources of bank funding have pulled back during the past 6 months, deposits have not. They remain a stable source of funding because depositors know that insured deposits are absolutely safe.

My testimony will discuss the condition of the Deposit Insurance Fund and the need for an increase in the FDIC's borrowing authority. I will also comment on other current and potential changes to the deposit insurance system.

At the beginning of 2008, the Deposit Insurance Fund had a balance of $52 billion. By the end of the year, the balance had declined to $19 billion. The decline was caused by the costs of protecting depositors of banks that failed last year and by the reserves that we set aside to cover the expected costs of bank failures this year.

Last October, the FDIC Board, as required by law, put in place a plan to restore the insurance fund to a target range within 5 years. Based on projections at that time, the restoration plan called for banks to pay higher premiums. Recently, the FDIC updated those projections, and because of continued deterioration in the financial system, our estimated losses are significantly higher. As a result, the FDIC's Board of Directors made a series of difficult decisions to ensure that our deposit insurance system remains sound. Most importantly, the Board adopted an interim rule setting a special assessment of 20 basis points.

These increases in assessments are necessary to ensure the adequacy of the FDIC's industry-funded resources. The FDIC's guarantee—for 75 years—has always been funded by the industry. Deposit insurance has been an important source of stability during our current financial crisis, and it has not relied on taxpayer funding.

The FDIC realizes that these assessments are a significant expense, particularly during a financial crisis and recession when bank earnings are under pressure. And we recognize that banks face tremendous challenges right now, even without having to pay higher assessments.

So let me turn now to our borrowing authority. While the FDIC is an industry-funded program, the FDIC guarantee is backed by the full faith and credit of the U.S. Government. In light of this, Congress has always provided the FDIC with a line of credit with the U.S. Treasury.

The FDIC's borrowing authority was last raised by Congress in 1991 to $30 billion and has not been raised since then. Meanwhile, in the banking industry, assets have grown. They have tripled from $4.5 trillion to close to $14 trillion, and the FDIC believes it is necessary to adjust the line of credit to reflect that growth.

The Depositor Protection Act of 2009, S. 541, would increase the FDIC's authority to borrow from Treasury from $30 billion to $100 billion. As Senator Crapo mentioned, it would also allow a temporary increase above $100 billion, but not to exceed $500 billion, based on a process that requires the FDIC Board, the Federal Reserve Board, and the Secretary of Treasury, in consultation with the President, to make a finding that the additional borrowing is necessary. It is important to note that any use of that borrowing authority is required by statute to be repaid by the banking industry.

The recent decision to impose a special assessment reflected the FDIC's responsibility to maintain resources sufficient to cover unforeseen losses, and the size of the borrowing limit is critical to this decision. Chairman Bair has stated that an increase in our borrowing authority would give the FDIC the flexibility to reduce the size of the special assessment.

The events of the past year have demonstrated the importance of contingency planning to make sure the FDIC can seamlessly fulfill its commitment to protect insured depositors. The Depositor Protection Act would ensure that the FDIC will continue to have the resources necessary to address future contingencies. The FDIC strongly supports this legislation and looks forward to working with the sponsors to enact it into law.

Now let me just turn briefly to the FDIC's systemic risk exception and how the costs of it are paid.

As you know, current law authorizes the FDIC to take extraordinary actions in certain circumstances to protect the financial system and the economy from systemic risk and to recover the costs of that action through a systemic risk assessment on banks.

The FDIC's recent experience suggests that we do not have sufficient flexibility to allocate any such assessment fairly among the parties who benefit. For example, recent actions taken under the systemic risk authority have benefited parties who are not subject to any assessment by the FDIC.

The statutory language in H.R. 1106 would address this by allowing the FDIC to impose systemic risk assessments on parties that benefit from the systemic risk exception, including bank holding companies.

The last area that I will comment on is the level of deposit insurance coverage. With regard to proposals to make permanent the current temporary increase in deposit insurance coverage to $250,000, the FDIC believes that the level of deposit insurance coverage is a policy determination that appropriately should be made by Congress. However, because any increase in the level of deposit insurance coverage increases exposure of the fund, such a change must also permit the FDIC to account for the newly insured deposits when setting premiums necessary to maintain the fund.

In conclusion, the events of recent months have clearly demonstrated the benefits of deposit insurance. Assured by this guarantee, consumers have continued to maintain deposits in insured financial institutions that have provided vital credit for communities across the country. With additional modifications to the deposit insurance system, such as the increase in the FDIC's borrowing authority, we can maintain a system that continues the FDIC's mission of providing stability to the financial system.

Thank you, and I look forward to your questions.

Senator JOHNSON. Mr. Marquis.

STATEMENT OF DAVID M. MARQUIS, EXECUTIVE DIRECTOR, NATIONAL CREDIT UNION ADMINISTRATION

Mr. MARQUIS. Thank you, Chairman Johnson, Ranking Member Crapo. Good afternoon. The National Credit Union Administration appreciates this opportunity to provide the agency's position on "Current Issues in Deposit Insurance." Federally insured credit unions comprise a small but important part of the financial institution community, and hopefully NCUA's perspective will add to the understanding of issues relating to Federal insurance at this critical juncture.

Recent events underscore how important Federal insurance is to consumers, and the National Credit Union Share Insurance Fund has played a valuable role in reassuring credit union members that their federally insured funds are safe to $250,000. I would like to confine my oral statement to a few key points.

First, NCUA supports the permanent increase in Federal deposit insurance to $250,000. Reverting to the pre-2008 level of $100,000 would likely have a negative effect on consumer confidence at this time when federally insured depositories such as credit unions are appropriately seen as a port in the storm.

Second, NCUA supports the extension of the period of time the agency has to assess a premium to restore the NCUSIF to its statutory minimum. Currently, the Federal Credit Union Act requires credit unions to pay a premium in the event the NCUSIF equity ratio falls below the 1.2 percent. That premium to restore the level must be collected in the same year as the decline. NCUA believes that extending the time the agency has to restore the equity level from 1 year to 5 years would provide important flexibility for credit unions. A premium assessment would occur during a period of economic difficulty when credit unions could least afford it. This in turn reduces the amount of dollars credit unions can lend to their members, which stimulates and supports the economy in a very direct way. A 5-year period is a sensible way to address this strain on credit unions without sacrificing the financial soundness of the insurance fund.

Third, the authority of NCUSIF to borrow from the Treasury has remained at $100 million since the inception in 1970—this despite significant growth in industry assets and insured funds. Borrowing authority is vital because the insurance fund's cash needs could far exceed expected losses during difficult periods. In the event of a failure of a large institution, NCUA might need to properly pay out all the insured shares, which would exceed available liquidity resources. The maintenance of public confidence in this kind of extraordinary event strongly suggests that Congress update the NCUSIF figure to a more realistic and useful number, given the size of the industry today versus what it was in 1970.

A recently passed House bill has a provision that would increase the NCUSIF borrowing authority to $6 billion. This figure is an appropriate reflection of the growth in the industry today. Furthermore, emergency borrowing authority, such as the one that Chairman Crapo recently put into legislation for the FDIC in a multiple of 5 times ordinary borrowing authority, would be an important contingency tool in the event of further dislocations in the market. NCUA views these increases as a vital step in our effort to maintain a stable insurance fund for credit union members.

Finally, Congress should consider providing NCUA with systemic risk authority similar to the FDIC. This enables FDIC to provide assistance to banks in emergency situations subject to concurrence by the Treasury and the Fed. NCUA has certain tools available to it, but these tools are very limited by statute and too narrow in focus in the event of a broad, large-scale financial dislocation like the one we are now experiencing.

NCUA does not have sufficient ability to respond when certain extraordinary circumstances threaten to undermine confidence in the credit union system as a whole. During some of the recent disruptions in the corporate credit union system, for example, NCUA was forced to resort to makeshift, burdensome share guarantee programs that, while workable, required a complicated execution of agreements between the NCUA Board and the corporate credit unions. Given the size and complexity of the adverse events that can occur, broader, more direct remedies available through a systemic risk authority are needed.

The problem facing our financial markets and the institutions that serve them are real, but so is the safety and stability provided by a sound and well-functioning Deposit Insurance Fund. NCUA is working to give consumers a significant measure of reassurance during these troubled times. NCUA's hearing and legislative process before you represent an appropriate opportunity for Congress to identify and act on important improvements that will make a good system even better for the Nation's consumers.

Thank you, and I will be glad to answer any questions.

Senator JOHNSON. Thank you, Mr. Marquis.

Mr. Murton, in addition to the potential increase in costs because of increased coverage, FDIC has increased premiums to restore the DIF as part of the restoration plan and announced a special assessment. How does the FDIC intend to address the concern that the special assessment and other costs will unfairly affect small banks, particularly those that played by the rules and did not contribute to our current economic crisis?

Mr. MURTON. Yes, thank you. The FDIC has proposed higher premiums. As you know, and as I said in my statement, the insurance fund that we administer has been declining over the last year or so and falling well below the target range.

We have always been an industry-funded deposit insurance system, and we think it is important to maintain that status, and the banks that we talked to agree with that.

We feel that it is important now to maintain a cushion for any contingencies, and that is why we are asking for increased borrowing authority.

We recognize that the higher premiums that we are asking banks to pay come at a difficult time, and the FDIC Board has always struggled at times like this with the tradeoff between maintaining a sound deposit insurance fund, on the one hand, and allowing banks to have the funds necessary to meet the credit needs of their community.

What the board has proposed has tried to strike that balance, but we have also indicated that if our special borrowing authority were increased, we think we would have enough of a cushion so that we could lower the special assessment. So that is one thing that we are trying to do.

We have also recently, as part of our guarantee, our temporary guarantee program, we recently changed the fee structure of that, so we are shifting more of the fees toward the larger users of this guarantee program, and those additional funds will be placed into the DIF, and that will allow us to offset some of the special assessment.

In terms of the community banks that have played by the rules, we have made some changes to our risk-based premium system, which was part of the legislation in 2006. We have asked as part of our risk-based pricing system for the banks that are taking on more risk to pay more of the burden, and for those traditional banks that have basically stuck to their knitting to pay less of the burden. So we are trying to address those very legitimate concerns.

Senator JOHNSON. Mr. Marquis, does the NCUA have a concern about the equity levels in credit unions that they need emergency borrowing authority? The Treasury Department has said that it supports an increase in FDIC's emergency borrowing authority. Does the Treasury feel the same way about increasing NCUA's emergency borrowing authority?

Mr. MARQUIS. Our borrowing authority right now is limited to $100 million, and at the time when that was enacted in 1970, the credit union industry had total deposits of $13 billion. Today, the credit union industry has assets of a little bit greater than $800 billion, so that is 62 times the asset size. In order to get the equivalent ability of NCUA and the insurance fund to act on issues of need in terms of payouts, we would have to go to $6 billion in order to equal that equivalent. I do not know if the Treasury supports that. To my knowledge, we are not sure. I am not sure that is the case. But as we wrote this for this hearing, we did talk to some of the members, at least a pack of folks did, members of the Committee on the House side, and tried to come up with a reasonable number that kind of mimicked or matched what the FDIC was and kind of where we were in relationship to what the size of the industry was back in the 1970s.

Senator JOHNSON. Do you both agree that the temporary increase in deposit insurance to $250,000 should be extended beyond 2009? Should the increase be made permanent?

Mr. MARQUIS. Yes, we believe it should be made permanent. Again, the last time this issue was looked at was in 1980 when the $100,000 was established. Looking on it on an inflation-adjusted basis, that would bring us to about 243. Prior to that, in the 1970s, the insurance limit was $40,000. We think this would allow some of the small credit unions, medium-sized community credit unions to be able to generate more deposits in the smaller institutions in the home towns and hopefully keep the money for credit available in those locations as opposed to spreading it out in the branches in the real large institutions.

We think this is helpful to especially the community credit unions and smaller credit unions and helping them to—basically, it would help us from insurance and spread out the systemic risk in that it would more be—it would have the opportunity to let folks that start out in credit unions in their 20s, and then by the time they get into their 70s, they do not want to keep $100,000, so they turn in their home town and have to go put it somewhere else, and this would allow them to stay with their institution and keep a little more money there.

Senator JOHNSON. Mr. Murton?

Mr. MURTON. Yes, the FDIC has always taken the position that the level of deposit insurance coverage is an important policy call for Congress to make, and the FDIC understands that there are tradeoffs on both sides of that issue.

If the increase in the guarantee is made permanent to $250,000, we would ask that the FDIC be able to take that into account in setting our reserves or our premiums in order to maintain the fund.

Senator JOHNSON. Mr. Crapo.

Senator CRAPO. Thank you very much, Mr. Chairman.

For both of you, right now both the banks and the credit unions are facing the impact of special assessments as a result of FDIC's and NCUA's efforts to maintain adequate resources. As we are all painfully aware, these special assessments are creating a concern about the financial impact on our financial institutions at a time when they really need to have as much bang for the buck in terms of providing credit as possible.

The question I have is—well, further in that context, it is my understanding that the increased borrowing authority that both of you are talking about would be able to provide both the FDIC and the NCUA some pathways to relieving that pressure. And the question I have is: First, how does the increased borrowing authority really help you relieve that pressure on the assessments? And, second, what would be some of the unintended consequences if Congress delays action on this borrowing authority issue? Mr. Murton or Mr. Marquis, whoever wants to go first.

Mr. MURTON. Yes, I will take it. We are asking for the increased borrowing authority, and we do think that will help to allow us to set a lower special assessment. Basically, our insurance fund has been declining, and as a result, the cushion that we have for contingencies, for unforeseen circumstances, has been getting smaller. And the borrowing authority is part of that cushion for the contingency.

So if Congress sees fit to increase our borrowing authority to keep pace with the growth in the industry over the last 25 years, then the board can take more comfort in allowing the lower special assessment and allowing the fund to go somewhat lower.

If we do not, if Congress does not act quickly, the board does have to make a decision soon on the special assessment. We are planning to go to the board in mid- to late May, and the board will have to decide whether to keep the 20-basis-point special assessment in place. And so action soon enough to allow that decision to be affected would be welcome.

And then, as I say, the line of credit is for contingencies, and given the circumstances that we are facing, there are a number of contingencies that we may face.

Senator CRAPO. Thank you.

Mr. Marquis.

Mr. MARQUIS. Thank you. As you know, the insurance fund for NCUSIF is structured in a way where the first 1 percent that credit unions are required to deposit is an asset on their balance sheet and it is not a premium. The other part of the Share Insurance Fund is equity that we built up over time and allowed us to go to 1.3 over time, over the past several years.

The borrowing authority gives us the ability to have cash needs for payout priorities or payout issues should those issues arise, which we are not anticipating at this point. But the 1 percent, if we have an issue that causes us to reserve or to fund for anticipated losses, still does impact the Share Insurance Fund 1 percent because it is an impaired asset, because it was never collected as a premium. So accounting-wise, that does cause an impairment, and currently, at our January 28th meeting, we did have to reserve a significant amount of money for some issues, and that caused our Share Insurance Fund to go down to about 0.51, and that is going to trigger a premium later on in this year.

Senator CRAPO. So if I understand both of you correctly, decisions have to be made relatively soon with regard to the special assessments, and the failure to be able to rely on the increased borrowing authority could cause higher assessments, and that in turn would reduce our ability to get more cash into credit markets than into these types of assessment funds. Correct?

Mr. MURTON. That is correct.

Senator CRAPO. The point I am trying to get at here is the longer Congress takes to act, the greater the threat to our system, or maybe to put it a different way, the less likelihood we will—or the less opportunity we will have to be able to free up more credit in the banks and credit unions for the public sector—the private sector.

Mr. MURTON. That is absolutely right.

Senator CRAPO. All right. Could you each just quickly go through with me the process that would be followed if there were a failure of a credit union or a failure of a bank? And what I am getting at is this: I think it is very important for the public to understand that these dollars are—even if the loans have to be accessed, ultimately the funds that would be used for the insurance protection here are going to come from the industry itself, and that is the point that I wanted to get at from both of you.

Mr. MARQUIS. Yes. The process of putting a credit union into receivership and liquidation is one that we take over the institution and pay it out, all the share deposits, within a couple days in order to maintain confidence in the system. That is a cash drain, of course, on the Share Insurance Fund.

Then a process takes place in terms of recovery of assets on the other side of the balance sheet, which is a long, drawn-out process at times as you try to liquidate the assets, or sell them or merge them or what have you. So that does take—and the loss ultimately takes capital out of the system which reduces the premium charge, which reduce the ability of a credit union to extend more credit in the market because they have to contract their balance sheets in order to meet their capital requirements.

Senator CRAPO. Thank you.

Mr. MURTON. Yes. When an FDIC-insured bank fails, we are able to resolve it quickly without interruption to the funds for depositors.

Senator CRAPO. So the depositors in both cases get their funds protected within days?

Mr. MURTON. Absolutely. Usually the next business day. In virtually all cases, there is no interruption to their funds.

Senator CRAPO. All right. Continue.

Mr. MURTON. And so in order to be able to do that, we need cash, we need to have the cash available to do that. And this borrowing authority helps us to make sure that we have the cash for whatever contingencies. To pay back that borrowing, we pay it back through the collection from the assets that we get from the failed bank, but also through the premiums that we assess on the banks. And we have always been able to pay—we have only borrowed from the Treasury once, and that was for short-term liquidity needs, and we paid that back within 2 years.

But any resources that we use and any losses that we incur as a result of a bank failure are paid for through assessments on the banking industry.

Senator CRAPO. So the bottom line is in both cases the depositors are protected immediately, the taxpayers ultimately do not end up holding the bill for the protection that is provide.

Mr. MURTON. That is right.

Mr. MARQUIS. Correct.

Senator CRAPO. Thank you.

Senator JOHNSON. Chairman Dodd.

Chairman DODD. Well, first of all, Senator Johnson, let me thank you and Senator Crapo for doing this. I appreciate it very much. We almost ran into each other. The hearing this morning went a little long because of votes. I thought we would be done much earlier. So we were leaving the room as you were coming in the room. So I want to thank you very much for holding this very important hearing, because we have got to in the coming days here now—we are trying to resolve some matters which I—we will either resolve or we will not. One way or the other, we will move forward. But Senator Johnson and Senator Crapo have been tremendously supportive of the idea of a need for doing what we need to be doing. I guess it goes back some time. Actually, we have been living with the $30 billion ceiling since 1991, so for the last almost—you know, number of years here, 20 years we have had people talking about the need to move up. And obviously the situation we are in I think makes that point very loudly to us. And dealing, obviously, with raising statutorily to the 250 also makes a great deal of sense as well. And then the issues related with it I think are important.

And let me just—I just have a couple of quick ones for you. There have been some concerns raised about our current system of collecting premiums for deposit insurance, that is, it is procyclical, that is, banks are charged more for deposit insurance during economic downturns, which is exactly when they can least afford to pay them. And so I wonder what we can to minimize this procyclical impact of deposit insurance assessments, because obviously we heard it again today. Senator Bunning was talking about assessments in his State. I do not know if you heard his comments, but talked about a 1,000-percent increase in premium costs. Sheila Bair was willing to sit down and talk about that particular case. But, nonetheless, that assessment, according to Senator Bunning, would make it impossible for that lending institution in his home State of Kentucky to make a profit based on that cost.

So I wonder if you might respond to this issue of how we can maybe think about a more creative way. Mr. Murton, we will start with you.

Mr. MURTON. The issue of procyclicality——

Chairman DODD. Is that microphone on?

Mr. MURTON. Sorry. Yes, sorry. The issue of procyclicality has been one that the FDIC has dealt with for a number of years, and, in fact, for a number of years we had a system that was more procyclical. It required us to charge whatever it took to get the fund back up to a target of 1.25 within a year.

The legislation that passed in 2006, which Senator Johnson was a strong advocate for, helped with that situation, and because that law was passed, we have not had to charge the high premiums for the last 2 years. We have been able to allow premiums to be lower than they otherwise would.

