

Extending Full Coverage of Noninterest Bearing Transaction Accounts Beyond 2012

Discussion Document

Unlimited FDIC insurance for non-interest bearing transaction accounts (including IOLTA accounts)—provided under the Dodd-Frank Act (DFA) Section 343—***expires at end of this year***. Extending this would require Congressional action and full support of the FDIC. ABA is seeking industry feedback on extending this coverage. This discussion draft lays out the background, data, issues to consider and questions to be answered.

Background:

Section 343 was an extension of the Transaction Account Guarantee (TAG) introduced by the FDIC on August 13, 2008. TAG was designed to strengthen confidence and encourage liquidity in the banking system at the height of the financial crisis. It was voluntary, with participants paying 10 bp on deposits over the standard coverage level. It was extended twice by FDIC and changed to a risk-based pricing regime (with 15, 20, and 25 bp assessments) in recognition that weaker banks would be more likely than healthier ones to elect to participate. DFA moved to a compulsory system, and FDIC chose to cover these added deposits as part of the regular assessments (i.e., no added a la carte pricing).

Data:

- Estimated insured deposits, since Q3/2008, increased 49% from \$4.5 trillion to \$6.8 trillion – which includes both the increase from \$100k to \$250k and the TAG program.
- \$1.2 trillion exceed the basic \$250,000 limit and are fully insured through 2012. This represents a 21% increase in FDIC exposure (from \$5.57 trillion in insured deposits to \$6.77 trillion).
- Of the \$1.2 trillion, banks under \$1 billion in assets hold \$41 billion or 3.4%, with an average account size of \$691,000 and an average number of 14 accounts per bank.
- Deposits with Section 343 temporary coverage funded 4% of assets at banks with less than \$10 billion in total assets and 10.1% of assets at banks with more than \$10 billion.
- Since Section 343 replaced TAG in December 2010, the median deposit growth rate for banks under \$1 billion was 2.8%; \$1-\$10 billion, 3.3%; \$10-\$100 billion, 7%; over \$100 billion, 14.3%.

Issues and Questions:

Benefits of the Program

Many banks report benefiting significantly from the TAG program as liquidity was a key concern throughout the recession and financial crisis. While economic conditions have improved, some areas continue to suffer from the downturn. Customers value the FDIC protection, particularly since interest rates are so low.

Questions:

- Is this program still needed to maintain liquidity?
- Is this program still needed to meet customer demand for safety? Is that a temporary need?
- Do you expect a significant run-off of deposits if the program ended?
- Are there adequate funding substitutes (e.g., FHLB Advances or reciprocal deposits)?
- Would these deposits leave the bank quickly as rates rise? What implication does this have for interest rate risk?

Cost of Extending the Program

Although this coverage is included in general assessments, banks pay for it in several ways:

- Higher costs in bank failures (as the FDIC must pay out more insured deposit claims and receive lower premiums from acquirers for all deposits). Bank failure costs were about 3.7% higher due to the TAG program. This is about \$250 million for the failures in 2011.
- It takes longer to reach the minimum and designated reserve ratio, since the reserve ratio is calculated as the fund-to-insured deposits. We estimate the fund would have to be \$15 billion larger to reach 1.35% with the additional coverage and \$23 extra to reach 2.00% (the designated reserve ratio). As a point of reference, banks paid about \$13.7 billion in premiums in 2011.

Questions:

- All costs considered, are the benefits worth the costs?
- Is there a moral hazard risk for deposits to flow to weak institutions?
- Do healthy banks subsidize these risks?

Political considerations

Since this requires Congressional action to extend this program, it raises several issues, including the fact that it is an election year making all bills difficult to pass; it opens up DFA (which would be resisted on principle by some); and it requires the full support of the FDIC. It might also be viewed as another handout to the industry or a sign of continued weakness, and could be an avenue for additional anti-bank legislation, such as credit union business lending, extension of Durbin to credit cards, or additional regulations.

Outside of banks that support an extension, it will also have other supporters, particularly businesses that value the coverage for payroll and other large accounts. It will also have opponents, including money market funds that do not have federal guarantees or insurance coverage. Money market funds were granted temporary full protection at the height of the crisis, but that was allowed to expire. Private firms that may offer alternatives to protect deposits beyond the \$250,000 limit would likely oppose extending this coverage.

Question:

- Do you support an extension of Section 343 coverage?