Testimony of

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On behalf of the

Independent Community Bankers of America

Before the

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Hearing on

"Current Issues in Deposit Insurance"

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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 at this 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% of FDIC premiums, although they hold about 20% 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 are safe 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.

<u>Congress Should Address Inherit Inequities in the Deposit Insurance System</u>

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 community banks 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% of FDIC premiums, although they hold about 20% 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, or about 20% of deposit insurance premiums rather than the current 30%. 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% of their 2009 earnings; 17% estimate it will consume 26-40%.

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-too-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 a systemic risk premium to compensate for the risk too-big-too-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.