

COMPARING FUTURE NCUA AND FDIC ASSESSMENTS

Executive Summary

The administrators of the two federal deposit insurance funds in the U.S. recently took actions and announced plans that provide a clear picture of their intentions for fund management over the coming several years. NCUA announced a 2010 NCUSIF premium of 12.4 basis points (bp), which along with the earlier 13.4 bp Corporate Stabilization Fund assessment brought the total for the year to 25.8 bp, and also brought the fund's equity ratio to its normal operating level of 1.3% of insured shares. NCUA also announced it plans to deal with the "legacy assets" of five conserved corporates over the coming eleven years, and disclosed estimates of assessment ranges for 2011. At its October Board meeting, the Federal Deposit Insurance Corporation (FDIC) updated the condition of the Bank Insurance Fund from minus 30 bp to minus 28 bp of insured deposits, and announced a plan to impose sufficient assessments to eventually raise the fund's reserve ratio to 2.5%.

Following more than a decade of negligible assessments, both funds have imposed significant levies in the past three years. From 2008 on, FDIC's assessments have totaled 47 bp of total deposits, which is equivalent to 52 bp on insured deposits. Over the same period, NCUA's total assessments have totaled about one fifth less, at 41 bp of insured shares.

Looking ahead to the next few years, both federal deposit insurance funds will have to impose significant assessments on their insured institutions to restore their funds. For FDIC, the Bank Insurance Fund (BIF) must be replenished. For NCUA, the NCUSIF does not need replenishment, but the Corporate Stabilization Fund must be repaid.

From 2011 through 2021, the remaining term of the NCUA Corporate Stabilization Fund, combined NCUA assessments are expected to average about 8 bp of insured shares per year, or a total of 90 bp. Over the same period, FDIC assessments are expected to average about 13 bp of insured deposits for a total of 144 bp, or 50 percent greater than the NCUA costs.

Both sets of projections of future FDIC and NCUA assessments are estimates based on FDIC's and NCUA's current expectations about future losses from failed institutions and the performance of the Stabilization Fund's legacy assets. If the economic recovery turns out to be very weak, or even slows to a double dip recession, future assessments at both funds will be greater than these estimates. Conversely, if the economy surprises on the strong side, current expectations of future losses will turn out to have been excessive, and future assessments at both funds will be less than these estimates.

The rest of this white paper provides a further description of the condition of the two funds, and the derivation of the estimates of future assessments.

Introduction

The administrators of the two federal deposit insurance funds in the U.S. recently took actions and announced plans that provide a clear picture of their intentions for fund management over the coming several years. Although these are only plans, and the actual outcomes for both funds depend on the future course of the economy and its effect on the condition of insured institutions, the announcements allow a comparison on the likely costs to be borne by insured credit unions and banks. This white paper compares these costs from the point of view of a typical credit union, i.e., what it can expect to pay in NCUA assessments compared to what a bank with a similar balance sheet could expect to pay in FDIC assessments. The analysis takes into account the more complicated structure of FDIC premium assessments.¹

Recent Actions and Announcements by NCUA

Over the past several months, the National Credit Union Administration (NCUA) took the following actions pertaining to the National Credit Union Share Insurance Fund (NCUSIF) and the Corporate Stabilization Fund:

- In June, assessed a 2010 Corporate Stabilization Fund assessment of 13.4 basis points (bp).
- In September, assessed a 2010 NCUSIF premium of 12.42 bp, bringing the fund's equity ratio to its normal operating level of 1.3% of insured shares.
- The combined assessments for the year are therefore 25.82 bp of insured shares.
- In September, conserved three more corporate credit unions, in addition to the two conserved last year, and announced a plan to deal with the "legacy assets" of the five conserved corporates with the following implications:
 - Roughly \$50 billion of legacy assets will be funded by \$35 billion of guaranteed notes, with final maturities ranging to 2021.
 - This funding is based on expected ultimate credit losses of around \$15 billion on the \$50 billion of legacy assets. Of the \$15 billion of estimated losses, \$6.9 billion has already been paid (\$5.6 billion from extinguished capital at the five conserved corporates and \$1.3 billion paid by credit unions in previous assessments this year and last year.) That leaves \$8.1 billion yet to be paid by credit unions (to be assessed by NCUA) over the remaining term of the Corporate Stabilization Fund.
 - Because the notes funding the legacy assets will have maturities to 2021, the remaining term of the Corporate Stabilization Fund was extended from five to eleven years.
- In November, announced estimated ranges for 2011 assessments of 0 to 10 bp for the NCUSIF premium and 20 to 25 bp for the Corporate Stabilization assessment.