But we are at a time where the fund has declined, and it has declined so that the cushion that we have is getting uncomfortably small, and that is why the borrowing authority, the increase in the borrowing authority will help to alleviate some of that pressure and allow the board to lower the special assessment.

We are looking at other ways to try to address the special assessment. We have, as I indicated, changed the fee structure for the guarantee program that we have put in place, and we have raised some of the fees for that, and we are going to put them in the deposit insurance fund, so that will help lower the special assessment. And we have also put in place a risk-based pricing system where riskier banks are asked to pay more than the safer banks. So we are trying to take steps to lower the impact on the industry at what is probably one of the worst times for them to be facing.

Having said that, it is important to maintain an industry-funded program. We feel it is very important, and the banks that we have talked to feel that is an important feature of deposit insurance.

Chairman DODD. I appreciate that. One more question. I will ask you, Mr. Marquis, for the answer. On the second panel, Mr. Wright, who is from the National Association of Federal Credit Unions, and Mr. West from the Credit Union National Association expressed concerns over the increased assessments resulting from the National Credit Union Association's Corporate Stabilization Plan announced earlier this year to mitigate the cost to credit unions. Both witnesses propose allowing corporate credit unions to access the central lending facility and making the central lending facility available for capital as well as liquidity.

I wonder if you could share what your organization's position is on this proposal. And if you are not for it, why? And what alternatives would you suggest?

Mr. MARQUIS. NCUA supports the concept of trying to find a way for credit unions to mitigate the cost of having to recapitalize the 1-percent deposit all at one time. However, we also are mindful that we want a program that is not going to create further problems. Credit unions built their insurance fund—or built their portfolios up of capital from 1992, the last time we charged a premium, from about 6.4 percent to 11.5 percent. So their balance sheets are very healthy during the good times.

The Share Insurance Fund at that time was maintaining a rate of about 1.3, and it cannot charge a premium beyond that point. We have to give it back once it goes—or we do not have to give it back, but we cannot charge a premium.

On the CLF issue, the CLF is established for liquidity purposes, and it is funded through—its borrowing authority is set out in a multiple of its capital. It can borrow 12 times its subscribed and paid-in capital. So today that is $41 billion.

If we were allowed to put in capital instead of liquidity into an institution that would be at risk or the capital would be subject to covering an insolvent institution, that capital would be impaired, and impaired on the CLF books as well, on its capital. That in turn would reduce the borrowing authority from the CLF, and if you had an insolvency or a capital position that got impaired to the tune of about $3.4 billion, it would wipe out the borrowing authority altogether.

On the other hand, the additional would be the capital for the most part is subscribed for credit unions on behalf of them through our largest corporate, U.S. Central, and if that issue—or if that capital was impaired, it would further impair the capital of that institution and further put that institution in harm's way.

So those issues make it somewhat problematic, at least the way the structure of the CLF is currently written, not that that could not be adjusted, but you have to make some significant changes on how the CLF authority is established in terms of how its borrowing authority is set out.

I know our Chairman is working with staff, and we are due to give him something to present to our board on Tuesday as a possible way that this could be done to mitigate that issue, a proposal that might work through a stabilization fund on top of the Share Insurance Fund. But he has to vet that with his other board members before he is ready to present it to Congress.

Chairman DODD. Thank you very much.

Thank you, Mr. Chairman.

Senator JOHNSON. I would like to thank our first panel of witnesses for taking the time the time to testify today on this important issue. You may be excused for the second panel.

Now I would like to welcome our second panel of witnesses to the table. Thank you for being here today to discuss such a timely and important matter.

[Pause.]

Senator JOHNSON. Our first witness is Mr. William Grant. Mr. Grant is Chairman and CEO of First United Bank and Trust in Oakland, Maryland. He is here today on behalf of the American Bankers Association. Welcome.

Our second witness is Mr. Terry West, President and CEO of VyStar Credit Union in Jacksonville, Florida. He is here today on behalf of the Credit Union National Association. Welcome.

Our third witness is Mr. Steve Verdier, Senior Vice President, Independent Community Bankers of America. Welcome.

And last, Mr. David Wright. I have known Mr. Wright for many years. He is CEO of Services Center Federal Credit Union, which serves the communities of Yankton, Parkson, and Springfield in South Dakota. Thank you for being here today on behalf of the National Association of Federal Credit Unions, and thank you for traveling all this way.

Mr. Grant, please begin.

STATEMENT OF WILLIAM GRANT, CHAIRMAN AND CEO, FIRST UNITED BANK AND TRUST, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. GRANT. Chairman Johnson, Ranking Member Crapo, and other members of the Subcommittee, First United Bank and Trust is a 108-year-old community bank headquartered in Oakland, Maryland, a rural town in Appalachia with a population of about 2,000. We have assets of about $1.6 billion and serve four counties in Maryland and four counties in West Virginia.

The ABA strongly supports, with the sponsorship of Chairman Dodd, the Depositor Protection Act of 2009, S. 541. It would provide the FDIC with the needed funds to manage the cash-flows in handling bank failures, and more importantly, this added flexibility would allow the FDIC to significantly reduce the special assessment on the industry that has been proposed for June 30, 2009.

Let me be very clear. The banking industry fully supports a strong FDIC Fund. We know how important deposit insurance is to our customers, and banks have always paid the full cost of the FDIC since its inception in 1933 and we will honor the obligations to support it today. How this is done, however, is very important to every bank in all communities across the country.

The special assessment, as currently proposed, would pull $15 billion from banks in the second quarter of this year. This would be on top of the regular quarterly payments of about $4 billion. Even at half of that cost, and that is what the FDIC has suggested is likely if S. 541 were enacted, there would still be a substantial burden on banks at the very time we are making every effort to get credit into our local communities.

The money to pay such high assessments cannot come out of thin air. It is very important, therefore, to lower the up-front costs and to spread the obligation to FDIC over time. Happily, S. 541 helps to accomplish this.

For my bank, First United, the proposed special assessment would cost $2.5 million, to be paid all in the second quarter of 2009. This will reduce our bank's capital, which is necessary to support lending, by about $1.6 million. This very high and unexpected cost is in addition to the regular risk-based premium, which will total about $1.7 million in 2009. First United is not alone. All banks face similar challenges.

I do want to be very clear in saying that First United Bank and Trust will meet its obligations to the FDIC regardless of whether S. 541 is enacted. In doing this, however, we would encounter limits on our ability to lend in our communities, support local functions and charities, and to provide jobs. In fact, the special assessment is completely at odds with our bank's efforts to help our communities rebuild from this terrible economic downturn.

This assessment would also make it more expensive to raise new deposits, and fewer deposits means less lending. The subsequent reduction in earnings will make it harder to build capital when it is needed the very most.

In places where the economic conditions are even more severe, this added burden will make new lending practically impossible. Some banks have reported that they may have to consider reducing bank staff in order to pay this new additional assessment.

It is critical to consider alternatives that would reduce this burden. S. 541 does this by enhancing the FDIC's ability to draw on its line of credit. Importantly, the FDIC does not intend to use this line of credit at all unless the economy deteriorates even more dramatically than is anticipated. And if it does draw on the line, it is a borrowing that will be repaid by the banking industry with interest.

This obligation of our industry is often lost in the discussions about government support and is frequently confused with taxpayer losses. America's banks are prepared to do our part and pay for 100 percent of the cost of FDIC insurance. The only issue is one of timing. S. 541 will be very helpful in providing the industry with the time needed to fund the FDIC Insurance Fund while enabling the industry to meet its needs within the communities.

Therefore, the ABA fully supports S. 541 and urges quick action to enact it into law.

Mr. Chairman, I would be happy to answer any questions that you or the Subcommittee might have. Thank you.

Senator JOHNSON. Mr. West?

STATEMENT OF TERRY WEST, PRESIDENT AND CEO, VYSTAR CREDIT UNION, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION

Mr. WEST. Thank you, Chairman Johnson and Ranking Member Crapo. I appreciate the opportunity to be before you this afternoon and represent the Credit Union National Association. I am President and CEO of VyStar Credit Union, headquartered in Jacksonville, Florida. We were founded in 1952 with 12 people and $60 to serve members, provide them a place to borrow money and save money. I am proud that 57 years later, we still do that every day.

We today serve 350,000 members and they have $3.8 billion in assets in their credit union. We provide a full range of services to those members. Last year alone, we loaned out over $300 million in mortgage loans for them. And Senator Crapo, I heard your comments about lending. We think it is important. Today, we have over $200 million in our mortgage loan pipeline that we are hoping to close in the next couple of months. Most of that are members refinancing mortgages from other institutions at lower rates to our institution. We also pay up to $5,000 in closing costs for those members so that they will have a better opportunity to get into those loans.

We also serve about 9,000 businesses in the area. Many of them have their deposit accounts with us because we charge them less fees. They also have small business loans with us.

I also Chair CUNA's Task Force on Corporate Credit Unions that Mr. Marquis referenced earlier, and our charge on that task force has been to look at the corporate credit union structure and advise NCUA, and hopefully Congress, and hopefully the Treasury, on how to properly restructure them in the future.

A couple of things I would like to mention as we talk today, and as we said, this is a very important and timely meeting. The banks currently have some pending bills to increase the deposit coverage up to $250,000. They have pending bills to rebuild their FDIC Insurance Fund, which we very much agree. At present, they have

5 years to rebuild their fund, and as Mr. Marquis said, we have 1 year to rebuild our fund. According to what we have read, FDIC recently has extended that to 7 years and they are asking for 8 years. We would ask that the credit union movement have at least 8 years to rebuild our fund, as well. And Mr. Marquis had mentioned five. Five would help, eight would be better.

We also recognize that FDIC has asked for increased borrowing authority. We as credit unions are asking for assistance, as well. In general, we are operating well. I am proud to say we had net income last year, and we are in Florida, one of the toughest States in the Nation economically right now. We are asking that we also have $250,000 in insurance coverage. I talked with members, and it may be a surprise, we have 350,000. I talk with them daily and weekly. That is how I run our credit union.

They are constantly asking us, will this coverage be permanent, and they think it needs to be permanent and I think it needs to be permanent, because every day, they are wanting to feel more secure in this economic environment. They come in not worried about their credit union, but worried about the money they have been working hard to save. Anything we can do to give them a comfort during this environment, I think is important.

Mr. Marquis talked about the Central Liquidity Fund, or Central Lending Fund. We also believe that natural person credit unions and corporate credit unions should be able to borrow from that and use it as a source of capital, and Mr. Marquis talked about the structuring that would need to occur in how it is set up. We think that would provide considerable relief to the credit union movement.

We also support NCUA having the ability to increase their borrowing from $100 million to $6 billion during this, and we also support them having the same authority that FDIC has today in systemic risk issues. Today, NCUA does not have that authority. We also support them having the authority during systemic risk issues to borrow up to $30 billion.

Mr. Marquis touched on the corporate credit union issue, and as chairing that committee, I will give you a little more insight into that. U.S. Central is the largest corporate credit union in the nation. Earlier this year, late 2008, they had to experience an other than temporarily impaired write-down of $1.2 billion for investments that they purchased that were AAA-rated because of mark-to-market issues. The resulting issue in that is, as Mr. Marquis addressed, brought the Share Insurance Fund down to 0.49 percent to write down that amount of money to boost their capital with $1 billion and also to cover with a guarantee the uninsured deposits at corporate credit unions.

The impact to credit unions, on average, will be 81 basis points of the insured shares, 58 basis points in their net worth, and as Mr. Marquis said, we have lots of net worth. Ours at VyStar ended the year at about 9.23 percent. When we subtract 58 basis points from that—and I have 56 and 58 in spaces, we aren't exactly sure—it will bring it down to about 8.5 percent. We still have plenty of net worth, but as we all address, that is what we need during this environment.

What that will do, to put it more specifically, when this fee is assessed this year, about 75 percent of the credit unions in the Nation will be operating in the red. That is going to cause undue concern for our members, even though we can afford to take it out of our net worth.

So we are asking for any way that the Senate and NCUA could have the authority to spread this assessment out for a longer period of time. We actually believe that NCUA, under the Federal Credit Union Act, has some implied authorities to spread a portion of this assessment out over a longer than 1-year period of time, but it is not explicit, so we are asking for two things. Could we have explicit authority in the Federal Credit Union Act to spread it out over 5 years if the banks have that, or 8 years if the banks get that, and also to encourage NCUA to take any actions they can under the implied authority today to go ahead and take actions.

Senator Crapo, you talked about the sense of urgency. We think it is there.

Also, we would ask that the Central Liquidity Fund be expanded to corporate credit unions so that they could borrow and use it as capital.

And finally, we would ask—we would hope to never use it—there are no funds allocated for credit unions in the Troubled Asset Relief Program, and we would ask that at least some funds be set aside as a backstop measure if the economy continues to worsen. We would hope to never use them, but at least to know that the funds are there if we ever need them.

And finally, we would ask any pressure that the Senate could put on FASB to work on mark-to-market issues. That seems to be part of what we are all dealing with today. I know if I sell my house tomorrow, it is worth whatever it is purchased for. If I sell it in 5 years, it is worth what it is purchased for.

So I appreciate greatly the opportunity to talk with you. I will be happy to answer any questions you have.

Senator JOHNSON. Mr. Verdier?

STATEMENT OF STEPHEN J. VERDIER, SENIOR VICE PRESIDENT, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. VERDIER. Chairman Johnson, Ranking Member Crapo, I am Stephen Verdier, the Senior Vice President and Director of Congressional Relations for the Independent Community Bankers of America. I am pleased to represent ICBA and its 5,000 community bank members at this important hearing.

Federal Deposit Insurance has helped stabilize our nation's banking system for 75 years. It promotes public confidence by providing safe and secure depositories for both businesses and consumers. The deposit insurance system also protects the funding base for community banks.

Despite the challenges that they face, the community bank segment of the financial system is working and working well. ICBA members are open for business, making loans, and are ready to help all Americans weather these difficult times.

But I must also report that community bankers are angry. Almost every Monday morning, they wake up to news that the government has bailed out yet another "too big to fail" institution. On Saturdays, they hear that the FDIC has summarily closed one or two "too small to save" institutions. And now the FDIC has proposed a huge special premium to pay for losses imposed by large institutions. This assessment and the other inequities in the deposit insurance system will damage community banks and the customers and small businesses that our members serve.

ICBA believes it is urgent that Congress act quickly on several critical deposit insurance reforms. Congress should require the FDIC to impose a systemic risk premium against the "too big to fail" institutions to compensate the taxpayers and the FDIC for the risks they impose. The depositors of the "too big to fail" banks have unlimited deposit insurance coverage, giving those banks an unfair advantage.

Congress should also direct the FDIC to make the assessment base more equitable. Community banks pay approximately 30 percent of FDIC premiums, although they hold only about 20 percent of bank assets. They fund themselves 85 to 90 percent with domestic deposits, while banks with more than $10 billion in assets use domestic deposits for only 52 percent of their funding. So while community banks pay assessments on nearly their entire balance sheet, large banks pay on only half. It would be fairer if the FDIC were to use assets minus capital as its assessment base.

Congress should immediately increase the FDIC's borrowing authority, as provided in S. 541. According to FDIC Chairman Bair, the increased borrowing authority would allow the FDIC to reduce the special assessment to as much one-half the proposed rate. ICBA opposes the special assessment, and my written statement suggests viable alternatives. But unless Congress quickly increases its borrowing authority, the FDIC will likely vote to impose the full special assessment, perhaps within weeks. The special assessment will have real effects on our members' communities because community bank earnings will fall drastically.

A recent ICBA survey reveals the FDIC's estimate of this effect is much too low. Thirty-two percent of community banks tell us the special assessment will consume 16 to 25 percent of their 2009 earnings. Seventeen percent estimate it will consume 26 to 40 percent. This means that a small bank with $100 million in deposits will pay $200,000. This is unfair. Community banks did not participate in the risky practices engaged in by large Wall Street institutions that led to the economic crisis, yet they are being assessed to pay for them. Their employees, customers, and communities will all suffer.

ICBA remains committed to the principle of an industry-funded FDIC. Under S. 541 or the other proposals we suggest, the FDIC will still be industry-funded, but we could spread the cost over time. The proposal to make permanent the increase in deposit insurance coverage from $100,000 to $200,000 [sic] is also urgent. The clock is already ticking on the CD market. Without Congressional action, coverage on a long-term CD will revert to $100,000 as of December 31.

ICBA also urges Congress to make permanent the unlimited coverage for transaction accounts, which is now temporarily provided by the FDIC. Both this program and the increase to $250,000 have not only bolstered depositor confidence, but have also helped community banks compete for deposits against the “too big to fail” banks and the money market mutual funds. The additional coverage has helped community banks be part of the solution to the credit crisis.

In conclusion, the ICBA urges Congress to act quickly to shore up the FDIC and address the inequities in the deposit insurance system. The “too big to fail” banks should finally pay their fair share and community bank depositors should continue to have the coverage they are depending on in this troubled time.

Thank you, Mr. Chairman.

Senator JOHNSON. Mr. Wright?

STATEMENT OF DAVID J. WRIGHT, CEO, SERVICES CENTER FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. WRIGHT. Good afternoon, Chairman Johnson, Ranking Member Crapo, and members of the Subcommittee. My name is Dave Wright and I am testifying today on behalf of the National Association of Federal Credit Unions, NAFCU.

For the last 33 years, I have been the CEO of Services Center Federal Credit Union, headquartered in Yankton, South Dakota. Services Center is a low-income-designated credit union operating in six counties, four counties in South Dakota and two in Nebraska. Services Center has some 6,200 members and assets of $37.5 million.

I am pleased to share with the Subcommittee NAFCU's assessment of how the National Credit Union Share Insurance Fund, the fund, is structured and our thoughts on current issues in deposit insurance. NAFCU believes it is imperative that there be parity in the coverage levels between the FDIC and the Share Insurance Fund. We believe that an aspect of this parity has to include the ability of NCUA to have the authority it needs to take actions to maintain the stability of the fund. As part of the Emergency Economic Stabilization Act, Congress increased the coverage on FDIC and NCUSIF insured accounts to $250,000 through December 31 of 2009. NAFCU urges the Senate to enact legislation to permanently extend this increase.

While credit unions have fared better than most financial institutions in these turbulent economic times, many have been impacted through no fault of their own by the current economic environment. In particular, the corporate credit union system has felt the biggest impact.

On January 28, the NCUA Board announced a corporate credit union stabilization plan that would have the fund provide a guarantee to uninsured shares at corporate credit unions. The resulting impact on the fund will be approximately $4.7 billion, dropping the fund's equity ratio from the current 1.28 percent to an estimated 0.49 percent. Because credit unions follow GAAP, there was an immediate impairment to the 1 percent deposit. Federally insured credit unions had to recognize this impairment by setting aside enough money in a contingent liability account to bring the deposit at the fund back to a 1-percent level.

The Federal Credit Union Act requires NCUA to assess a premium when the fund's equity ratio drops below 1.2 percent. That premium assessment must occur before the end of 2009, and NCUA intends to bring the fund's equity ratio up to 1.3 percent by assessing a premium of 0.3 percent later this year. The consequence is that over 5,350 federally insured credit unions will be in the red in 2009, and a number of them could face potential additional prompt corrective action concerns.

NAFCU urges the Senate to enact a change to the Federal Credit Union Act to establish a restoration plan period for the fund. H.R. 1106 included such an amendment that would extend the repayment period over 5 years. NAFCU also urges the Senate to provide the fund an increase in borrowing authority from the Treasury Department. This change is long overdue, since the current level of $100 million was established in 1971 and has not been modified for the growth of credit unions and their members' savings over time. H.R. 1106 would increase the borrowing authority to $6 billion and we support NCUA's request for emergency authority up to $30 billion.