Recent Actions and Announcements by FDIC

- At its October Board meeting, the Federal Deposit Insurance Corporation (FDIC) updated its estimate of the condition of the Bank Insurance Fund (BIF), and proposed a long-term plan for management of the fund, consistent with changes to FDIC's statutory authorities in the Dodd-Frank Wall Street Reform Act.²

¹ NCUA assesses a flat rate, and bases it only on insured shares and deposits. FDIC assessments depend on the risk profile of the bank, and currently range from as little as 7 bp to as high as 77.5 bp. FDIC assessments are based on total (not just insured) deposits (subject to a few possible adjustments), and will include a special FICO premium for most of the rest of the decade.

² FDIC's analysis and description of the Restoration Plan can be found in an October 14, 2010 memo from FDIC staff to the Board at www.fdic.gov/deposit/insurance/memo_2010_10_14.pdf

- Because of reduced estimates of insurance losses for 2010, FDIC’s reserve ratio has risen from minus 38 bp of insured deposits as of March 2010 to minus 15 bp as of September. This, coupled with the extension of the time for the fund to reach the Designated Reserve Ratio (DRR, the target level), from 2016 to 2020, allowed the FDIC to announce the suspension of a three basis point assessment increase, previously planned for the first quarter of 2011.
- The proposed fund management plan takes into account the following statutory changes in the Dodd Frank Act:
 - Raises the DRR to 1.35% from 1.15%, and removes the upper limit on the DRR (formerly capped at 1.5%).
 - Requires that the fund ratio reach 1.35% by 2020 (from the previous target of 1.15% by 2016).
 - Requires that only banks with over \$10 billion in assets be assessed the amount necessary to raise the reserve ratio from 1.15% to 1.35%.
 - Eliminates the requirement that FDIC pay dividends when the fund is between 1.35% and 1.5%.
 - Allows, but does not require, the fund to pay dividends when the reserve ratio exceeds 1.5%.
- Based on its new authorities, and in response to the recent financial crisis, FDIC is proposing a new fund management plan with the following two goals:
 - That fund assessments be stable and predictable over the long term, and not subject to large increases during periods of financial stress.
 - That the fund balance remain positive, even during times of a banking crisis.
- To achieve these goals, FDIC’s plan would gradually increase the fund’s reserve ratio to a level high enough to withstand a banking crisis, without substantial premiums during such a crisis. FDIC estimates that the fund ratio necessary to meet these requirements is 2.5% of insured deposits.
- According to FDIC’s analysis, this long term goal would be reached by maintaining current assessment rates until the fund reaches 1.15% (around 2018), then charging a special, short-term premium to banks with over \$10 billion in assets to raise the fund ratio to 1.35%, then continuing to charge all banks premiums at reduced rates as the fund ratio passes through specific target ranges until the ratio reaches 2.5% as follows:

Planned FDIC Base Assessment Rates

For Banks in Risk Category 1

Whenever the FDIC’s Reserve Ratio is:	Base Assessment Range ³ (basis points of total deposits)	Expected Period this Rate Will be in Effect
Below 1.35%	12 – 16	Until 2018
1.35% to 2%	8 – 12	Until 2027
2% to 2.5%	6 – 10	Not specified
Over 2.5%	4 – 8	Not specified

³ These are “base assessment rate” ranges for banks deemed to be in Risk Category 1, the lowest risk category. Banks in this risk category must be adequately capitalized and have a CAMELS code of 1 or 2. Actual assessment rates for banks in this risk category could be 5 bp lower or 8 bp higher, for a total possible range of 7 bp to 24bp, depending on a bank’s issuance of unsecured or secured debt.

- Assessment rates for banks that are not adequately capitalized, or that have CAMELS codes of 3, 4 or 5 would be substantially higher than the ranges shown in the table, as high as 77 bp. However, FDIC reports that in times other than during a financial crisis, the average assessment rate is about 1 bp above the lower end of the Risk Category 1 ranges shown above. Thus, the most likely base assessment rate to be faced by a bank for the next several years is 13 bp of total deposits.
- If FDIC approves the proposed plan, which is now out for comment, banks would continue to pay premiums at current elevated levels until 2018, followed by significant, but reduced premiums indefinitely.

Comparing Recent NCUA and FDIC Assessments

Prior to 2008, both NCUA and FDIC assessments had been negligible for over a decade. Since then, FDIC has assessed total premiums, including the FICO assessment, of 47 bp (5 bp in 2008, 24 bp in 2009, and at an annual rate of 18 bp so far in 2010). Because FDIC assessments are based on total deposits rather than insured deposits, the total of 47 bp would be equivalent to a credit union paying 52 bp of insured shares.⁴

Since 2007, NCUA has assessed total premiums, including the Corporate Stabilization assessments, of 41 bp (0 in 2008, 15 bp in 2009, and 26 bp in 2010).