NAFCU believes that NCUA and Congress should work to find additional ways to help stabilize the corporate credit union system outside of using the fund. In particular, NAFCU supports an amendment to the Federal Credit Union Act which would allow NCUA to use funds from the Central Liquidity Facility directly to help the liquidity and capital needs of all credit unions, including corporate credit unions. This change, if coupled with some form of flexibility on OTTI accounting, would go a long way toward helping credit unions. We would welcome the opportunity to work with the committee to address this issue.

In conclusion, NAFCU continues to support an independent fund. Furthermore, we believe Congress must make the temporary increase in deposit insurance coverage permanent. Actions by the NCUA to help stabilize the corporate credit union system using the fund threaten to put a strain on natural person credit unions. We believe legislative relief in the form of extending the repayment time, increasing the borrowing authority of the fund, and modification of the Federal Credit Union Act as it relates to the CLF are all steps that will help the continued stability of the fund.

Thank you for the opportunity to appear before the Subcommittee today. I welcome any questions you may have.

Senator JOHNSON. Thank you.

Mr. Wright, in your testimony, you propose allowing corporate credit unions access to the Central Lending Facility and making the Central Lending Facility available for capital as well as liquidity. How does this benefit the natural person credit unions you represent? Are there risks associated with giving corporate credit unions this authority?

Mr. WRIGHT. I believe that the corporate credit unions need the access to the fund to be able to borrow for capital purposes. Their capital has been severely affected by the economic turbulence that we are currently experiencing, and without the ability to borrow, we have had to kind of patch together, if you will, a system whereby NCUA loaned money to natural person credit unions, my credit union included. Then we turned around and we invested this in the corporate credit unions. Again, I think that there is a better way to do this and I think the better way is to be able to have the funds go directly from the CLF to the corporate credit unions.

Senator JOHNSON. Mr. West, in your testimony, you asked for the systemic risk authority on a similar basis as that provided to FDIC. Can you expand on why you believe the credit union regulator needs this authority?

Mr. WEST. As we shared earlier, the credit union environment in general is OK right now. What we are concerned about is if the economy continues to worsen, and we certainly see one or two credit unions here or there that may propose systemic risk to the credit union industry and we feel like our regulators should have whatever authority it needs to take care of those situations, which would be on a limited basis. And the concern we have is they just do not have that authority at present.

Senator JOHNSON. Mr. Grant and Mr. Verdier, both of you indicated that you opposed the special assessment announced by the FDIC on February 27. As a member from a State with many community banks, what impact will it have on institutions you represent? Do you have alternative proposals to increase the DIF while not negatively affecting your institutions? And do you think the FDIC coverage should be applied differently to banks that engage in more risky activities? Should the size of the institution determine the cost and type of insurance coverage?

Mr. Grant?

Mr. GRANT. Again, Mr. Chairman, we firmly support a bank industry-funded FDIC program. There are already steps under the most recent legislation that vary the premiums based upon the risk that the institution undertakes. We believe those to be adequate.

And again, with the special assessment, we certainly recognize the need to restore the fund to its appropriate levels. Our concern is, again, as we mentioned in the testimony, with the timing, bringing all that special assessment into 1 year. We would much prefer, Mr. Chairman, to see that spread out over a longer period of time, and S. 541 allows the flexibility to the FDIC to make that a reality.

Senator JOHNSON. Do you think the FDIC coverage is adequate to apply to banks that engage in more risky activities? Is that adequate?

Mr. GRANT. I believe, Mr. Chairman, that the risk-rated premium system that they have put together is adequate.

Senator JOHNSON. Mr. Verdier?

Mr. VERDIER. No, we don't think that the premium system as it exists now is adequate to adjust for risk, and so we are advocating a broader assessment base to cover the larger banks, as I indicated in our testimony, and that furthermore, we have recommended and earlier this week recommended that any bank that is affiliated with a "too big to fail" financial services company should also pay a special systemic risk fee into the Deposit Insurance Fund. So those two additions, we think, would go a long way to leveling that disparity that we already see.

And you asked earlier about the potential effects on a community bank and its community and customers of the special assessment. I gave the one example of the $200,000 that would not—that would be going out of a community bank. I think you just have to look at it as a small business owner and say, well, if a small business, in effect, has a tax increase of $200,000, what does that mean? Well, maybe they don't hire people. Maybe they don't open up another branch if the bank is large enough to be thinking of another branch. Maybe they don't make as many loans as they were going to make. Maybe the tellers don't get the same kind of pay increase that they were hoping for. And maybe local investors don't receive dividends, and that means that money is again taken out of the local community.

And so the effects would differ from bank to bank, but I think they would be substantial when you take it throughout the country, the $15 billion that would be taken out. It is, in effect, a tax increase on small towns and communities in your State and around the country.

Senator JOHNSON. Mr. Crapo?

Senator CRAPO. Thank you very much, Mr. Chairman.

My first question, I am just going to ask generally to the panel and I really don't need anything more than an expression of assent or disagreement. I have already heard from most of you in your testimony and I think I know where you are headed on this, but in the last panel, I focused on the question of whether we face a sense of urgency here in terms of the legislation that has been proposed, both the House and the Senate legislation, to deal with increasing the borrowing authority for banks and credit unions and for the funds.

Do you all agree that we face an urgency there in the context of needing to get as much credit availability to the private sector as possible?

Mr. WEST. Yes.

Mr. VERDIER. Absolutely.

Mr. GRANT. Yes.

Mr. Wright.

[Nodding yes.]

Senator CRAPO. Let the record reflect that everyone did indicate that they agreed with that.

The reason I am pushing this point is here in the Senate, we are facing a battle, I will call it, over whether we should move this legislation on its own and move it quickly, or whether we should add to it some other more controversial provisions, and I think you know the most controversial of those provisions that we are debating here in the Senate is what has become the cram down legislation for bankruptcy and which the House legislation contains.

As I indicated in my opening statement, I strongly oppose putting the cram down legislation with this legislation and with S. 541. I am just interested in, again, if you can, brief responses, as to whether you would support the cram down legislation, and if not, would you agree that we should not make this issue, the issue of increasing the loan limits for the banks and the credit unions, the battleground where we fight that issue out.

Mr. Grant?

Mr. GRANT. I would agree with your assessment, Senator Crapo. There are two very important issues, and you have identified them very clearly. One is allowing the flexibility to the FDIC that S. 541

provides in order to deal with the issue of making sure that the fund is whole.

The mortgage cram-down, as it has become called, is an entirely different issue. We remain opposed to it because it is going to limit credit. It is going to increase the cost of credit. And we believe that that is an issue that should be debated separately from the very important matters covered under S. 541.

Senator CRAPO. Thank you.

Mr. West?

Mr. WEST. We, as far as CUNA is represented, we would be better off if we didn't have to include the cram down part of this in there. There is a tremendous sense of urgency on the other side of it. I think Mr. Grant has made some very positive comments in this area and I agree with him.

Senator CRAPO. Thank you very much.

Mr. Verdier?

Mr. VERDIER. Yes, Senator. We oppose the cram down provisions and we do share your sense of urgency on the deposit insurance provisions, all the ones I have mentioned. So we would very much like the Senate and the entire Congress to move very quickly on the deposit insurance provisions, and as I say, we oppose the cram down provisions for the reasons we have been discussing. So I leave it to the Senators to decide exactly how to achieve the result that we are hoping for.

Senator CRAPO. Thank you.

Mr. Wright?

Mr. WRIGHT. I will make it unanimous. We do not support having the cram down integrated with the things that you have before you today. We do not support cram down and we think that it should be kept separate. Don't muddy the waters. Keep it separate.

Senator CRAPO. All right. Thank you very much.

And back to you, Mr. Verdier. You had indicated the anger that you were feeling from your members. I noted you mentioned the "too big to fail" issue and then you also noted the "too small to save" issue that seems to be bubbling up out there in the communities. You made the point that we need a more equitable distribution of the burden of the assessments and a broader assessment base.

Could you tell me, is that something that would require legislative action or could that be done administratively, do you know?

Mr. VERDIER. The FDIC, for its general assessment authority, does have the flexibility to broaden the assessment base except in the one instance of the systemic risk authority. They do need some additional flexibility, as Art Murton indicated in the earlier panel. They are covering some bank holding company debt that is exempt from assessments, and so that needs to be fixed. H.R. 1106 does make that change. But, of course, any directive from the Congress to the FDIC in terms of using its existing authority or firming up their resolve in that regard would be most helpful.

Senator CRAPO. Thank you very much.

And I do note, Mr. West, I agree with your comments about the mark-to-market issue and we are encouraging our regulators to act with all due speed in terms of helping us put that part of the solution in place.

The last question I have, I am running out of time here, but you probably all noticed that when we debated the Omnibus Appropriations Act of 2009, the big omnibus bill just recently, there was language in there that gave the Federal Trade Commission authority to expedite rulemaking over mortgage loans, and many of us were very concerned that that extended the regulatory authority of yet another agency, the FTC, into the arenas of banking and financial institutions that were federally insured unnecessarily and improperly.

We had a colloquy on the floor at that time among Senator Dodd, Senator Dorgan, Senator Inouye, and myself in which we agreed that that was not intended by the language and that we would reg—or statutorily correct that as quickly as possible and explained to the FTC that they should not try to assert new jurisdictional regulatory authority over federally insured depository institutions.

The question I have to you is, and maybe rather than having all four of you answer this, if there is one of you who would like to volunteer and jump out first, I really only have time to probably take one answer here, but could one of you take just a moment to explain the consequences of adding yet another Federal regulator into the system here?

I see two hands on a tie, so we will take Mr. Verdier and then Mr. Grant.

Mr. VERDIER. Thank you. Our community bankers report that they have plenty of regulators, thank you very much. On a serious note, the Truth in Lending Act is very carefully enforced by the banking regulators and the Federal Trade Commission probably has plenty to do without adding more to do on that issue.

The colloquy was excellent. We congratulate you on that. I am sure that the FTC has been reading that and we encourage them to maybe read it every morning.

Senator CRAPO. We will be sure they do.

Mr. Grant?

Mr. GRANT. And I can just really echo those remarks again. Thank you very much for your leadership in bringing together that issue. I can certainly say that there is more than enough regulation right now. We recently had the FDIC in our bank, and we are a very good bank, but they were still there for 7 weeks in the examination process. And the concern would be with another regulator, not only the additional regulatory burden, but also the whole issue of possible confusion, as I understand this, might also bring in the attorney generals of various States and things like that. There could be a lot of confusion in addition to the regulatory burden.

Senator CRAPO. Well, thank you all very much.

Mr. Chairman, I went over badly. I apologize.

Senator JOHNSON. Senator Vitter?

Senator VITTER. Thank you, Mr. Chairman, and thanks to all of the witnesses.

First, Mr. Chairman, I would just like to publicly underscore a request I made of our committee Chairman today to have a hearing as quickly as possible, hopefully next week, about the AIG bonus issue and related issues. I think this is absolutely necessary for two reasons. First of all, because of the understandable outrage Americans are expressing over this and the issue itself. Second, because the House has already passed retroactive legislation to address this. And I take a novel view that I actually think we should know the facts, what bonuses were exempted, what weren't, what the universe is, who participated in that decision, when the administration understood this, particularly before we act on legislation. So I want to re-urge that request to Chairman Dodd publicly.

I am also preparing an amendment to that House legislation that would say we are stopping the TARP program, and administration, you can come back to us with that program or another program once you get your act together and understand how we are going to avoid these horrible problems in the future, and this is just but one example. But as of now, we are stopping the TARP program.

On this issue, thank you again for your testimony. I have a big general concern that as we work to shore up the insurance fund, and everybody agrees that we need to make sure it is sound, that we are going to be really penalizing and hurting sound, stable community banks and other banks that had absolutely nothing to do with the mess with subprime mortgages, with exotic mortgage-backed securities, or anything else. And so my big concern goes to that.

Specifically, as we all work together to shore up the fund for the insurance program, and we have no disagreement about that, shouldn't we change how assessments are made so that it more appropriately reflects the enormous risk the bigger banks have brought to the system, which in my opinion is not adequately reflected now in the rating of risk in terms of how that goes into FDIC insurance assessments. I would love anybody's opinion about that.

Mr. VERDIER. Senator, I totally agree with you. The point we would like to make is that there should be a broadening of the assessment base so that the banks that fund themselves with unassessed liabilities will begin to pay assessments on those, and also that any bank that is affiliated with a systemic risk institution should pay an additional systemic risk fee, and in testimony that will come before this committee next week, we will also talk about a possible Systemic Risk Fund that would be funded by those institutions so that those kinds of costs that are now being paid by the TARP program could be somewhat, at least, pre-funded by the systemic risk segment of the financial services industry.

So I think there is—it is interesting that the FDIC is the only pre-funded part of this whole effort. Everything else has been funded by the taxpayers. And so I think we really need to take a close look and say, who is imposing the costs and who is paying the bills?

Senator VITTER. All right. Does anyone else have opinions about that or input?

OK. Well, I hope we take a hard look at that, because I think it is necessary. Basically, the institutions that created the problem are, of course, getting enormous bailout relief, and meanwhile, the smaller institutions that had nothing to do with the problem are getting an enormous bill because of the problem that the bigger institutions created. And in some cases, it is threatening their profitability and their ability to continue to be out in the real world making loans, and that is just crazy.

So I think, moving forward, we need to look at changing the way FDIC insurance premiums are calculated, because there are huge differences between a community bank whose whole universe is deposits and a Citigroup or other institutions which have big investment banking arms that are funded in fundamentally different ways, and as a result bring enormous risk to their deposits and to all deposits that community banks don't. And so I would hope the whole committee can look at that issue.

I support Senator Crapo's proposal with others in terms of expanding lending authority. I just don't think that should be the end of the conversation.

Thank you, Mr. Chairman.

Senator JOHNSON. I would like to thank our second panel of witnesses for taking the time to testify today on this important issue.

You are excused, and with that, this hearing is adjourned.

[Whereupon, at 3:31 p.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF SENATOR TIM JOHNSON

MARCH 19, 2009

As we all know, the economic landscape has undergone significant change since the Committee last looked at deposit insurance issues. In these times of economic instability, it is increasingly important that we have a strong and stable deposit insurance fund and that our regulators have the tools they need to wind down failed institutions while at the same time guaranteeing that Americans' savings and retirement remain safe. I am pleased to hold this hearing today to take a closer look at deposit insurance issues that the FDIC, National Credit Union Administration, and our nation's banks and credit unions currently face. I would also like to welcome our panel of witnesses, and thank them for their time and for their thoughtful testimony.

As our nation's housing crisis has spread through the economy—impacting banks, credit unions, secondary markets and millions of Americans, neither the FDIC's deposit insurance fund nor NCUA's share insurance fund have failed to make good on its promise to pay for the insured deposits when a institution fails. This protection is the bedrock of our financial system, but it has not come for free—the FDIC's Deposit Insurance Fund ratio has fallen to .4 percent, substantially lower than the 1.15 percent required ratio, and the NCUA's share insurance fund has struggled as corporate credit unions face losses on securities tied to home mortgages. These extraordinary times have warranted emergency and temporary actions to ensure continued stability and protection.

There are currently two pieces of legislation pending before the Banking Committee that seek to address continued deposit insurance concerns. Senator Dodd has introduced the Depositor Protection Act, legislation to permanently increase the FDIC's borrowing authority to $100 billion, and temporarily increase the emergency borrowing authority to $500 billion until the end of 2010. In addition, the House of Representatives has passed H.R. 1106, the Helping Families Save Their Homes Act of 2009. This bill has been referred to the Senate Banking Committee, and I look forward to hearing more from today's witnesses about the potential benefits and disadvantages of each of these pieces of legislation.

While we work to maintain stable insurance funds for our nation's financial institutions, there is no doubt in my mind that further action will be needed. I am sensitive to concerns that without increased borrowing authority, assessments could force financial institutions to raise consumer fees and curtail lending. This is the last thing we want as consumers across our nation struggle and frozen credit markets limit lending to consumers. I am also concerned that too high assessments could disproportionately affect small banks. I also believe that any money borrowed from the Treasury must be repaid, with interest, and that all actions must be temporary with an eye to the long term restoration of the insurance funds. In addition, this Committee must consider what is the appropriate level of deposit insurance coverage and whether the emergency increases should be extended or even made permanent.

All that said, deposit insurance is a benefit to depository institutions, and institutions should not look to taxpayers to pay for deposit insurance. When the financial system recovers, Congress must do all it can to make sure that banks and credit unions do not resist efforts to build back up the deposit insurance fund (DIF) and the share insurance fund.

I will now turn to Senator Crapo, the new ranking member of this Subcommittee, for his opening statement. Senator Crapo, I have valued our ability to work together on a number of issues in the past, and I look forward to working with you on this Subcommittee.

PREPARED STATEMENT OF ARTHUR J. MURTON

DIRECTOR, DIVISION OF INSURANCE AND RESEARCH,
FEDERAL DEPOSIT INSURANCE CORPORATION

MARCH 19, 2009

Chairman Johnson, Ranking Member Crapo and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on current issues in deposit insurance.

Since the creation of the FDIC during the Great Depression, deposit insurance has played a crucial role in maintaining the stability of the banking system. By protecting deposits, the FDIC ensures the security of the most important source of funding available to insured depository institutions—funds that can be lent to businesses and consumers to support and promote economic activity.

Under the current severe economic conditions, the FDIC's deposit insurance guarantee has proven to be more valuable than ever. While many sources of bank funding have disappeared during the past 6 months, deposits have not. They remain a stable source of funding because depositors know that insured deposits are absolutely safe. No one has ever lost a penny on an insured deposit.

My testimony will discuss the current condition of the Deposit Insurance Fund (DIF) and the reasons for the recent decision by the FDIC Board of Directors (Board) to increase deposit insurance premiums and impose a special assessment on insured institutions. In addition, I will discuss the need for an increase in the FDIC's borrowing authority with the Treasury Department, which has not been permanently increased in almost 20 years. I will also comment on legislative proposals to make permanent the temporary increase in the deposit insurance coverage, to extend the time period for restoring the DIF to the statutorily mandated range for the reserve ratio and to improve the systemic risk provisions of the Federal Deposit Insurance Act. Finally, I will discuss whether we should reexamine the mandatory rebate provisions that were enacted as part of the Deposit Insurance Reform Act in 2006.

Condition of the Deposit Insurance Fund

During 2008, 25 FDIC-insured institutions with assets of $372 billion failed, the largest number of failures since 1993 when 41 institutions with combined assets of $3.8 billion failed (excluding thrifts resolved by the RTC). So far this year, 17 FDIC-insured institutions with combined assets of $7.7 billion have failed. In addition, two banking organizations have received assistance under a systemic risk determination over the past 6 months. As part of its restoration plan and recent final rulemaking on assessments, the FDIC is estimating a range of possible failure cost estimates over the 2009–2013 period, with $65 billion considered the most likely outcome.

In 2008, the DIF balance fell by more than $33.5 billion (64 percent), primarily because of over $40 billion in loss provisions.[1] The industry funded Deposit Insurance Fund (DIF) decreased by almost $16 billion during the fourth quarter to $19 billion. This fund balance is net of loss reserves totaling $22 billion set aside for failures anticipated in 2009, which are subject to adjustments based on changing economic and financial conditions.

The DIF's reserve ratio equaled 0.40 percent on December 31, 2008, which was 36 basis points lower than the previous quarter. During 2008, the reserve ratio decreased by 82 basis points, from 1.22 percent at year-end 2007. The December figure is the lowest reserve ratio for a combined bank and thrift insurance fund since June 30, 1993, when the reserve ratio was 0.28 percent.

Recently, the FDIC's Board of Directors made a series of very difficult decisions to ensure that our nation's deposit insurance system maintains the integrity of its industry funded assessment base. First, they extended the period in which the DIF reserve ratio must return to 1.15 percent from five to 7 years, due to the extraordinary circumstances facing the banking industry. Second, they set an assessment rate schedule under which most insured institutions would pay between 12 and 16 basis points before certain adjustments, effective the second quarter of 2009. These rates are in line with the rates we had signaled would be necessary last October to bring the reserve ratio back up to the statutorily mandated minimum of 1.15 percent over the restoration plan horizon. Finally, and most importantly, the Board adopted an interim rule setting a special assessment of 20 basis points for June 30, to be collected September 30. We welcome comments on the interim rule that will be considered in any final rulemaking.