Therefore, on an equivalent basis (based on insured shares) over the past three years, total costs for credit unions have been about one fifth lower than for FDIC insured institutions: 41 bp of insured shares at credit unions and 52 bp of insured deposits at banks. Viewed the other way, FDIC costs have been about 25% higher than NCUA's. Comparable assessment rates are shown in the following table:

Recent FDIC vs. NCUA Assessments

Expressed as Basis Points of Insured Shares/Deposits

	FDIC	NCUA
2008	6	0
2009 ⁵	27	15
2010	19	26
Total	52	41
Average	17	14

⁴ In 2008 and 2009, insured shares at credit unions were about 88% of total shares. With the increase in the insurance limit to \$250,000, in 2010 credit union insured shares are about 96% of total shares. Had a credit union paid FDIC assessments over the past three years at the rate of 47 bp of total shares and deposits, it would have been equivalent to a rate of about 52 bp on insured shares.

⁵ Late in 2009, FDIC required insured institutions to prepay their assessments for 2010, 2011, and 2012. This was to meet FDIC's cash flow needs. Only the 2009 assessments were expensed in 2009. The remaining prepaid assessments will be expensed as they are assessed in 2010, 2011, and 2012. The 29 bp shown in the table represents only the amount expensed in 2009. An additional \$42 billion, or 56 bp of total deposits, was collected as prepaid assessments, equivalent to 64 bp of insured deposits. Therefore, the total amount of cash provided to FDIC by insured institutions in 2009 was equivalent to 91 bp of insured shares.

Comparing Prospective NCUA and FDIC Assessments

Both of the federal deposit insurance systems have been significantly damaged during the recent financial crisis. As a result, both will have to impose significant assessments on their insured institutions over the next several years to restore their funds. For FDIC, the Bank Insurance Fund (BIF) must be replenished. For NCUA, the NCUSIF does not need replenishment, but the Corporate Stabilization Fund must be repaid. Following is a description of the current condition of each system:

BIF's current reserve ratio stands at a negative 0.15% of insured deposits. By law the ratio must be restored to at least 1.35% by 2020, a total difference of 1.5% of insured deposits. It is the restoration of the reserve ratio that will require the significant assessments in the coming several years.

Following a recently announced premium of 12.42 bp, NCUSIF's current reserve ratio is at 1.29% of insured shares. Since 1.3% is the normal operating level for the fund, premiums over the next few years will only be necessary to maintain rather than to replenish the fund. However, NCUA will have to collect substantial assessments to pay for the estimated \$8.1 billion remaining cost of the Corporate Stabilization Fund.

The table on the following page shows the expected assessment costs at FDIC and NCUA from now until 2011. The final year was chosen as the last year of the Corporate Stabilization Fund. The table provides an apples-to-apples comparison of the expected costs for a typical credit union, or a commercial bank with the same balance sheet as a typical credit union. Following is an explanation of the derivation of the estimates for each of the funds.

FDIC. The base assessment rate used for FDIC insured institutions is one point from the bottom of the four-point range for Risk Category 1 banks, i.e., the lowest risk category. In addition, since the bank assessment rate is applied to total deposits rather than to insured deposits, the FDIC rates are grossed up (divided) by the average ratio of insured to total shares at credit unions (96%). For example, the FDIC base assessment for 2011 is expected to be 13 bp of total deposits. For the typical credit union, with insured shares equal to 96% of total shares, that 13 bp of total shares would be equivalent to 13.5 bp of insured shares.

NCUA. The primary cost for credit unions insured by NCUA will be to pay for the Corporate Stabilization Fund. Assuming the \$8.1 billion expected cost is straight lined over the 11 year life of the Fund, the annual assessment would be \$736 million. The assessment rates for Corporate Stabilization in the table below assume an annual assessment of \$736 million, and that insured shares grow by 5% a year. Future premiums for the NCUSIF are assumed to be quite small as the Fund is already at its normal operating level of 1.3%. As is the case for FDIC, NCUA has already accumulated a substantial reserve for future insurance losses based on information about the current condition of credit unions. However, because credit unions are still under stress, there are likely to be some additional, not-yet-reserved losses at natural person credit unions in the coming year or two. Also, low interest rates on Treasury securities will depress the earnings on the Fund's investments. We estimate the resulting premiums will be around 5 bp in 2011 and 2012.