The FDIC realizes that these assessments are a significant expense, particularly during a financial crisis and recession when bank earnings are under pressure. Banks face tremendous challenges right now even without having to pay higher assessments. We also recognize that assessments reduce the funds that banks can lend in their communities to help revitalize the economy. However, the reality is that these increases in assessments are necessary to ensure the adequacy of the FDIC's industry funded resources to resolve projected bank failures. The FDIC's guarantee has always been funded by the industry. All banks benefit from the FDIC's industry funded status and deposit insurance has been one key component of addressing our current financial crisis that has not relied on taxpayer funding.

Some have suggested that the assessment burden should fall more squarely on weaker, higher risk banks. In point of fact, the new risk-based rules the FDIC final-

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[1] The figure includes $18 billion in losses not previously reserved for failures in 2008 and $22 billion in estimated losses for anticipated failures in 2009.

ized on February 27, 2009 assure that the regular assessment system will charge higher risk banks significantly more. But there is only so much burden that we can place on weaker banks without forcing them into insolvency, a self-defeating exercise which would end up costing the insurance fund even more. This is why a flat-rate special assessment was deemed the wiser course. Moreover, any system of insurance requires to some degree that premiums paid by well-managed and healthier institutions cover the losses caused by their weaker counterparts.

It also has been suggested that the assessment should target larger banks. The Board is seeking public comment on whether the base for the special assessment should be total assets or some other measure that would impose a greater share of the aggregate special assessment on larger institutions than the regular assessment base (domestic deposits). We are also seeking comment on whether the special assessments should take into account the assistance provided to systemically important institutions.

Borrowing Authority

The FDIC strongly supports S. 541, the Depositor Protection Act of 2009, legislation to increase the FDIC's borrowing authority with the Treasury Department if losses from failed financial institutions exceed the industry funded resources of the DIF.

The FDIC's borrowing authority was statutorily set in 1991 at $30 billion and has not been raised since that date. Assets in the banking industry have tripled since 1991, from $4.5 trillion to almost $14 trillion, and the FDIC believes it is prudent to adjust the statutory line of credit proportionately to leave no doubt that the FDIC can immediately access the necessary resources to resolve failing banks and provide timely protection to insured depositors. Deposits insured by the FDIC are backed by the full faith and credit of the United States and the FDIC's borrowing authority ensures that this obligation to protect depositors is met seamlessly and without interruption.

S. 541 would permanently increase the FDIC's authority to borrow from Treasury from $30 billion to $100 billion. In addition, the bill also would authorize a temporary increase in that borrowing authority above $100 billion (but not to exceed $500 billion) to address exigent circumstances, based on a process that would require the concurrence of the FDIC, the Federal Reserve Board and the Treasury Department, in consultation with the President. Any use of the borrowing authority is required by statute to be repaid by assessments on insured institutions. This temporary emergency authority is being requested as part of contingency planning. From a public confidence standpoint, we believe it is important to demonstrate the FDIC's ability to immediately access significant liquidity in even high stress scenarios. We want to make sure the funding mechanics are in place to meet all contingencies.

The FDIC Board's decision regarding the size of the recently announced special assessment reflected the FDIC's responsibility to maintain adequate resources to cover unforeseen losses. Chairman Bair has stated that increased borrowing authority would give the FDIC flexibility to reduce the size of the recent special assessment, while still maintaining assessments at a level that supports the DIF with industry funding based on current loss projections. While the industry would still pay assessments to the DIF to cover projected losses and rebuild the Fund over time, a lower special assessment would mitigate the impact on banks at a time when their communities need them more than ever and they are called upon to revitalize the economy.

The events of the past year have demonstrated the importance of contingency planning to cover unexpected developments in the financial services industry. Indeed, in temporarily increasing deposit insurance coverage from $100,000 to $250,000, Congress also temporarily lifted all limits on the FDIC's borrowing as necessary to carry out the increase in the maximum deposit insurance amount. The Depositor Protection Act would leave no doubt that the FDIC will continue to have the resources necessary to address future contingencies and seamlessly fulfill the government's commitment to protect insured depositors against loss. The FDIC strongly supports this legislation and looks forward to working with the sponsors to enact it into law.

Improving the Systemic Risk Special Assessment

Section 13(c)(4)(G) to the Federal Deposit Insurance Act (FDI Act) authorizes action by the Federal Government in circumstances involving systemic risk to the banking industry. It permits the FDIC to take action or provide assistance as necessary to avoid or mitigate the effects of the perceived risks, following a recommendation of the existence of systemic risk by the FDIC's Board, with the written concurrence of the Board of Governors of the Federal Reserve System (FRB) and an eventual determination of systemic risk by the Secretary of the Treasury (after consultation with the President).

The FDI Act also requires the FDIC to recover any loss to the DIF arising from any action taken or assistance provided pursuant to a systemic risk determination. Under current law, the FDIC must recover any loss expeditiously from one or more emergency special assessments on the insured depository institutions based on the amount of each insured depository institution's average total assets minus the sum of the institution's average total tangible equity and its average total subordinated debt.

The Federal Government exercised the systemic risk authority for the first time in September 2008, and on three more occasions since then. In each of these cases, the FDIC took sound actions, such as charging fees, to offset its new risk exposure and minimize the likelihood that there will be a loss requiring a systemic risk special assessment. However, the FDIC's recent experience suggests that the current statutory provisions regarding a systemic risk special assessment may not provide sufficient flexibility to appropriately allocate any special assessment among the parties who benefit from government action to address challenges that pose a risk to the financial system.

For example, the recent actions taken under the systemic risk authority have directly and indirectly benefited holding companies and non-bank affiliates of depository institutions, including shareholders and subordinated creditors of these organizations. Among the beneficiaries are large holding companies owning depository institutions that make up only a very small part of the consolidated organization. Such actions were necessary to stabilize financial markets and provide increased liquidity in the financial system. Yet, while holding companies and their non-bank affiliates, shareholders, and subordinated creditors stand to benefit from the government's actions, they would bear a cost under the current systemic risk assessment that is disproportionately small compared to the benefits. Instead, the assessment would disproportionately burden many traditional banking companies, particularly those with few or no non-bank affiliations.

The statutory language in H.R. 1106 would allow the FDIC to impose systemic risk special assessments, by rulemaking subject to the notice-and-comment procedures of the Administrative Procedure Act, on insured depository institutions or depository institution holding companies, or both. When exercising the authority to assess holding companies, the FDIC would consult with the Secretary of the Treasury and the Board of Governors of the Federal Reserve System. This authority would not be used to pre-fund assessments to pay for losses that the FDIC contemplates may be incurred as a result of invoking the systemic risk authority; rather, it would be used to recover losses actually incurred.

This approach would be more consistent with the statutory provisions governing the FDIC's other assessment authority, which set broad direction for the FDIC to implement through notice-and-comment rulemaking, and with the provisions governing systemic risk determinations. In prescribing systemic risk special assessment regulations, the FDIC would be required to consider certain factors, including economic conditions; the effects on the industry; and such other factors as the Corporation deems appropriate. In addition, the proposed amendment would enable the FDIC to establish the appropriate timing for recovering any loss in its assessment rulemaking in a manner that is not pro-cyclical and does not exacerbate problems in the financial industry. Depository institution holding companies also would be subject to the statutory requirements to pay assessments and penalties for late payment or nonpayment.

In addition to the provisions in H.R. 1106 to broaden the base for a systemic risk special assessment, the FDIC would recommend a statutory change to provide a priority for the government over general creditors in cases where the bank defaults on debt that has been guaranteed by the FDIC and is placed in receivership. In October 2008, the FDIC Board of Directors approved the Temporary Liquidity Guaranty Program (TLGP) to free up funding for banks. Indications to date suggest the program has improved access to funding and lowered banks' borrowing costs.

The purpose of this statutory change would be to put the FDIC and senior unsecured debt holders that are guaranteed by the TLGP immediately after depositors to recover from the assets of the estate of a failed insured depository institution. Debt guaranteed by the FDIC serves an important public policy purpose and should receive a priority in a bank receivership over general creditors. Without this amendment, the debt holders of insured depository institutions and the FDIC as subrogee of their rights will share pro rata with general creditors of the estate. This provision will increase the likely recovery to the FDIC for the costs of any guarantee of insured institution debt that it might be required to honor and could reduce the need for or amount of a systemic risk special assessment.

Permanently increasing coverage to $250,000

With regard to proposals to make permanent the current temporary increase in deposit insurance coverage to $250,000, the FDIC believes that the level of deposit insurance coverage is a policy determination that appropriately should be made by Congress. However, because any increase in the level of deposit insurance coverage increases exposure to the DIF, such a change must also permit the FDIC to account for the newly insured deposits when setting premiums necessary to maintain the DIF.

Permanently increasing the level of insurance coverage also will have the effect of immediately reducing the reserve ratio of the DIF. Since the DIF reserve ratio is currently below the statutorily mandated range for the reserve ratio, the FDIC is operating under a restoration plan to return the reserve ratio of the DIF to at least 1.15 percent of estimated insured deposits. The FDIC Board recently extended the length of that plan from five to 7 years due to the extraordinary circumstances facing the banking industry and instituted a combination of premium increases and special assessments necessary to implement the restoration plan. Because of the immediate dilutive effect on the DIF of permanently increasing coverage to $250,000, extending the statutory 5-year time period for restoring the DIF reserve ratio to at least the bottom end of the statutorily mandated range would be appropriate.

Mandatory Rebates

One of the most important goals of the reforms included in the Federal Deposit Insurance Reform Act was to make the deposit insurance assessment system less pro-cyclical. To achieve this result, in 2006, the FDIC was provided with greater flexibility to assess institutions based on risk and to buildup the DIF in good times. However, the legislation included restrictions on the growth of the DIF that may still contribute to higher assessments against financial institutions during times of economic stress.

Under current law, the FDIC is required to rebate half the assessment revenue it collects when the DIF reserve ratio is above 1.35 percent. In addition, the FDIC is required to rebate all amounts in the DIF that keep the reserve ratio above 1.5 percent. The result of these mandatory rebates is to limit the ability of the DIF to grow in good times and to effectively cap the size of the DIF.

These restrictions on the size of the DIF will limit the ability of the FDIC to rebuild the Fund in the future to levels that can offset the pro-cyclical impact of assessment increases during times of economic stress. Limits on the size of the DIF of this nature will inevitably mean that the FDIC will have to charge higher premiums against the industry when conditions in the economy are causing significant numbers of bank failures. As part of the consideration of broader regulatory restructuring, Congress may want to consider the impact of the mandatory rebate requirement or the possibility of providing for greater flexibility to permit the DIF to grow to levels in good times that will establish a sufficient cushion against losses in the event of an economic downturn.

Conclusion

The events of recent months have clearly demonstrated the benefits of deposit insurance to depositors and banks. During this difficult period, insured deposits have been fully protected in every bank failure. Assured by this guarantee, consumers have continued to maintain deposits in insured financial institutions that have provided vital liquidity for communities across the country. With additional modifications to the deposit insurance system, such as the increase in the FDIC's borrowing authority, we can maintain a system that continues the FDIC's mission of providing stability to the financial system.

PREPARED STATEMENT OF DAVID M. MARQUIS

EXECUTIVE DIRECTOR, NATIONAL CREDIT UNION ADMINISTRATION

MARCH 19, 2009

I. INTRODUCTION

The National Credit Union Administration (NCUA) appreciates this opportunity to provide the agency's position on "Current Issues in Deposit Insurance." Federally insured credit unions comprise a small but important part of the financial institution community, and the NCUA's perspective on this matter will add to the overall understanding of the needs of the credit union industry and the members they serve.[1] Financial institutions play a critical role in the economy, and it is vital they remain safe and sound. The protection and security provided by Federal deposit insurance to depositors is a key foundation of the confidence in and stability of America's financial institutions. Therefore, it is important and timely to consider methods to improve the framework for deposit insurance coverage and the operational authorities available to the Federal deposit insurers.

The NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. It performs this important public function by examining all Federal credit unions, participating in the examination and supervision of federally insured State-chartered credit unions in coordination with State regulators, and insuring federally insured credit union members' accounts. In its statutory role as the administrator of the National Credit Union Share Insurance Fund (NCUSIF), the NCUA insures and supervises 7,806 federally insured credit unions, representing 98 percent of all credit unions and approximately 88 million members.[2]

Overall, federally insured, natural person credit unions maintained satisfactory financial performance in 2008. As of December 31, 2008, federally insured credit unions maintained a strong level of capital with an aggregate net worth ratio of 10.92 percent.[3] While earnings decreased from prior levels due to the economic downturn, federally insured credit unions were able to post a 0.30 percent return on average assets in 2008.[4] Delinquency was reported at 1.37 percent, while the net charge-off ratio was 0.84 percent.[5] Shares in federally insured credit unions grew 7.71 percent with membership growing 2.01 percent, and loans growing 7.08 percent.[6]

The NCUA's comments will focus in particular on the following areas:

- Provisions of H.R. 1106 to permanently increase deposit insurance coverage to $250,000, increasing the NCUA's borrowing authority to $6 billion, and extending the share insurance fund's restoration period to 5 years. The NCUA supports these proposals.
- Emergency borrowing authority for the NCUA. NCUA should be provided up to $30 billion in emergency borrowing authority under the same conditions applicable to the proposed emergency borrowing authority for the Federal Deposit Insurance Corporation (FDIC) in S. 541.
- Systemic risk authority for the NCUA. Providing the NCUA with authority, similar to FDIC, to address systemic risk under extreme circumstances when the authority provided by Section 208 of the Federal Credit Union Act is insufficient.

II. DEPOSIT INSURANCE COVERAGE—PERMANENT INCREASE TO $250,000

The NCUA agrees with the provision in Section 204(a) of H.R. 1106 to make the temporary increase to $250,000 of the standard maximum share insurance amount (SMSIA) permanent.[7] Reverting the general limit for share insurance coverage to $100,000 at the end of 2009 would likely be a destabilizing event, affecting public confidence and creating burdens for institutions and consumers. Conversely, continuing the expanded coverage will allow federally insured credit unions at all asset levels to better meet contemporary member needs.

The temporary increase in the SMSIA to $250,000 helped preserve public confidence in federally insured credit unions. Despite the widely publicized challenges of the current economic environment, during 2008 the average share balance[8] in federally insured credit unions increased by 5.59 percent. All share categories posted respectable gains. Since shares were increasing at a projected annual rate of 7.69 percent through September 30, 2008, the temporary increase in the SMSIA helped prevent a deterioration of liquidity during the fourth quarter. While it is impossible

[1] 12 U.S.C. §1759. Unlike other financial institutions, credit unions may only serve individuals within a restricted field of membership. Other financial institutions serve customers that generally have no membership interest.

[2] Approximately 162 State-chartered credit unions are privately insured. Based on December 31, 2008 Call Report (NCUA Form 5300) data.

[3] Based on December 31, 2008 Call Report (NCUA Form 5300) data.

[4] Ibid.

[5] Ibid.

[6] Ibid.

[7] The term "standard maximum share insurance amount" or "SMSIA" means $100,000, adjusted pursuant to subparagraph (F) of section 11(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1821(a)(1)(F)), notwithstanding the temporary increase to $250,000 authorized by the Emergency Economic Stabilization Act.

[8] Reflecting their status as member-owned cooperatives, deposit accounts in federally insured credit unions are called shares not deposits.

to isolate this trend from other factors, such as uncertainties in equity markets, NCUA attributes the stability of insured shares during the fourth quarter of 2008 to public confidence in federally insured credit unions.

If the SMSIA limit of $250,000 remains temporary, the NCUA envisions federally insured credit unions experiencing operational challenges. During the fourth quarter of 2008, federally insured credit unions bolstered efforts to educate their members about the value of Federal insurance. Members, in turn, continued to support their federally insured credit unions and helped stem a national liquidity crisis. NCUA also initiated an intensive national advertising campaign and public awareness efforts to reinforce the safety of federally insured credit unions. Inconsistency in the SMSIA would undermine this progress. In addition, federally insured credit unions would face increased balance sheet management challenges if large depositors display a reluctance to invest in or renew certificate accounts with maturities extending beyond 2009.[9]

Historically, increases in the SMSIA coverage level have not been methodical. When created in 1970, the NCUSIF provided $20,000 in maximum coverage. Subsequently, the ceiling increased to $40,000 during 1974 and $100,000 during 1980. Although the maximum available coverage for Individual Retirement Accounts (IRAs) increased to $250,000 during 2006, the SMSIA remained at $100,000 for all other types of share accounts. Section 2103(a) of the Federal Deposit Insurance Reform Act of 2005 allowed for the adjustment of the SMSIA every 5 years beginning April 1, 2010 based on the Personal Consumption Expenditures Chain-type Price Index (PCEPI). However, there is no legal guarantee an increase in the SMSIA will occur.

Making the $250,000 SMSIA permanent would create parity, when adjusting for inflation, with the SMSIA limits of the 1980s. From 1980 to 2008, the PCEPI increased from 49.688 to 120.606.[10] Using the PCEPI as a basis, adjusted for inflation the $100,000 SMSIA in 1980 would equate to approximately $243,000 in 2008 dollars. [11]

Historically, some have expressed concern that increased coverage limits of federally insured deposits creates additional moral hazard. NCUA believes improvements in the regulation of financial institutions offset this concern. In addition, NCUA remains prepared to contribute toward reducing insurance losses over the long term as a participant in the current review of the Federal regulatory structure. Other traditional arguments against higher coverage limits also now have diminished relevance. In the past, many perceived higher federally insured limits as a detriment to smaller institutions based on the belief consumers with greater resources could consolidate their business with larger financial institutions. NCUA is not aware of any evidence indicating the higher SMSIA has adversely affected smaller federally insured credit unions since the fourth quarter of 2008.[12] Federally insured credit unions at all asset levels continue to respond proactively to the needs of their respective fields of membership. As the table below indicates, the NCUA's 2008 year-end statistics reflect how all asset classes of federally insured credit unions reported share increases.

Asset Group	Under $10 million	$10 million to $100 million	$100 million to $500 million	Over $500 million
# of Federally Insured Credit Unions	3,274	3,249	954	329
Share Growth	4.68%	6.61%	8.12%	8.32%

[9] As of December 31, 2008, shares with maturities exceeding twelve months exceeded eleven percent of all shares.

[10] The base year for this data is 2000, with an index value of 100. The source of this data is the archived Federal Reserve Economic data available at the Internet site *http://alfred.stlouisfed.org/series?seid=PCEPI.*

[11] The computation is as follows: 1) convert the 1980 SMSIA limit of $100,000 to 2000 base year dollars [$100,000 / .49688 = $201,255.84]; and 2) convert the base year equivalent of the 1980 level of coverage to 2008 dollars using the 120.606 index value for 2008 [$201,255.84 × 1.20606 = $242,726.61].

[12] Consumers have continued a broader diversification of assets beyond exclusively using federally insured financial institutions. The Board of Governors of the Federal Reserve's 2007 Survey of Consumer Finances *(http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf)* indicates just 15.1 percent of the financial assets of families was in transaction accounts or certificates of deposits (not including retirement accounts).

If the SMSIA limit of $250,000 remains temporary, members with funds in excess of $100,000 would need to use multiple insured institutions to be fully insured. A lower SMSIA could have the effect of causing members with higher levels of funds to conduct business with an institution they would otherwise prefer not to use. Efforts to impose a limit to consumer choices would not eliminate the ultimate need for any federally insured institution to respond to consumer needs. In addition, higher limits could also enhance the competitiveness of smaller institutions over a longer period of time with a greater ability to attract larger deposits.[13]

Another common objection to higher Federal deposit insurance limits relates to concern about favoring relatively affluent segments of society. As the agency charged with overseeing a movement with the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means, the NCUA recognizes the value members with the ability to make large deposits have in providing affordable borrowing opportunities for all classes of members. While the overwhelming majority of federally insured credit union members have deposits well below the current SMSIA, an additional option for members with high levels of assets would only help in continuing a successful model.[14] The NCUA also notes federally insured credit unions would benefit from a higher SMSIA limit because of a lack of access to other avenues of building deposits available to other types of institutions such as unlimited coverage for business accounts and certificate of deposit registry services.

The NCUA does not anticipate encountering significant operational issues if the higher SMSIA became permanent. The agency has the infrastructure in place to effectively communicate with both federally insured credit unions and members to announce any changes in the insured limits. In addition, the NCUA Board left the regulations discussing share insurance coverage and signage requirements flexible to accommodate additional potential changes to the SMSIA.

As in the past, if the higher SMSIA limit became permanent, the agency would complement formal communications with other resources, such as the NCUA's Internet site and periodic educational initiatives such as webinars. Although these types of initiatives would have some initial costs, ultimately the federally insured credit union system would experience a savings through the benefits derived from greater long-term liquidity in the system.

If the SMSIA of $250,000 became permanent, federally insured credit unions would incur negligible costs to bring the NCUSIF's equity ratio to its targeted level of 1.30 percent. With a SMSIA of $250,000, NCUA estimates insured shares would increase by $49 billion for the entire federally insured credit union system, reducing the equity level of the NCUSIF by only 2 basis points. Since federally insured credit unions maintain a NCUSIF capitalization deposit of 1 percent of insured shares, an increase to the SMSIA would equate to aggregate additional NCUSIF capitalization needs of approximately $490 million. This total represents less than one tenth of 1 percent of the total assets in federally insured credit unions.

III. EXTEND NCUSIF REPLENISHMENT AUTHORITY TO 5 YEARS

In the event the NCUSIF equity ratio falls below 1.20 percent, NCUA is required to assess a premium (and if necessary recapitalize the 1 percent deposit) to restore the equity of the NCUSIF to 1.20 percent. NCUA believes that extending the time the agency has to reach the statutory minimum equity ratio provides an important anti-cyclical tool. This would allow, to some extent, the equity level to vary with the economic cycle and reduce the impact of recapitalization at the trough of the business cycle. Not only does the current structure necessitate premium assessments against federally insured credit unions when they can least afford it, but it also reduces the amount of funds federally insured credit unions can put to work supporting the economy when the need is the greatest. In particular, every dollar charged in premiums translates to ten dollars not available to be loaned to credit union members.

IV. INCREASED BORROWING AUTHORITY FOR THE NCUSIF

The NCUA strongly supports the provision in Section 204(c) of H.R. 1106 increasing the NCUA's borrowing authority. Borrowing authority is vital for a deposit insurer as the insurance fund's short-term cash needs typically far exceed expected losses. For example, with the failure of a large institution NCUA might need to

[13] This is especially true for federally insured credit unions serving predominantly low-income members relying upon nonmember deposits to compensate for an inability to develop a competitive deposit base organically.

[14] The agency notes that without maintaining the $250,000 limit in the SMSIA, only individuals able to open IRAs would have access to higher levels of coverage.

promptly (generally within 2 days) payout all the insured shares, which for the largest institutions would exceed immediately available liquidity, even though the ultimate loss (expense) to be absorbed by the insurance fund after assets of the institution are liquidated may only be a small amount.

When Congress established the NCUSIF in 1970, it provided the NCUA Board the authority to borrow from the Treasury in an aggregate amount not to exceed $100,000,000.[15] With the passage of time, the size of the credit union system, the amount of insured shares, and the corresponding size of the NCUSIF and its obligations have all grown significantly. As the chart that follows demonstrates, the NCUSIF's assets and equity, as well as the assets and insured shares held by federally insured credit unions, were much lower than they are today. By the end of 1972, borrowing authority was six times NCUSIF assets of $16.7 million, nearly six and a half times NCUSIF equity of $15.6 million, and 0.7 percent of federally insured credit union assets. The chart includes figures for year-end 1972 since, after the law establishing the NCUSIF was enacted in 1970, NCUA extended Federal insurance to State-chartered credit unions over a 2-year period.[16]

Basis for Computing 2008 Equivalent Borrowing Authority	(A) 1972 Figures	(B) Ratio of Borrowing Authority to 1972 Figures	(C) 2008 Figures	(D) 2008 Equivalent Borrowing Authority (Column B × C)
NCUSIF Assets	$16,785,000	6.0	$7,845,581,935	$46,741,626,065
NCUSIF Equity	$15,559,000	6.4	$7,667,860,827	$49,282,478,482
NCUSIF Retained Earnings	$15,559,000	6.4	$1,690,946,528	$10,867,964,059
Insured Shares	$13,699,458,000	0.007	$598,122,224,526	$4,366,028,382
FICU Assets	$13,849,997,000	0.007	$801,672,388,418	$5,788,249,546

To keep pace with these changes, and to help the NCUSIF position itself for current and future challenges to the economy and the financial system, the NCUA recommends the NCUSIF's statutory borrowing authority be adjusted proportionally to the increase over time in the total assets of insured credit unions. The NCUA believes the assets of federally insured credit unions are the best measure of potential risk exposure for the NCUSIF. This would result in an increase in NCUSIF borrowing authority to approximately $6 billion.

Finally, the NCUA recommends that Congress provide the NCUSIF with additional, temporary emergency borrowing authority. The proposal in S. 541 to amend the Federal Deposit Insurance Act (FDIA) to increase FDIC's borrowing authority from $30 billion to $100 billion also includes a temporary provision allowing FDIC to borrow up to $500 billion if the Treasury Secretary, in consultation with the President, approves the higher borrowing authority. Credit unions, like banks, are facing challenging times. Many of the challenges are systemic, such as the problems with the asset-backed securities held by many corporate credit unions. To address such systemic problems, and the potential for sudden liquidity needs associated with such problems, the NCUSIF may need quick access to very large, short-term borrowings.

Thus, Congress should add a similar, temporary emergency borrowing authority for the NCUSIF in an amount not to exceed $30 billion, five times the proposed base borrowing authority of $6 billion.[17] The NCUA would exercise this emergency bor-

[15] "If, in the judgment of the Board, a loan to the fund is required at any time for carrying out the purposes of this title, the Secretary of the Treasury shall make the loan, but loans under this paragraph shall not exceed in the aggregate $100,000,000 outstanding at any one time. Except as otherwise provided in this subsection and in subsection (e) of this section, each loan under this paragraph shall be made on such terms as may be fixed by agreement between the Board and the Secretary of the Treasury." FCU Act, §203(d)(1) (12 U.S.C. §1783(d)(1)).

[16] Equivalent borrowing authority today would be much higher if the initial, small volume of insured credit unions during the fund's first year of operation were used as the basis for the calculation.

[17] The amendments to the FCU Act incorporating both the increase in the base limit to $6 billion and the new emergency limit of $30 billion might look like this: Section 203(d) of the Federal Credit Union Act (12 U.S.C. 1783(d)) is amended—

(1) in paragraph (1), by striking '$100,000,000' and inserting '$6,000,000,000'; and

(2) by adding at the end the following:

'(4) TEMPORARY INCREASES AUTHORIZED—

(A) RECOMMENDATIONS FOR INCREASE—During the period beginning on the date of enactment of this paragraph and ending on December 31, 2010, if, upon the written *(continued)* rowing authority on terms and conditions similar to the emergency borrowing authority for the FDIC. The NCUA's emergency authority would only be exercised with the concurrence of the Secretary of the Treasury, after consultation with the President. This emergency authority would be temporary, expiring on December 31, 2010. Any use of this special authority by the NCUA would require the agency to submit a report to the House Financial Services and Senate Banking Committees.

The NCUA would like to emphasize that this requested borrowing authority, while large in dollar terms, does not represent any potential burden on the taxpayer. If the NCUA was forced to borrow from the Treasury, the funds would be repaid with interest either through the sale of assets or by assessments on all federally insured credit unions.

V. SYSTEMIC RISK AUTHORITY FOR THE NCUA

The NCUA charters, regulates, and provides share (deposit) insurance to credit unions. In its role as share insurer for credit unions, it functions very much like the FDIC as insurer of banks. The FDIA, however, provides the FDIC with a particular statutory authority related to its deposit insurance called the "systemic risk" authority (FDIA §13(c)(4)(G), 12 U.S.C. §1823(c)(4)(G)) that the NCUA does not have. Congress should consider amending the Federal Credit Union Act (FCUA) to provide the NCUA with a systemic risk authority similar to that available to the FDIC.

Section 13(c) of the FDIA empowers the FDIC to provide certain assistance to insured banks that are in danger of closing on a voluntary basis, subject to certain statutory limitations, such as that the assistance be at the least cost to the Deposit Insurance Fund (DIF) and that the actions not protect depositors for more than the insured portion of their deposits. In an appropriate situation, the FDIC may exercise its systemic risk authority to provide assistance not otherwise authorized by §13(c). This systemic risk authority requires a determination by the Secretary of the Treasury that compliance with §13(c) statutory limitations would have serious adverse economic effects on economic conditions or financial stability, and, with the concurrence of two-thirds of the members of the Board of Governors of the Federal Reserve and two-thirds of the FDIC directors, the FDIC may then take actions to assist insured banks without regard to the various limitations enumerated in §13(c).

The FDIC used its systemic risk authority last fall. As the current financial crisis was unfolding, the FDIC launched its Temporary Liquidity Guarantee (TLG) Program as an initiative to counter the current system-wide crisis in the nation's financial sector. The TLG Program provided two guarantee programs: One that guaranteed newly issued senior unsecured debt of insured banks and most U.S. holding companies of such insured banks, and another that guaranteed certain noninterest-bearing transaction accounts at insured banks. The FDIC announced that the TLG Program was necessary to promote financial stability by preserving confidence in the banking system and encouraging liquidity in order to ease lending to creditworthy businesses and consumers. Because the two guarantee programs were beyond the general assistance authority contained in FDIA §13(c), the FDIC first obtained a determination of systemic risk from the Secretary of the Treasury (after consultation with the President), supported by the written recommendations of the FDIC Board and the Board of Governors of the Federal Reserve System.

The NCUA Board has certain tools available under §208 of the FCUA (12 U.S.C. §208) to address a threat to any given institution that is in danger of closing.[18] These tools are similar to those available to the FDIC under FDIA §13(c), including making loans to, purchasing the assets of, or establishing accounts in the institution in danger of closing. Like the FDIA §13(c), FCUA §208 is also a limited authority. For example, Section 208 assistance can only be provided to federally insured credit unions that are in danger of closing; and each of the assistance actions contemplated

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recommendation of the Board (upon a vote of not less than two-thirds of the members of the Board) and the Board of Governors of the Federal Reserve System (upon a vote of not less than two-thirds of the members of such Board), the Secretary of the Treasury (in consultation with the President) determines that additional amounts above the $6,000,000,000 amount specified in paragraph (1) are necessary, such amount shall be increased to the amount so determined to be necessary, not to exceed $30,000,000,000.

'(B) REPORT REQUIRED—If the borrowing authority of the Board is increased above $6,000,000,000 pursuant to subparagraph (A), the Board shall promptly submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives describing the reasons and need for the additional borrowing authority and its intended uses.'.

[18] Section 208(a)(1) provides for assistance to federally insured credit unions in danger of closing. Section 208(a)(2) provides for assistance to credit unions to facilitate a merger or purchase and assumption. The references to §208 assistance in this testimony mean §208(a)(1) assistance.

under §208 is in the nature of a bilateral agreement, that is, assistance in the form of asset purchases, loans, and establishment of accounts all require that there be a voluntary agreement between the NCUA and the affected institution.

These §208 constraints limit the NCUA's ability to respond when circumstances arise that present a threat to the overall viability of the credit union system. In the current economic climate, such circumstances are plentiful. Economic recession has produced a substantial rise in unemployment; deterioration in the residential real estate market has placed a strain on housing values and mortgage lenders and a severe tightening of credit; securities markets are disrupted and the values of asset-backed securities are uncertain; and all this is leading to significant losses at depository institutions across the nation. The cumulative effect of these factors can undermine the confidence of the public in the credit union system as a whole, creating systemic risk.

In order to quickly and effectively respond to such circumstances, the NCUA needs authority to take action in response to systemic risk. There are two recent examples of circumstances in which the NCUA, confronted with systemic risks, was forced to take less than optimal actions in dealing with these risks.

1. Temporary Corporate Credit Union Share Guarantee Program (TCCUSGP).

The NCUA Board took action on January 28, 2009 to address concerns in the corporate credit union system related to declines in the value of asset backed securities and precipitated by a substantial capital impairment at a corporate credit union. The NCUA Board, on behalf of the NCUSIF:

- Infused $1 billion in capital into the corporate credit union;
- Temporarily guaranteed the entire amount of all share (deposit) accounts at each corporate credit union for about a 1-month period; and
- Offered to guarantee the share accounts at each corporate credit union, on a voluntary basis, through December 31, 2010.

In support of the latter two actions, collectively referred to as the TCCUSGP, the Board found that each of the corporate credit unions in the system met the requirements for assistance under §208 of the Federal Credit Union Act. To maintain confidence in all corporate shares, and prevent runs on any particular corporate, the NCUA Board would have preferred having the option of *involuntarily* guaranteeing all corporate shares through 2010. Because of the lack of authority to address systemic risks, however, the Board was forced to implement the TCCUSGP in two steps, using separate legal authorities: a short-term involuntary guarantee until such time as each corporate could consider whether it wanted a voluntary guarantee, followed by the long-term voluntary guarantee.

In support of the involuntary temporary guarantee, the Board determined that an emergency existed that required the NCUSIF provide the corporates with an immediate share guarantee during a short time period while the Board solicited a written voluntary guarantee agreement with each participating corporate. The Board cited its §203(a) power to requisition NCUSIF money "for such . . . other expenses incurred in carrying out the purposes of this title as it may determine to be proper," combined with the Board's §209(a)(7) incidental powers. 12 U.S.C. §§1783(a), 1789(a)(7). The authority for the long-term, voluntary share guarantee was found in §208, as the voluntary guarantee was tantamount to a conditional line of credit, or a loan, and specifically authorized under §208.

This two-step process for the share guarantee program was makeshift and burdensome, and was also potentially disruptive for the system because it relied on unanimous, voluntary participation for full effectiveness. The NCUA could not require every corporate to participate in the voluntary portion of the TCCUSGP, and a few ultimately did not. The final outcome of this less-than-100 percent participation remains to be seen.

2. Transaction account guarantees.

Also, as noted above, this past year the FDIC issued an interim rule implementing a TLG program that provided an unlimited DIF guarantee for non-interest bearing transaction accounts at insured banks. This FDIC action provided assurance to businesses that maintained large transaction accounts with balances in excess of insured limits that, despite the uncertainties in the economy and among depository institutions, they need not move or restructure their accounts to in an effort to find a safe haven. The action also helped to preserve liquidity and to encourage banks to continue lending activities. To implement this DIF guarantee, the FDIC employed its systemic risk authority, as the action included banks that were not in specific danger of closing, and the FDIC extended the guarantee to all banks on an involuntary basis. Some federally insured credit unions, like banks, offer non-interest bearing transaction accounts, and the NCUA Board considered taking action similar to what the FDIC had done to guarantee those accounts. Lacking authority to take global action based on systemic risk, the NCUA had no authority to pursue a similar, global account guarantee at all federally insured credit unions, and so was unable to provide a blanket guarantee to small business owners and other entities with transaction accounts at credit unions.

With regard to the corporate credit union concerns and the various guarantees discussed above, the credit union system as a whole would have been better served if it had been able to employ a systematic risk authority. Still, because the corporate credit unions are a small universe, the Board was able to cobble together other legal authorities to work around the lack of systemic risk authority. However, the next time the NCUA needs to take systemic action for problems that could occur within the universe of natural person credit unions, current legal authorities might be inadequate to address this much larger universe. Accordingly, it is important Congress consider providing NCUA with systemic risk authority that parallels the authority of the FDIC.[19]

VI. CONCLUSION

The NCUA is committed to ensuring a safe and sound financial system and appreciates the opportunity to provide input on legislation to improve the country's Federal deposit insurance system. At a minimum, Congress should act to permanently increase the deposit insurance coverage level to $250,000, to increase NCUA's base borrowing authority to $6 billion with emergency authority extending up to $30 billion, to provide the NCUA with the authority to replenish the NCUSIF over a 5-year period, and consider providing the NCUA with systemic risk authority. These authorities will provide the agency with additional tools to continue to deal with the serious economic challenges facing all financial institutions.

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[19] For example, to parallel the provisions of the FDIA §13(c)(4)(G), Section 208 of the FCUA (12 USC §1788) could be amended by inserting at the end thereof a new paragraph (d) to read as follows:

(d) Systemic risk.

(1) Emergency determination by Secretary of the Treasury. Notwithstanding subparagraphs (a), (b) and (c), if, upon the written recommendation of the Board and the Board of Governors of the Federal Reserve System (upon a vote of not less than two-thirds of the members of such Board), the Secretary of the Treasury (in consultation with the President) determines that—

(A) the Board's compliance with subparagraphs (a), (b) and (c) with respect to an insured credit union would have serious adverse effects on economic conditions or financial stability; and

(B) any action or assistance under this subparagraph would avoid or mitigate such adverse effects, the Board may take other action or provide assistance under this section as necessary to avoid or mitigate such effects.

(2) Repayment of loss. The Board shall recover the loss to the National Credit Union Share Insurance Fund arising from any action taken or assistance provided with respect to an insured credit union under clause (1) expeditiously from 1 or more emergency special assessments on insured credit unions as the Board determines appropriate.

(3) Regulations. The Board shall prescribe such regulations as it deems necessary to implement this paragraph. In prescribing such regulations, defining terms, and setting the appropriate assessment rate or rates, the Board shall consider the types of credit unions that benefit from any action taken or assistance provided under this subparagraph, economic conditions, the effects on the credit union industry, and such other factors as the Board determines appropriate.

(4) Documentation required. The Secretary of the Treasury shall—

(A) document any determination made under subparagraph (1); and

(B) retain the documentation for review under subparagraph (5).

(5) GAO review. The Comptroller General of the United States shall review and report to the Congress on any determination under subparagraph (1), including—

(A) the basis for the determination;

(B) the purpose for which any action was taken pursuant to such subparagraph; and

(C) the likely effect of the determination and such action on the incentives and conduct of insured credit unions and uninsured members.

(6) Notice.

(A) In general. The Secretary of the Treasury shall provide written notice of any determination under subparagraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Representatives.

(B) Description of basis of determination. The notice under subparagraph (6)(A) shall include a description of the basis for any determination under subparagraph (1).

(7) Rule of construction. No provision of law shall be construed as permitting the Board to take any action prohibited by paragraphs (a), (b) or (c) unless such provision expressly provides, by direct reference to this paragraph, that this paragraph shall not apply with respect to such action.

PREPARED STATEMENT OF WILLIAM GRANT

CHAIRMAN AND CEO, FIRST UNITED BANK AND TRUST,
ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

MARCH 19, 2009

Chairman Johnson, Ranking Member Crapo and members of the Subcommittee, my name is William Grant, Chairman and CEO of First United Bank and Trust. My bank is a 108-year old community bank, headquartered in Oakland, Maryland—a rural town in Appalachia with a population of about 2,000. We have assets of $1.6 billion, and serve four counties in Maryland and four counties in West Virginia.

I am pleased to present the views of the American Bankers Association (ABA), where I am a member of the ABA's deposit insurance task force and where I serve on the America's Community Bankers Administrative Committee. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members—the majority of which are banks with less than $125 million in assets—represent over 95 percent of the industry's $13.9 trillion in assets and employ over 2 million men and women.