Projected FDIC vs. NCUA Assessments

For the Eleven Years from 2011 to 2021, in basis points of insured shares/deposits

	FDIC ⁶			NCUA			Difference NCUA- FDIC
	FDIC	FICO	TOTAL	Corp Stab. ⁷	NCUSIF	Total	
2011	13.5	1.0	14.6	9.2	5	14.2	-0.4
2012	13.5	1.0	14.5	8.8	5	13.8	-0.7
2013	13.5	0.9	14.5	8.4	0	8.4	-6.1
2014	13.5	0.9	14.4	8.0	0	8.0	-6.5
2015	13.5	0.8	14.4	7.6	0	7.6	-6.8
2016	13.5	0.8	14.3	7.2	0	7.2	-7.1
2017	13.5	0.7	14.3	6.9	0	6.9	-7.4
2018	13.5	0.7	14.2	6.6	0	6.6	-7.7
2019	9.4	0.6	10	6.2	0	6.2	-3.8
2020	9.4	0.0	9.4	5.9	0	5.9	-3.4
2021	9.4	0.0	9.4	5.7	0	5.7	-3.7
TOTAL	136.5	7.5	144.0	80.4	10	90.4	-53.6
AVERAGE	12.4	0.7	13.1	7.3	0.9	8.2	-4.9

The comparison of FDIC and NCUA costs can be summarized as follows:

- NCUA's assessments will be comparable to FDIC's over the next two years, and substantially lower in the third and later years.
- Credit union assessments will gradually decay as the Corporate Stabilization Fund is paid off.
- FDIC assessments will remain elevated through 2018, after which time they will fall by about 4 bp and remain at that level for about 10 years.
- From 2011 to 2021, annual NCUA assessments are expected to average about **8 bp** of insured shares, for a total of **90 bp**.
- From 2011 to 2021, annual FDIC assessments are expected to average about **13 bp** of insured deposits, for a total of **144 bp**.
- Therefore, over the 11 year period, NCUA assessments are projected to be more than one third lower than FDIC assessments, i.e., FDIC assessments will be almost 60% higher.

⁶ FDIC base assessment rates are assumed to be one point above the lower end of the range for Risk Category 1 banks (12bp to 16bp until 2018). The FICO assessment is a temporary requirement to cover interest on the bonds issued to fund the FSLIC bailout in the early 1990s. The FICO rate is assumed to decay at the same rate it has since 2006 until 2019 when the last of the FICO bonds will mature. FDIC and FICO rates are adjusted to the average credit union ratio of insured deposits to total deposits of 96%. Projections for FDIC do not include the special assessment to be levied on large banks (assets over \$10 billion) necessary to raise the fund's reserve ratio from 1.15% to 1.35%.

⁷ The rates shown for the Corporate Stabilization Assessments would raise \$736 million a year for eleven years for a total of \$8.1 billion. For cash management reasons, NCUA will likely need more of the funds earlier, and has announced a projected assessment range of 20 bp to 25 bp in 2011, instead of the roughly 9 bp shown in the table. The total estimated cost remains at \$8.1 billion. We expect that NCUA will be able to collect the additional amount on a prepaid basis, similar to the FDIC's collection of prepaid assessments in 2009 (see footnote 5). The amounts for Corporate Stabilization shown in the table represent when they would likely be expensed by credit unions rather than when the cash is actually transferred.

The eleven year period shown in the table above covers the time that NCUA will assess credit unions to repay the Corporate Stabilization Fund. All but the last three years cover the period that FDIC expects to assess banks to restore the BIF to its historical Designated Reserve Ratio. The FDIC assessments shown for the years 2019 to 2021 will go toward the slow process of raising BIF's reserve ratio toward 2%. It is possible under those circumstances that NCUA may wish or be required to raise the normal operating level of NCUSIF above its current 1.3%. Given that NCUSIF has never suffered setbacks anywhere close to what FDIC has experienced, we believe that an increase in the NCUSIF normal operating level would be unnecessary. However, if NCUA were to take that action, NCUSIF premiums greater than those shown in the table would be required.

Both sets of projections of future FDIC and NCUA assessments are just that, estimates. They are based primarily on FDIC's and NCUA's current expectations about future losses from failed institutions and the performance of the Stabilization Fund's legacy assets. They are probably based on fairly conservative estimates by NCUA and FDIC of economic growth--a long slow economic recovery over the next several years. If the economic recovery turns out to be very weak, or even slows to a double dip recession, future assessments at both funds will be greater than those shown in the table (more likely, elevated assessments would last longer). Conversely, if the economy surprises on the strong side, current expectations of future losses will turn out to have been excessive, and future assessments at both funds will be less than those in the table (more likely, elevated assessments would end sooner).

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