We appreciate the opportunity to testify on The Depositor Protection Act of 2009, S. 541, introduced by Chairman Dodd and cosponsored by many other members of this subcommittee. That bill would increase the FDIC's line of credit to Treasury from $30 billion to $100 billion. The ABA strongly supports this bill as it would provide the FDIC with needed flexibility to manage the cash-flows in handling bank failures and most importantly—because of this added flexibility—would allow the FDIC to significantly reduce the special assessment on the industry it has proposed for June 30, 2009.

Let me be very clear at the outset: the banking industry fully supports having a strong FDIC fund and stands behind the efforts to ensure FDIC's financial health. The industry has always taken our obligation to the FDIC seriously, and banks will honor the obligation to support the FDIC.

How this is accomplished is the critical question. The money to pay such high expenses cannot be created out of thin air. It is very important, therefore, to lower the upfront costs and spread the obligation to FDIC over time. S. 541 helps to accomplish this.

Let me illustrate the impact of the FDIC special assessment: the original proposed special assessment would pull over $15 billion from the industry in the second quarter of this year. This is on ***top*** of the regular risk-based quarterly premium paid by the industry which will be between $3 billion and $4 billion each quarter. To give you a sense of the magnitude of this cost, the industry's full year 2008 net income was $16 billion. Even at half the cost, which the FDIC has suggested is likely if S. 541 is enacted, it still will impose a substantial burden on banks at the very time that they are making every effort to get credit into local communities.

The special assessment is a significant and unexpected cost to all banks that has the potential to devastate earnings. We are already dealing with a deepening recession, accounting rules that overstate economic losses and unfairly reduce capital, regulatory pressure to classify assets that continue to perform, and a significant increase in regular quarterly FDIC premiums. Each of these is a big challenge on its own—but collectively, they are a nightmare. Adding another huge one-time cost compounds this burden dramatically. Thousands of banks like mine that never made a toxic subprime mortgage loan and have served our communities in a responsible way for years and years are being unfairly penalized. In fact, a small bank in Texas commented recently: "Is there not a better approach here than choking down the small community banks that still have prudent underwriting standards and are still trying to serve their long-term customers?"

Let me tell you the impact such a charge will have on my bank: the proposed special assessment would cost my bank $2.47 million—all in second quarter of 2009. This will reduce the bank's capital—which is the base to support all our lending—by $1.64 million. This very high and unexpected cost is in addition to the regular risk-based premium we pay to FDIC, which is expected to be about $429,000 per quarter, or $1.7 million for 2009. To put this in perspective, the regular premiums are four times greater this year than last—not including the large special assessment cost. This same story is being repeated across thousands of banks in our country. Moreover, some areas, where the economic conditions are even more problematic, this added burden will make any new lending practically impossible.

I do want to be clear in saying that First United Bank & Trust will meet its obligation to FDIC, regardless of the disposition of S. 541. In doing so, however, we will encounter limits on our ability to lend in our communities, support local functions and charities, and provide jobs.

In fact, the special assessment is completely at odds with banks' efforts to help communities rebuild from this economic downturn. This assessment makes the cost of raising new deposits much higher, and therefore, acts as a disincentive to raise new deposits. Fewer deposits will hinder our ability to lend. The reduction in earnings will make it harder to build capital when it is needed the most. Banks will also be forced to look at ways to lower other expenses, which may limit their ability to sponsor community activities or make charitable donations—something most banks have done year after year. Some banks have told us that they may even have to consider reducing bank staff in order to pay for this high cost. In fact, a small community bank in Wisconsin, with 11 employees, commented that: "The proposed assessment to us is equivalent to the cost of one fulltime employee. We may not be able to afford to keep existing staff. I'm concerned that we will be forced to reduce our head count or certainly not be able to add staff as planned."

The implications for this significant FDIC charge will impact every corner of my community, and indeed, every community the banking industry serves. It is patently unfair and harmful to burden a healthy bank like mine that is best positioned to help the economy recover. Given the impact that the proposed assessment will have on banks and their communities, it is critical to consider alternatives that would reduce the burden and provide the FDIC the funding it needs in the short-term. S. 541 is an extremely important step in this direction as it would enhance FDIC's ability to draw on working capital, if necessary, and enable the FDIC to reduce the special assessment considerably.

Importantly, the FDIC does not intend to use the line of credit at all unless the economy deteriorates even more dramatically than anticipated. If it does draw on it, it is a ***borrowing that must be repaid by the industry—with interest.*** This obligation of the industry is often lost in the discussion about government support and confused with taxpayer losses. Nothing is further from the truth. The banking industry stands fully behind the FDIC and remains committed to assuring its financial health. The FDIC has been funded completely by banking premiums since it came into existence in 1933. All the costs of bank failures and all the personnel and other program costs have been borne by the industry. It has been the healthy banks which have had nothing to do with the excessive risk-taking of banks that have failed that end up bearing the cost. While the industry is prepared to meet its obligations, in this difficult time it is critical to reduce the impact and spread the cost over a long period of time. This is why enacting S. 541 is so important and so urgently needed.

In my statement today, I'd like to focus on three main ideas:

- **The banking industry is committed to assuring that the FDIC is financially secure.** Banks have always paid the full cost of FDIC. Since the industry will bear the full cost of any FDIC expenses, it is a question of ***timing*** of the payments and balancing the impact of any payment on the ability of banks to lend in their communities.
- **The FDIC special assessment is a significant burden that will impact earnings, capital, and cost of funds—all of which makes it far more difficult to lend.** The cost of rebuilding the deposit insurance fund needs to be reduced and spread out over time.
- **The $100 billion line of credit is critical to reducing FDIC assessments on banks.** ABA fully supports S. 541 and urges quick action to enact it.

I will cover each of these in turn.

I. The Banking Industry is Committed to Assuring that the FDIC is Financially Secure

The banking industry knows how important deposit insurance is to our customers. In fact, the very rapid growth in deposits over the last quarter, indeed the last year, shows just how valuable this additional level of security is to bank customers. It is no wonder that depositors feel this way as no insured depositor in a failed bank has ever lost a penny. Perhaps less well-known is that ***bank*** premium payments have paid ***all*** the costs of the FDIC—including all the personnel and administrative costs to run the agency (which is in excess of $1 billion per year) and all the bank failure costs.

The industry remains committed to assuring the financial strength of the FDIC. The industry had built up the Deposit Insurance Fund (DIF) to over $50 billion by the end of 2007. The housing market collapse and rapidly deteriorating economy have resulted in 25 bank failures last year and 17 this year. The IndyMac failure on July 11, 2008 was particularly costly—subtracting about $10 billion from the DIF. As a result of these losses, the DIF reserve ratio (the fund divided by insured deposits) fell to 0.40 percent at the end of the last year. This was due not only to the rapid growth in insured deposits, but more importantly reflects the fact that the FDIC has set aside over $22 billion from the fund to pay for losses expected in 2009. These reserves are ***not*** included in the calculation of the reserve ratio. Thus, in total, the FDIC has $41 billion in resources—$22 billion for possible failures plus $19 billion in the fund to cover additional unexpected costs.

In February 2006, Congress made important improvements that allowed the FDIC greater flexibility to manage the insurance fund and authority to enhance the risk-based premium system. Unfortunately, there was little time to allow this system to become fully operational before this severe economic downturn began to take its toll. Nonetheless, the reform act of 2006 continues to provide a solid base for rebuilding and maintaining the FDIC deposit insurance fund.

Under the new rules, the banking industry pays quarterly premiums that are set to reflect differences in "risk" of the banks, determined by a combination of bank examiner ratings and financial ratios. Under that system, premiums paid this year will raise about $12 billion. This represents a fourfold increase in premiums from last year. For banks located in more economically distressed areas, the risk-based increase is likely to be even higher. Bank examiners have also been very critical of banks (particularly in these areas) even though most of the banks in these regions remain well-capitalized and ready to lend. The expense will adversely affect a bank's earnings, perhaps leading to a CAMELS downgrade and a higher FDIC insurance premium, where the cycle begins again.

In spite of these challenges, banks had planned for and budgeted for the increase expected in quarterly premium assessments. However, the huge special one-time assessment announced on February 27, 2009 was unexpected. The negative consequences of this change—all at once—will be dramatic.

The industry is prepared to do its part and pay for 100 percent of the insurance needed to preserve confidence in our industry. The only issue is one of timing. S. 541 will be very helpful in providing the industry with the time needed to fund the DIF while at the same time enabling the industry to meet the needs of our communities.

II. The FDIC Special Assessment is a Burden That Will Significantly Impact Earnings, Capital, and Cost of Funds—All of Which Makes it Far More Difficult for Banks to Lend

The FDIC is proposing to siphon funds out of the banking system at precisely the time that it and other parts of the government are trying to pump money in. This is the ultimate in mixed messages and will significantly undermine the effectiveness of the other programs. It would be far better to adopt a plan that would enable banks to fund the system at a time when higher insurance premiums will not jeopardize an already fragile economy.

The $41 billion already at the FDIC and $12 billion a year ($60 billion over 5 years) in risk-based premiums should be sufficient—under current economic assumptions—to cover the FDIC's estimated $65 billion in losses over the next 5 years and rebuild the DIF back to its normal operating range. The FDIC has told the industry, however, that the special assessment is needed as an additional layer of protection against the possibility that losses this year and next may be greater than anticipated, leaving the agency with less flexibility to manage the cash-flow required to satisfy insured-depositor claims.

Let me again be very clear: the banking industry will meet its commitment to fully fund the FDIC. We appreciate the difficult situation that the FDIC is in, and understand that rising losses from bank failures have created short-term funding needs. The industry has always taken our obligation to the FDIC serious and banks will honor the obligation to support the FDIC. It is a matter of timing that is the issue here, not the obligation. Thus, ***how the repayment is done, and over what time period, is the critical question.***

Here's an example of how many bankers feel:

- From an Illinois community bank ($425 million in assets): "The FDIC seems to be failing to realize that most community banks continue to serve as a stable foundation for lending to businesses and individuals. By imposing this assessment, the FDIC is placing further strain on the institutions that have great potential to help pull our nation out of this financial crisis. Wall Street has been rewarded, and now Main Street is being penalized."
- From an upstate New York community bank ($500 million in assets): "We annually provide over $100 million in loans to a wide range of businesses, consumers and homeowners. We truly operate the way a main street bank should, safely and profitably, all with an focus on supporting the community in every way possible. We never issued a subprime mortgage, purchased private label CMOs or

MBSs. Basically, we did what we were supposed to do. This year we estimated that our FDIC insurance premiums were going to increase to $610,000 up approximately $410,000 from 2008. While we were extremely disappointed that banks that operated very poorly, without prudent controls and with an eye for ever greater profits at the expense of everything else, were the source of the increase, we understood that all must share in the pain if this Country is going to move forward. However, the increases in premiums being proposed now will increase our costs another $950 thousand. This is not acceptable!

The money to pay such high expenses must come out of earnings or reductions in expenditures. Banks will also be forced to look at ways to lower other expenses, which means less lending, fewer sponsorship of community activities, fewer donations to local charities, and in some banks, reductions in staffing. The implications for this significant FDIC charge will impact every community. Spreading the costs over a long period of time is the best method to minimize disruptive effects. Alternatives are clearly needed to help ease this burden on all banks.

III. The $100 Billion Line of Credit is Critical to Reducing FDIC Assessments on Banks

Enacting S. 541 will provide the necessary flexibility to the FDIC to continue to meet its responsibilities without extracting significant funds from the banking industry that could be better used to facilitate loans in banks' communities. S. 541 would increase the FDIC's line of credit to Treasury from $30 billion to $100 billion and provide for additional flexibility for the FDIC to borrow beyond that under extraordinary circumstances. What is not well understood is that the FDIC's ability to borrow for working capital (to handle the cash needs in resolving bank failures) is ***directly*** related to the level of the fund and the (current) $30 billion line of credit. Thus, increasing that line to $100 billion significantly ***increases*** the FDIC's working capital line.

The last time the line of credit was increased was in 1991, when Congress increased it from $5 billion to $30 billion in the FDIC Improvement Act. At that time, Congress also provided for working capital that, as I mentioned, is many multiples of (roughly nine times) the $30 billion line of credit plus the fund balance. Since that time, the banking industry has more than tripled in total assets; thus, setting a new line of credit at $100 billion is consistent with the growth of the industry.

By expanding the flexibility to access working capital, the FDIC has less immediate need for cash from the industry as a buffer against unexpected losses. Thus, rather than pull $15 billion out of the industry, the FDIC has suggested that it could cut that level in half and have sufficient funding. Of course, even at half the proposed rate, the cost is significant, and we continue to look for ways to eliminate the upfront cost or, if it cannot be eliminated, at least lower it significantly and certainly spread it out over a much longer period of time. We emphasize that the special assessment is on top of significantly elevated risk-based premiums.

The FDIC should assess premiums to recapitalize the insurance fund over a reasonable period, keeping in mind the present need to keep capital in the system to increase stability and to bolster lending. Recently, the FDIC extended the recapitalization period for the reserve ratio to return to the statutory level of 1.15 percent from 5 years to 7 years. The FDIC should consider extending the recapitalization period further, to at least 10 years, and be reassured that the industry remains fully committed to bringing the fund back to required levels as conditions improve.

Policymakers should consider other options to help stretch out the repayment period for banks. One option to consider is a funding source like the Financial Corporation (FICO) bonds issued from 1987 to 1989 to pay for the costs incurred by the Federal Savings and Loan Insurance Corporation (FSLIC) from savings association failures in the late 1980s. These were a series of 30-year bonds with an aggregate principal of $8.2 billion. This helped to spread out the cost of failures at that time. Other types of borrowing or even capital investments by banks in the FDIC should be considered. Having options in place is important so that there is a viable mechanism to provide the FDIC with capital to offset losses, yet have the commitment of the banking industry to repay any temporary funding over a long period of time.

On a final note, let me say that the banking industry, like all businesses, is working hard to cut costs and make sure our operations are as efficient as possible. We believe that the FDIC should do the same. Thus, we urge the FDIC to continue seeking the least-cost resolution of failed institutions and provide details so the industry and public understand the costs incurred. Moreover, the FDIC should reduce all other unnecessary expenses, keeping in mind that every dollar the FDIC spends comes out of the insurance fund.

Conclusion

The ABA fully supports a strong, financially secure FDIC fund in order to maintain the confidence depositors have in the system. The banking industry has been responsible for all of the FDIC's cost since its inception in 1933. We appreciate the desire on the part of the FDIC to have an extra layer of protection in this difficult environment with so much uncertainty about the number and cost of bank failures. However, how this is done is very important to every bank and every community we serve. The special assessment is a significant and unexpected cost to banks that will devastate earnings and reduce lending so critical to our economic recovery. Therefore, the ABA fully supports S. 541 and urges quick action to enact it into law.

PREPARED STATEMENT OF TERRY WEST

PRESIDENT AND CEO OF VYSTAR CREDIT UNION,
ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION

MARCH 19, 2009

Thank you, Chairman Johnson, and Ranking Member Crapo, for the opportunity to appear before the Subcommittee today on behalf of the Credit Union National Association on issues relating to deposit insurance.

I am Terry West, President and CEO of VyStar Credit Union in Jacksonville, Florida. I am also serving as the Chairman of CUNA's Corporate Credit Union Task Force, which was formed to address concerns regarding corporate credit unions, institutions that provide payments, settlement, liquidity and investment services for natural person credit unions. The Credit Union National Association is the largest advocacy organization for credit unions in this country, representing the nation's 7,900 State and Federal credit unions, which serve approximately 92 million consumers.

VyStar CU

VyStar is a State-chartered, federally insured credit union serving the Jacksonville community; we have approximately 350,000 members and $3.8 billion in assets. I am pleased to report that VyStar continues to be an important source of lending as well as a variety of financial services to our members during this period of economic crisis, offering a variety of loan products, including 30-year mortgage loans where we pay up to $5,000 no closing costs at 5.375 percent, and small business loans. We also help our members modify existing loans and work with them to provide financial counseling and restructure their debt, particularly for those facing job losses or a reduced income. In addition, we help over 9,000 small businesses in our area meet their financial needs through deposit and loan services. We are also just now launching a Money Makeover on local television aimed at teaching consumers how to reduce debt and save, especially during this economic crisis.

Background on Natural Person and Corporate CUs

I am even more pleased to report that VyStar's efforts are being repeated in communities all across this country by the nation's State and Federal credit unions, as highlighted by the *Wall Street Journal* supplement on Sunday, March 15th. As the article points out, credit union loans in 2008 rose by 7 percent to over $575 billion, up about $35 billion from the previous year. Meanwhile, banks in this country saw loans decline about $31 billion in 2007, from $7.9 to $7.876 trillion, as the *Journal* reported. I have attached a copy of the *Journal* article. While credit unions are generally performing well, some natural person credit unions in States such as California, Florida, Arizona, Nevada and Michigan are facing real stresses, including capital reductions, primarily as a result of the collateral damage from their respective economic environments.

The corporate credit union network has been particularly hard hit, due in part to the impact of mortgage-backed securities, which are permissible investments for the corporate credit unions, on their net worth. These concerns are highly relevant to the Subcommittee's consideration of deposit and share insurance because they have a direct impact on the costs of insurance to credit unions that is provided by the National Credit Union Share Insurance Fund (NCUSIF).

The NCUSIF

Like the Federal Deposit Insurance Corporation (FDIC), the NCUSIF provides account insurance, backed by the full faith and credit of the U.S. Government, to the institutions it covers. However, the NCUSIF differs from the FDIC in one very important way. The FDIC is generally funded by assessing premiums to insured banks. The costs of the NCUSIF are borne by federally insured credit unions, which must provide and maintain with the NCUSIF 1 percent of their insured shares. Federally insured credit unions may also be assessed an insurance premium, up to twice a year, to bring the NCUSIF to its normal operating level, which is set by the NCUA Board within a range of 1.2 percent to 1.5 percent, as directed by the Federal Credit Union Act ("FCU Act" or "Act"). The current level is 1.3 percent. If the NCUSIF equity level falls below 1.2 percent, a premium must be assessed under the Act.

This system has many positive features. It reflects the self-help, cooperative nature of the credit union system by calling on federally insured credit unions to serve as the first line of defense against insurance losses before any taxpayer funds would ever become involved. However, the current economic crisis has also exposed some dangers in the system. In particular, when, as now, the industry faces a general economic downturn, and individual credit unions need their capital the most to support continued lending to local communities, the insurance fund can impose sudden, large, and unexpected drains on the capital of credit unions all across the country. This, in turn, can limit the continuing ability of credit unions to carry on their core functions just when they are needed most. Some of the reforms proposed below are designed to mitigate this problem.

NCUA's Actions To Assist Corporate CUs

Because the National Credit Union Administration (NCUA) took action in January to provide $1 billion in capital to the largest corporate credit union, U.S. Central, and to guarantee the uninsured shares of corporate credit unions, all federally insured credit unions have been hit with an estimated 80 plus basis points in insurance expenses this year and an average 62 basis point hit to federally insured credit unions' return on assets (ROA). This is comprised of more than 50 basis points to restore the 1 percent deposit and the remainder in the form of a premium assessment.

CUNA did not oppose NCUA's action in January to help the corporate credit unions, which we felt was necessary. However, we did not support the agency's decision as to how the costs would be funded or when they had to be recognized for accounting purposes. We believe NCUA did not thoroughly consider alternatives to contain those costs for the credit union system.

As a result of NCUA's actions, a very large number of credit unions will experience negative "bottom lines" or "net income" and all will see their net worth decline, solely because of the insurance expenses.

On February 27, 2009, the FDIC issued an interim final rule with a request for comments calling for an emergency 20 basis point special insurance assessment in June and possibly an additional assessment of up to 10 basis points thereafter. Bankers objected to the amount and according to the *Washington Post* and others, the FDIC has agreed to mitigate the impact of the assessment cutting it in half to 10 basis points. The FDIC has also adopted a rule that allows it up to 7 years to bring the reserve ratio of its Deposit Insurance Fund up to 1.15 percent. This will allow the agency, under its "extraordinary circumstances" authority, to spread out future assessments for federally insured banks and thrifts for two additional years. The agency also made changes to its assessment rate regarding its Temporary Liquidity Guarantee Program that will help reduce insurance assessments.

Actions to Mitigate CUs Costs That Do Not Require Legislation

We believe there are steps of a similar nature and effect that NCUA could take to help minimize the impact of insurance costs on federally insured credit unions. For example, while the 1 percent equity level in the NCUISF arguably must be replenished in the same year that it is drawn down, the NCUA Board currently has authority under the FCU Act to spread out credit unions' premium expenses that fund the remaining .30 percent balance of the NCUSIF to bring the ratio to 1.30 percent. We urge this Subcommittee to encourage NCUA to use its current authority to help reduce the impact of insurance costs on federally insured credit unions this year.

We also note that limited assistance—up to $10 billion—from the Treasury's Troubled Assets Relief Program (TARP), or Financial Stability Plan (FSP), to the NCUSIF and to a small number of individual credit unions could be extremely important in helping to blunt the impact of the insurance expenses on the credit union system. We believe such funding, which would be fully repaid by the credit union system in a reasonable amount of time, is appropriate under the circumstances. Some banker groups have had the temerity, given where certain banks are regarding TARP money, to charge that credit unions' tax exemption would be threatened if we receive such funds. In our view, this should not be the case, because any funds from TARP would be reimbursed. Further, Treasury has developed a TARP program specifically for Subchapter S Banks, which receive very favorable tax treatment. No one is suggesting that this step undermines their generous tax benefits the Subchapter S banks receive from the Federal Government. While this hearing is not focusing on accounting issues, the impact of accounting rules regarding fair value and assets that have to be reported as "other-than-temporarily impaired" have taken their toll on the credit union system, along with others in the financial system, particularly for corporate credit unions. While positive developments from the Financial Accounting Standards Board (FASB) are in the offing, we urge the Senate to remain vigilant and keep the pressure on FASB to address these issues in a timely and effective manner.

Legislation is Needed

We also think it is imperative that NCUSIF have the statutory authority it needs to address insurance issues and manage insurance costs, both to facilitate its operations and to help credit unions handle their expenses. This is particularly important in light of the current financial crisis. More specifically, CUNA is supporting the following:

- Legislation to continue share and deposit coverage for accounts up to $250,000. We feel this additional coverage has provided consumers with needed confidence in their financial institutions and hope the Senate will continue the current level of account insurance.
- Increased authority for the NCUSIF to borrow up to $6 billion from the U.S. Treasury to facilitate its ability to spread out insurance costs to credit unions. The FDIC is seeking an increase in its borrowing authority from $30 billion to $100 billion, with additional authority to borrow up to $500 billion with the concurrence of the Federal Reserve Board and the Treasury Department, in consultation with the President. NCUA has much more limited borrowing authority, which has not been increased from $100 million since the NCUSIF was created in the 1970s. As credit unions continue to be affected by the economy, and in recognition of the $250,000 insurance ceiling which may be extended, thereby increasing the NCUSIF's exposure, we urge the Senate to increase the NCUSIF's borrowing authority. We also support additional authority for the NCUSIF under exigent circumstances, which would allow it to borrow an additional amount, up to $30 billion, that we urge the Senate to approve for the NCUSIF.
- Authority for the NCUSIF to allow federally insured credit unions to spread out premium expenses for a period of up to 8 years. CUNA strongly believes that NCUA has authority now to spread out about 30 basis points in insurance expenses for a reasonable period of time, without any new legislative authority, and we urge this Subcommittee to encourage NCUA to use that authority. However, we also support legislation that would expressly permit NCUA to collect credit unions' premium costs over 8 years, as the FDIC would be permitted to do. This change would provide an extremely important mechanism that would allow NCUA to manage its resources more effectively while lessening the impact of assessments on federally insured credit unions.
- Enhanced authority for NCUA through its Central Liquidity Facility (CLF) to provide liquidity to all member credit unions, both natural person and corporate credit unions, and capital to those member credit unions that represent systemic risk to the NCUSIF. Such additional authority would provide another mechanism the NCUA Board could employ to spread out the costs associated with problem cases that are paid by credit unions. Authority for the program, which would be funded through the CLF's borrowing authority and that of the NCUSIF, would end after 7 years. Borrowings would be repaid from within the credit union system. The NCUA Board would be directed to write regulations to implement the program and NCUA's implementation would be subject to Congressional review.
- Systemic risk authority to NCUA, on a similar basis to that provided to FDIC. While we cannot imagine that Congress intended NCUA would not have such authority, the FDIC was able to point to specific provisions in its Act to provide unlimited deposit insurance coverage for non-interest bearing transaction accounts. Without a specific systemic risk provision, NCUA has been reluctant to take this action, even though we believe NCUA has such authority to act on a case-by-case basis under 12 U.S.C. §1788. We believe that given the uncertainty of the economic crisis, parallel authority for NCUA to address systematic risk issues in a timely fashion is reasonable.

Conclusion

While CUNA is supporting additional resources for the NCUSIF and urging Congress to help with other issues, such as mark-to-market accounting, that will have an impact on the credit union system including corporate credit unions, we are also supporting regulatory changes in the corporate credit union system that will substantially strengthen their capital, reduce their numbers to increase efficiencies, focus their services on core activities that are needed by natural person credit unions, and address corporate governance issues. All of these changes are designed to prevent problems of the nature and magnitude that the credit union system is currently facing.

In closing, Mr. Chairman, Ranking Member Crapo and all the members of this Subcommittee, we appreciate your review of these issues today. Every day, credit unions reinforce their commitment to workers and a host of others seeking to better their quality of life by providing them loans on terms they can afford and savings rates that are favorable. We hope you agree that credit unions and other institutions that continue to do the right thing, despite impediments, should not be disadvantaged by the political process. We look forward to working with you to help ensure the credit union system continues to be a "safe haven" for the 92 million individuals and small businesses who look to their credit unions for financial services. I would be happy to respond to your questions.

SAFE HAVENS: CREDIT UNIONS EARN SOME INTEREST

The Wall Street Journal, March 15, 2009

By Jonnelle Marte

Cash isn't exactly flowing like it used to. The stock market can't find a bottom. Big banks have become wards of the government while smaller banks are failing at a rate of about one a week. Savers worry about the institutions where their cash is parked, while people who need to borrow scramble to find willing lenders.

Buffeted in every direction by the continuing financial Katrina, more and more savers and borrowers are finding a safe harbor in the sleepiest, most unexciting corner of the financial world: credit unions. Often, it's right in their office, maybe a couple of floors down or at the end of the hall.

Long a haven for cash-strapped workers, car buyers and Christmas-club savers, the nation's 8,000 credit unions are gaining new stature as reliable sources of lending in the tempest-tossed credit market.

Seeking Savers and Borrowers

They've also wooed consumers by offering a win-win combination of generally higher interest rates for savings accounts and lower rates for loans, when compared to most banks.

Tim Foley

Typical spreads: Right now, a 1-year certificate of deposit at a credit union pays about 2.29 percent versus 1.74 percent at a commercial bank, according to Datatrac, a financial research firm that analyzes interest rates for banks and credit unions. A home-equity line of credit at a credit union charges an average of 4.41 percent compared to 4.77 percent for banks—but banks charge slightly less for a 30-year fixed-rate mortgage with a 5.33 percent rate, compared with the 5.39 percent charged by credit unions.

Membership in credit unions rose to almost 90 million in 2008, from 85 million in 2004. And the loans on their books topped $575 billion in 2008, up from $539 billion in 2007. By comparison, 8,300 U.S. banks saw loans outstanding decrease $31 billion last year, to $7.876 trillion from $7.907 trillion in 2007.

Stephen Birkelbach joined the Community First Credit Union in Jacksonville, Fla., 3 years ago when he was shopping for a car. "Community First not only had the best rate," says Mr. Birkelbach, who at the time transferred over the accounts of his local carpet-cleaning business. "I was so impressed with the customer service and the up-front attitude I moved everything over to them."

Mr. Birkelbach financed a truck with the credit union a year later. Then he refinanced his mortgage in January. He says he couldn't find another financial institution that would match the 4.25 percent interest rate he got at his credit union.

Like the rest of the financial universe, credit unions can't help feeling pinched, but they've maintained stability and—so far—aren't being propped up with Federal money. (Although there is a plan to support 28 special "corporate" or "wholesale" credit unions that provide financing and other services to smaller "retail" credit unions.)

Only two retail credit unions have closed so far this year. Of the 15 credit unions that were liquidated in 2008, nine were due to real-estate problems, according to the National Credit Union Administration, the government agency that regulates federally insured credit unions.

"At this point the [credit union] industry is solid," says Karen Dorway, president and director of research for BauerFinancial, a firm that analyzes banks and credit unions.

Credit unions have largely avoided the banking world's turmoil by sticking to their plain-vanilla business model: taking in deposits from owner-members and lending the money back out to them. And they're writing more loan checks than they have in years—still mainly for home and auto loans, but for more business loans, too.

"Credit unions have not changed their standards so if you could get a loan 5 years ago, you can get a similar loan today," says Daniel Penrod, industry analyst for the California and Nevada Credit Union Leagues.

Loan Activity on the Rise

Loan growth has been robust—especially with first mortgages and used-auto loans. Last year's 7 percent growth in loans at credit unions was higher than the 2 percent growth seen in previous recessions, says Mike Schenk, senior economist for the Credit Union National Association, the industry trade association.

"We've been able to stay in the game," he says.

But that doesn't mean credit unions are immune to the troubled economy. Loan delinquencies are up—especially in housing-bust areas of Nevada, California, Arizona and Florida—but they are still far from the levels seen at most banks.

Nationwide, loan delinquencies for credit unions hit an estimated 1.45 percent in January, double the 0.68 percent rate from 2006, but less than half the 2.93 percent national delinquency rate for banks.

Here are few more things you may want to know:

Joining: Credit unions require members to have something in common, such as a neighborhood, school, workplace or church. Larger credit unions offer a full menu of banking services, from checking accounts to mortgages. Smaller credit unions may have more limited services. Most credit unions will let you open a savings account with just $25; but only members can take out loans. Use the online finder at *www.FindaCreditUnion.com*.

Deposit Insurance: The National Credit Union Administration is the Federal agency that regulates federally insured credit unions, which include all Federal credit unions and most State credit unions. The Federal insurance is through the National Credit Union Share Insurance Fund and the insurance limits are the same as at banks. As at banks, coverage is higher if the money is in different types of accounts, such as a regular share account and an individual retirement account.

Do some research: Compare credit unions and banks in your area by reviewing ratings at *Bankrate.com/brm/safesound/ss_home.asp* and *Bauerfinancial.com/btc_ratings.asp*. BankRate's reports are free but Bauer charges, with prices starting at $10. Both rate banks and credit unions by looking at qualities like capital ratio, loan delinquency and liquidity.

PREPARED STATEMENT OF STEPHEN J. VERDIER

SENIOR VICE PRESIDENT AND DIRECTOR OF CONGRESSIONAL RELATIONS GROUP, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

MARCH 19, 2009

Chairman Johnson, Ranking Member Crapo, members of the Subcommittee, I am Stephen J. Verdier, the Senior Vice President, and Director of Congressional Relations Group for the Independent Community Bankers of America (ICBA). I am pleased to represent the ICBA and its 5,000 community bank members atthis important hearing on "Current Issues in Deposit Insurance."

ICBA commends the Committee for conducting a hearing on deposit insurance issues at this critical time in our history. The current crisis demands bold action, and we recommend the following:

- ICBA strongly believes that now is the time for Congress and the FDIC to address the inequities between large and small banks in the deposit insurance system.

  - ICBA strongly believes Congress should require a systemic risk premium be assessed against the "too big to fail" institutions to compensate the taxpayers and the Federal Deposit Insurance Corporation (FDIC) fund for the risk exposure these companies represent because of their size and activities. Part of the premium could also be used to pay for the cost of improved regulation of the systemic risk institutions. The superior coverage received by depositors, other liability holders and even shareholders of "too big to fail" institutions alone justifies the premium.
  - The amount of assets a bank holds is a more accurate gauge of an institution's risk to the FDIC than the amount of a bank's deposits. Under the current system that assesses domestic deposits, community banks pay approximately 30 percent of FDIC premiums, although they hold about 20 percent of bank assets. And while community banks fund themselves 85–95 percent with domestic deposits, for banks with more than $10 billion in assets the figure is 52 percent. Thus, while community banks pay assessments on nearly their entire balance sheets, large banks pay on only half. ICBA believes that it would be fairer if the FDIC were to use assets minus tangible equity (to encourage higher levels of tangible equity) as the assessment base instead of domestic deposits. Congress should require this change.
  - Congress should also repeal a provision in the 2006 deposit insurance reform law that protects "too big to fail" banks from being assessed fairly for deposit insurance.
- In response to the strains on the Deposit Insurance Fund (DIF), the FDIC has proposed to more than double last year's base assessment rate and also to impose a special assessment of 20 basis points due on September 30, 2009. ICBA opposes this special assessment. When combined with the regular assessment rate for 2009, the special assessment will be detrimental to most community banks' earnings and capital and will adversely affect their ability to lend and serve their communities.
  - ICBA supports increasing the FDIC's standby line of credit with Treasury, as provided in S. 541, the Depositor Protection Act of 2009. According to FDIC Chairman Bair, the increased borrowing authority under S. 541 would allow the FDIC to reduce this special assessment to as much as one-half of the proposed rate.
  - ICBA appreciates Chairman Bair's commitment to a reduction in the special assessment, if S. 541 becomes law. Nevertheless, ICBA urges the FDIC to seek alternatives to the special assessment, such as borrowing from Treasury or the industry or issuing bonds, to temporarily fund the DIF, with the industry repaying the amount borrowed, with interest. This would keep needed capital within our communities for lending. The DIF will still be industry-funded if the FDIC uses its borrowing authority, but the industry would be able to spread the cost of funding the DIF over time.
- ICBA supports provisions in H.R. 1106, the Helping Families Save Their Homes Act, to make permanent the increase in deposit insurance coverage from $100,000 to $250,000.
- ICBA urges Congress to make permanent the unlimited coverage for transaction accounts, which is now temporarily provided by the FDIC under its Temporary Liquidity Guarantee Program. Both this program and the increase to $250,000 have not only bolstered depositor confidence in FDIC insured institutions, but they have helped community banks compete for deposits against "too big to fail" banks and money market mutual funds.
- ICBA supports a provision in H.R. 1106 to allow the FDIC to ensure holding companies with significant non-bank assets pay their fair share of any deficit in the FDIC's Temporary Liquidity Guarantee Program.

Deposit Insurance is Fundamental to a Sound Economy

Deposit insurance has been the stabilizing force of our nation's banking system for 75 years. It promotes public confidence by providing safe and secure depositories for both businesses and consumers. Some 85 to 90 percent of community bank funding comes from domestic deposits. As a result, the Federal deposit insurance system also provides important protection to the funding base for community banks.

A strong FDIC is a fundamental element of the American banking system and a sound economy. A strong FDIC gives the public confidence their deposits aresafe in the nation's 8,400 banks and savings associations. Unfortunately, there are inequities in the deposit insurance system that unfairly put community banks at a competitive disadvantage with respect to their larger competitors, particularly, the "too big to fail" banks.

Congress Should Address Inherit Inequities in the Deposit Insurance System

In the last twelve months, the Federal Government, faced with the most severe financial crisis since the Great Depression, has taken unprecedented measures to bolster a faltering financial services industry. While these actions were justifiable steps to protect the national economy, the past twelve months have exposed what community banks have always known to be true: the "too big to fail" banks enjoy a vastly superior form of protection from the Federal Government than the too-small-to-save community banks. The depositors of the "too big to fail" banks have unlimited deposit insurance coverage. They have no reason to fear a bank failure will diminish the amount of funds held in "too big to fail" banks because the Federal Government will not allow those banks to close. The protection for the "too big to fail" banks extends to other liability holders and often their shareholders. Yet, the "too big to fail" banks pay nothing extra for this superior coverage. ICBA strongly believes now is the time for Congress and the FDIC to address the inequities between large and small banks in the deposit insurance system.

Systemic Risk Premium

The government has dedicated more than $150 billion in taxpayer and FDIC funds to shore up the nine largest banks. ICBA strongly believes Congress should require a systemic risk premium be assessed against the "too big to fail" institutions to compensate the taxpayers and the FDIC fund for the risk exposure these companies represent because of their size and activities. Part of the premium could also be used to pay for the cost of improved regulation of the systemic risk institutions. The superior coverage received by depositors, other liability holders and even shareholders alone justifies the premium. As part of this effort, Congress should also repeal a provision in the 2006 deposit insurance reform law that protects these "too big to fail" banks from being assessed fairly for deposit insurance.

FDIC Assessment Base Must be Changed

Currently, the FDIC assesses deposit insurance premiums against all domestic deposits in banks and thrifts. This assessment base unfairly burdens communitybanks by requiring community banks to pay a disproportionately high share of deposit insurance premiums.

Bad assets, not deposits, cause bank failures, and all forms of liabilities, not just deposits, fund a bank's assets. The amount of assets that a bank holds is a more accurate gauge of an institution's risk to the FDIC than the amount of a bank's deposits. Under the current system that assesses domestic deposits, community banks pay approximately 30 percent of FDIC premiums, although they hold about 20 percent of bank assets. And while community banks fund themselves 85–95 percent with domestic deposits, for banks with more than $10 billion in assets the figure is 52 percent. Thus, while community banks pay assessments on nearly their entire balance sheets, large banks pay on only half.

ICBA believes it would be fairer if the FDIC were to use assets minus tangible equity (to encourage higher levels of tangible equity) as the assessment base instead of domestic deposits. Changing the assessment base does not change the amount of revenue the FDIC will receive. It only changes how the premium assessments are distributed among FDIC institutions. Under the asset-oriented assessment base, community banks would bear their proportionate share, orabout 20 percent of deposit insurance premiums rather than the current 30 percent. If the assessment base were broadened, as urged by ICBA, the special assessment would be reduced to 12 basis points.

In connection with the proposed special assessment, the FDIC has asked for comments on whether, for purposes of the special assessment only, the FDIC should use the asset-oriented assessment base. ICBA strongly believes the FDIC should use the asset-oriented assessment base for any special assessment and Congress should make the asset-oriented assessment base a permanent part of the deposit insurance system for all assessments.

Special Assessment Issues and Borrowing Authority under S. 541, the Depositor Protection Act of 2009

The current severe recession has put pressure on the FDIC's Deposit Insurance Fund due to bank failure losses. The FDIC projects further losses could severely strain the FDIC's resources, potentially undermining public confidence in Federal deposit insurance. The FDIC has always been funded by the banking industry, and community banks are willing to do their part to recapitalize the DIF to safer levels. However, the FDIC must maintain a balance between recapitalizing the DIF and ensuring assessments charged to banks for deposit insurance do not reach counterproductive levels that would divert capital needed for lending to promote economic recovery in our communities.

In response to the strains on the DIF, the FDIC has proposed to more than double last year's base FDIC assessment rate and also to impose a special assessment of 20 basis points due on September 30, 2009. These assessments would increase the DIF reserves by $27 billion, with the special assessment bringing in about $15 billion by itself. ICBA opposes this special assessment. When combined with the regular assessment rate for 2009, the special assessment will be detrimental to most community bank's earnings and capital and will adversely affect their ability to lend and serve their communities. The FDIC itself estimates the 20-basis-point special assessment would reduce aggregate 2009 pre-tax income for profitable banking institutions by 10 to 13 percent, increase losses for non-profitable banks by 3 to 6 percent and reduce the industry's aggregate year-end capital approximately 0.7 percent. A survey of ICBA members reveals this estimate is much too low. Thirty-two percent of community banks estimate the special assessment will consume 16–25 percent of their 2009 earnings; 17 percent estimate it will consume 26–40 percent.

Community banks are being unfairly penalized with this assessment. They did not participate in the risky practices engaged in by large Wall Street institutions that led to the economic crisis, yet they are being penalized by having to pay this onerous special assessment.

ICBA urges the FDIC to seek alternatives to the special assessment, such as borrowing from Treasury or the industry or issuing bonds, to temporarily fund the DIF, with the industry repaying the amount borrowed, with interest. The DIF will still be industry-funded if the FDIC uses its borrowing authority, but the industry would be able to spread the cost of funding the DIF over time. In addition, the FDIC should seek to shift the cost of replenishing the DIF to those institutions responsible for the economic crisis and away from community banks.

ICBA supports the Depositor Protection Act of 2009, S. 541 introduced by Banking Committee Chairman Dodd, Senator Crapo and others. The bill would increase the FDIC's standby line of credit with the Treasury from $30 billion to $100 billion. S. 541 would also temporarily allow the FDIC to borrow up to $500 billion with the concurrence of the Federal Reserve and the Secretary of the Treasury, in consultation with the President. According to FDIC Chairman Bair, the increased borrowing authority under S. 541 would allow the FDIC to reduce this special assessment to as much as one-half of the proposed rate.

ICBA appreciates Chairman Bair's commitment to a reduction in the special assessment, if S. 541 becomes law. We are also encouraged by reports that the FDIC may devote some fees received in connection with its Temporary Liquidity Guarantee Program to shoring up the DIF now, rather than waiting to transfer TLGP fees to the DIF at the end of the TLGP. However, we still believe it is in the best interest of our communities, if the FDIC were to find an alternative to the special assessment in order to keep as much capital in the community banking system for lending.

ICBA also urges the FDIC to use the asset-oriented assessment base for all deposit insurance assessments, including any special assessment, for the reasons cited above.

Coverage Levels

ICBA Supports Making the $250,000 Coverage Level Permanent

The Emergency Economic Stabilization Act temporarily increased deposit insurance coverage from $100,000 to $250,000 through December 31, 2009. Community banks face stiff competition for deposits, the primary source of community bank funding. The additional coverage has not only bolstered depositor confidence in FDIC-insured institutions, but it has helped community banks compete for deposits against "too big to fail" banks and money market mutual funds. The additional coverage has helped community banks be a part of solution to the credit crisis caused in large part by the activities of larger financial institutions. ICBA supports provisions in H.R. 1106, the Helping Families Save Their Homes Act of 2009 to make the increase permanent.

ICBA Supports Covering All Amounts in Transaction Accounts Permanently

As part of the FDIC's efforts to promote stability and liquidity in banks, the agency established an optional guarantee of all amounts above $250,000 in transaction accounts in FDIC-insured institutions under its Temporary Liquidity Guarantee Program (TLGP). The program provides a guarantee of all sums in non-interest bearing transactions accounts and very-low interest transactions accounts (interest at not more than 50 basis points per annum). More than 6,000 banks, including thousands of community banks, have chosen to participate in this program.

The program, like the $250,000 insurance level, has been a useful tool for community banks competing with larger banks—including the "too big to fail" banks—for commercial deposits.

Participation in the program also frees up capital and resources used by community banks to purchase Treasuries and other securities for repurchase agreements that secure commercial and public deposits. Community banks can use the freed up resources to promote lending in their communities. ICBA urges Congress to include permanent unlimited coverage for non- and low-interest bearing transaction accounts in deposit insurance legislation.

ICBA Supports a Fairer Assessment Method under Systemic Risk Provisions

H.R. 1106 addresses another issue ICBA has raised with respect to the FDIC's TLGP. The FDIC used its systemic risk authority to establish the TLGP. The net costs of any activity under the systemic risk authority must eventually be borne by all FDIC-insured banks and thrifts through an assessment based on the institutions' assets minus equity. The statute does not expressly authorize the FDIC to assess non-bank and non-thrift affiliates, including holding companies. The Debt Guarantee portion of the TLGP has been extended to holding companies because much of the bank debt is issued at the holding company level. However, should a special assessment be needed to make up for any deficit in the TLGP, the FDIC cannot levy an assessment against the non-bank assets of a holding company. H.R. 1106 would allow the FDIC to ensure holding companies with significant non-bank assets pay their fair share of any deficit in the TLGP. ICBA appreciates the support of the FDIC for this provision. We urge the Senate to include this change in any deposit insurance legislation.

Mandatory Rebates

The letter of invitation asks us to address mandatory rebates in the FDIC deposit insurance system. The 2006 deposit insurance reform legislation requires the FDIC to refund one-half of all amounts in the DIF in excess of the amount needed to keep the DIF's reserve ratio at 1.35 percent (and all of the excess over 1.50 percent). The legislation also gives the FDIC flexibility by allowing the FDIC to suspend a refund (*i.e.,* rebate), if the FDIC finds there is a significant risk of loss to the fund within the next year. Since under the FDIC's restoration plan the DIF would not reach a 1.15 percent reserve ratio until 7 years from now, at the earliest, ICBA does not believe the rebate provisions are a near-term issue. At some later point, it could be appropriate for Congress to reexamine these provisions. We note the rebate provisions have never been implemented because the DIF has not been at the trigger levels since the 2006 legislation was adopted.

Conclusion

Congress should address current inequities in the deposit insurance system that put community banks at a competitive disadvantage. Congress should adopt asystemic risk premium to compensate for the risk "too big to fail" banks create for taxpayers and the FDIC. Congress should require a fairer assessment base for deposit insurance by requiring assessments against bank assets minus tangible equity.

In addition, the Senate should adopt the increase in borrowing authority provided to the FDIC by S. 541. This would allow the FDIC more flexibility to recapitalize the DIF and avoid a special assessment. The Senate should make permanent the increase in deposit insurance limits to $250,000 and make the unlimited guarantee of transactions accounts permanent. These increases in coverage have helped bolster depositor confidence and helped community banks compete with "too big to fail" banks and money market mutual funds. The Senate should also adopt the fairer method for assessing for deficits in the FDIC's TLGP found in H.R. 1106. These provisions in H.R. 1106 will ensure holding companies with significant non-bank assets pay their fair share of any deficit.

ICBA appreciates the opportunity to testify today, and looks forward to working with this Committee on these vital issues.

PREPARED STATEMENT OF DAVID J. WRIGHT

CEO, SERVICES CENTER FEDERAL CREDIT UNION,
ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

MARCH 19, 2009

Introduction

Good afternoon, Chairman Johnson, Ranking Member Crapo and Members of the Subcommittee. My name is David Wright and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the CEO of Services Center Federal Credit Union, headquartered in Yankton, South Dakota. I have been CEO of Services Center FCU for the last 33 years. Services Center FCU is a low-income designated credit union operating in six counties. Four of the counties are in southeastern South Dakota and two are in northeastern Nebraska. This is a very rural part of the country. One of the counties has an average population of just 6 people per square mile. My credit union has some 6,200 members and assets of $37.5 million. Services Center FCU was selected as NAFCU's Credit Union of the year in 1990 and again in 2008.

I was selected as NAFCU's credit union professional of the year in 1993 and have served on numerous committees for the association, including the NAFCU Awards Committee, Membership Committee and Regional Advisory Committee.

NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU-member credit unions collectively account for approximately 65.4 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding deposit insurance issues for America's credit unions.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the Federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need-a niche that credit unions fill today for nearly 89 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 75 years have passed since the Federal Credit Union Act (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 7,800 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions, to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, Federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions have grown steadily in membership and assets, but in relative terms, they make up a small portion of the financial services marketplace. Federally insured credit unions have approximately $813.4 billion in assets as of year-end 2008. By contrast, Federal Deposit Insurance Corporation (FDIC) insured institutions held $13.9 trillion in assets and last year grew by an amount that exceeds the total assets of credit unions. The average size of a Federal credit union is $92.5 million compared with $1.673 billion for banks. Over 3,200 credit unions have less than $10 million in assets. The credit union share of total household financial assets is also relatively small, just 1.4 percent as of December 2008.

Size has no bearing on a credit union's structure or adherence to the credit union philosophy of service to members and the community. While credit unions may have grown, their relative size is still small compared with banks. Even the world's largest credit union, with $36.4 billion in assets, is dwarfed by the nation's biggest banks with trillions of dollars in assets.

America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA—P.L. 105–219) a decade ago. In the "findings" section of that law, Congress declared that, "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means . . . [and it] continue[s] to fulfill this public purpose."

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided but also—more importantly—to quality and cost. Credit unions are second to none in providing their members with quality personal financial service at the lowest possible cost.

While the lending practices of many other financial institutions led to the nation's subprime mortgage debacle, data collected under the *Home Mortgage Disclosure Act* (HMDA) illustrates the value of credit unions to their communities. The difference between credit unions and banks is highlighted when one examines the 2007 *HMDA* data for loans to minority applicants with household incomes under $40,000. According to the 2007 *HMDA* data, banks have a significantly higher percentage of mortgage purchase loans (20.8 percent) charging at least 3 percent higher than the comparable Treasury yield for minority applicants with household income under $40,000. Credit unions, on the other hand, had only 4.4 percent of their loans in that category.

The National Credit Union Share Insurance Fund (NCUSIF)

I am pleased to share with the Subcommittee NAFCU's assessment of how the National Credit Union Share Insurance Fund (NCUSIF) is structured, and our thoughts on current issues in deposit insurance.

As you may know, the primary reason credit unions came together in 1967 and formed NAFCU was to lobby Congress for the establishment of a Federal insurance fund for credit unions—a goal that was realized in 1970. Like the credit unions whose accounts it insures, the NCUSIF is itself *cooperative* in nature. Unlike FDIC insurance, which was initially funded with taxpayer dollars from the United States Treasury as seed-money, every dollar that has gone into the NCUSIF since its inception has come solely from the credit unions it insures.

The NCUSIF was originally structured in the same manner as the FDIC, *i.e.,* the source of funding was based on premium collected from insured institutions. In 1985 the amount of money at NCUSIF began to dwindle because of mounting losses, low earnings on investments and extensive growth in credit union insured savings. Credit unions realized that NCUSIF needed to be recapitalized and in 1985 every insured credit union made a deposit of 1 percent of its members insured savings to NCUSIF. By making this deposit, the mutual or cooperative structure of NCUSIF began. As of January 2009 NCUSIF has $7.5 billion in total assets with a total equity of $7.3 billion. As a percentage of total insured savings NCUSIF has an equity ratio of 1.28 percent.

Credit unions insured by the NCUSIF are required by statute to maintain a deposit equal to 1 percent of its insured shares in the insurance fund (12 USC 1782(c)(1)(A)(i)). This "insurance deposit" is adjusted annually in the case of a credit union with total assets of not more than $50 million, and semi-annually for those credit unions with total assets of $50 million or more (12 USC 1782(c)(1)(A)(iii)). The National Credit Union Administration (NCUA) Board has a statutory obligation to establish a "normal operating level" for the fund which "shall not be less than 1.2 percent and not more than 1.5 percent" (12 USC 1782(h)(4)). If the equity level of the NCUSIF is in the 1.2 percent to 1.3 percent range, the NCUA Board may assess a premium in order to restore the equity level back to the normal operating level. If it falls below 1.2 percent, the statutory floor, the NCUA Board is required to assess an insurance premium to restore the fund to a 1.2 percent equity level (12 USC 1782(c)(2)(C)).

While the NCUSIF is now fundamentally structured differently than FDIC insurance, we believe it is imperative that there be parity in coverage levels between the two funds. Failure to do so could create public confusion and concern over the safety of their deposits and destabilize the current system. We believe that an important aspect of this parity has to include giving the NCUA the authority it needs to take actions to maintain the stability of the fund.

Current Challenges in Deposit Insurance

As part of the *Emergency Economic Stabilization Act* of 2008, Congress increased the coverage on FDIC and NCUSIF insured accounts to $250,000 through December 31, 2009. This change serves to maintain public confidence in insured depository institutions in the current economic environment. This temporary increase prohibited the NCUA from using this higher amount to calculate any insurance premiums. NAFCU urges the Senate to enact legislation to permanently extend this increase. Failure to do so could lead to decreased confidence in financial institutions and lead people to withdraw funds, creating additional challenges for financial institutions.

While credit unions have faired better than most financial institutions in these turbulent economic times, many have been impacted, through no fault of their own, by the current economic environment.

In particular, the corporate credit union system has felt the biggest impact. In examining the corporates, NCUA notes that, "Nearly 80 percent of the securities held in the corporate credit union system remain highly rated, but a portion of the securities has been downgraded below investment grade due to underlying collateral performance." The expected losses from these investments by corporate credit unions are approximately $4.7 billion. It is with these facts in mind that on January 28, 2009, the NCUA Board approved a series of actions regarding the corporate credit union system.

Among the actions taken, NCUA:

- Guaranteed the uninsured shares of "all" corporate credit unions through February 2009 and established a voluntary guarantee program for the uninsured shares of 23 corporate credit unions through December 31, 2010 (the guarantee will cover all shares, but does not include paid in capital and membership capital accounts);
- Issued a $1 billion capital note to U.S. Central Federal Credit Union;
- Issued an Advance Notice of Proposed Rulemaking (ANPR) on restructuring the corporate credit union system; and,
- Will be declaring a premium assessment to restore the NCUSIF equity ratio to 1.30 percent, to be collected in late 2009.

The resulting impact on NCUSIF will be approximately $4.7 billion, dropping the NCUSIF's equity ratio from the current 1.28 percent equity ratio (as of January 2009) to an estimated 0.49 percent. Because credit unions follow GAAP accounting there was an immediate impairment to the 1 percent deposit. FICUs had to recognize this impairment by setting aside enough money in a contingency liability account to bring the deposit at NCUSIF back to 1 percent level. As previously noted, the FCUA requires NCUA to assess a premium when the fund's equity ratio drops below 1.2 percent. That premium assessment must occur before the end of 2009 and NCUA intends to bring the NCUSIF equity ratio up to 1.30 percent by assessing a premium of 0.3 percent later this year. As part of the same actions on January 28th, NCUA also announced a systematic review of the $64 billion in mortgage backed securities held by corporate credit unions in order to refine the ultimate liability and subsequent charge to each credit union. That review was recently completed, but results have not yet been made public.

The consequence is that over 5,350 federally insured credit unions (approximately 68.6 percent of all FICUs) will be in the "red" in 2009. Approximately 203 FICUs will be downgraded in PCA (Prompt Corrective Action) levels, which could lead to further NCUA actions to help stabilize those institutions.

NAFCU's analysis of 4th quarter call report data on credit unions indicates that, absent legislation, FICU member services will be adversely impacted in 2009. Such adverse impacts could include increased fees, higher rates, lower dividends, and/or decreased lending. In fact, as FICUs will suffer a reduction in $4.7 billion in capital in 2009, the impact on consumer and business lending alone (based on NCUA estimates that credit unions make approximately $7 worth of loans for every $1 in capital) could total $33B, further adversely impacting the economy as the Nation strives to rebound from its economic malaise.

Proposed modifications to the NCUSIF

NAFCU urges the Senate to enact an amendment that would amend the *FCUA* to establish a restoration plan period for the NCUSIF. This would provide the NCUA Board with the authority to replenish the NCUSIF by restoring the equity ratio through a restoration plan which is consistent with the *Federal Deposit Insurance Act* and could extend the replenishment over a period of up to 8 years versus the current 1-year timeframe. H.R. 1106 included such an amendment that would extend the repayment period over 5 years. Such an amendment would allow NCUA to assess premiums over 8 years to restore the fund from an equity ratio of 1.0 percent to 1.3 percent. Because credit unions must follow GAAP, and it is an impairment, restoration of the fund to the 1.0 percent deposit must, however, still occur in the same year.

NAFCU also strongly urges the Senate to provide the NCUSIF an increase in borrowing authority from the Treasury Department. This change is long due since the current level of $100 million was established in 1971, and has not been modified for the growth of credit unions and their member deposits over time. H.R. 1106 would increase the borrowing authority to $6B.

Furthermore, NAFCU encourages the Senate to provide systemic risk authority to NCUA, on a similar basis to that provided to FDIC. This would be a very important step to address systemic emergencies when the authority provided under Section 208 of the *FCUA* is inadequate. The FDIC has pointed out specific provisions in its Act to provide unlimited deposit insurance coverage for non-interest bearing transaction accounts. Providing NCUA with parallel authority to the FDIC to address systemic risk under extreme circumstances is an important step to provide consumer confidence in these very challenging economic times.

NAFCU believes that the NCUA and Congress should work to find additional ways to help stabilize the corporate credit union system outside of using the NCUSIF. One such approach could be to use the Central Liquidity Facility (CLF) for credit unions. Established by the *FCUA* and funded by Congress, the CLF provides loans to natural-person credit unions to meet their liquidity needs in turbulent times. We believe some changes to the *FCUA* to allow the CLF to help the corporate credit union system could help address the current situation, and provide relief from the current pressure NCUA's actions have had on the NCUSIF. In particular, NAFCU supports an amendment to the *FCUA* which would allow the NCUA to use funds from the CLF directly to help the liquidity and capital needs of all credit unions, including corporate credit unions. This change, if coupled with some form of flexibility on OTTI accounting, would go a long way to helping credit unions. We would welcome the opportunity to work with the Committee to address this issue. Some suggested language to accomplish this is outlined below.

Proposed Amendments to the Federal Credit Union Act (12 U.S.C. §§ 1751–1795)

Section 1795

The Congress finds that the establishment of a National Credit Union Central Liquidity Facility is needed to improve general financial stability by meeting the *liquidity and capital* needs of credit unions*,* and thereby encourage savings, support consumer and mortgage lending, and provide basic financial resources to all segments of the economy.

Section 1795a

(1) "liquidity needs" means the needs of credit unions ~~primarily serving natural persons for—~~

(3) . . . Reserves shall not be considered as part of surplus*;*

(4) "member" means a Regular or an Agent member of the Facility*; and*

(5) "capital needs" means cash available necessary to meet the needs of credit unions—

(A) to increase net worth or capital; and

(B) to stabilize the credit union system, as determined by the Board.

Section 1795c:

Membership.—(a) A credit union ~~primarily serving natural persons~~ may be a Regular member . . . "

Section 1795e

~~Extension of Credit~~ ***Provision of funds.***

(a)(1) A member may apply for an extension of credit from the Facility to meet its liquidity needs. The Board shall approve or deny any such application within five working days after receiving it. The Board shall not approve an application for credit the intent of which is to expand credit union portfolios. The Board may advance funds to the member on terms and conditions prescribed by the Board after giving due consideration to creditworthiness.

(2) A member may apply for the advancement of funds by the Facility to meet its capital needs under such terms and conditions as the Board shall prescribe to allow the funds to be categorized as net worth or capital.

Additional Section of the Legislation

Recoupment.

Upon the expiration of the 5-year period beginning upon the date of the enactment of this Act, the National Credit Union Administration Board shall:

(a) submit a report to Congress on the utilization of the authority conveyed by Section 1795e(a)(2) of the Federal Credit Union Act; and
(b) establish a plan under Board regulations implementing this section, to recoup, over a period of time, necessary amounts to ensure that Section 1795e(a)(2) does not add to the deficit or national debt.

Conclusion

In conclusion, NAFCU continues to support an independent NCUSIF. Furthermore, we believe Congress must make the temporary increase in deposit insurance coverage to $250,000 permanent. Actions by the NCUA to help stabilize the corporate credit union system using the NCUSIF threaten to put a strain on natural-person credit unions. We believe legislative relief in the form of extending the repayment time, increasing borrowing authority for the NCUSIF and modification of the *FCUA* as it relates to the CLF are all steps that will help the continued stability of the NCUSIF. Thank you for the opportunity to appear before the Subcommittee today, I welcome any questions that you may have.