



1. Why is it preferable to prepay assessments rather than borrow from the Treasury?

Prepayment of assessments would ensure that the deposit insurance system remains directly industry-funded and it preserves Treasury borrowing for emergency situations.

2. Isn't this a short term solution predicated on a swift banking recovery?

No. While industry earnings are weak, banks overall have enough liquid assets to make the proposed prepayment.

3. Would smaller banks be affected disproportionately by this action?

No. The FDIC believes that most of the prepaid assessment would be drawn from available cash and excess reserves. Furthermore, the FDIC could exempt institutions from the prepayment requirement if the FDIC determines that the prepayment would adversely affect the safety and soundness of the institution.

Finally, prepaying assessments would have the same proportional effect on insured institutions as the regular risk-based deposit insurance assessments. These payments would be determined by an institution's risk and amount of assessable deposits.

4. Didn't Congress raise the FDIC's borrowing limit for just this scenario?

The Helping Families Save Their Home Act, enacted on May 20, 2009, permanently increased the Deposit Insurance Fund's statutory line of credit with the U.S. Treasury from \$30 billion to \$100 billion, and increased it to \$500 billion through the end of 2010 if certain conditions are met.

It has not been the FDIC's intent to use this line of credit as the first source of funding in the event we needed additional liquidity to resolve failed banks. The line of credit is available in the event of an emergency or other unforeseen event that requires an unexpected large cash outflow.

The FDIC's current liquidity needs do not represent an emergency and can be planned for and met by industry resources.

5. Wouldn't this take much needed capital out of the system and constrict lending?

No. It doesn't take capital out as would a special assessment. Instead, it would draw on the ample liquidity of the banking industry.

As of June 30, FDIC-insured institutions held more than \$1.3 trillion in cash equivalents, or 22 percent more than they did a year ago. This total includes at least \$388 billion in balances held at the Federal Reserve Banks, of which an estimated 85 percent represents excess reserves above required levels.

6. How would the banks account for the prepayment?

Under GAAP accounting rules, unlike special assessments, prepaid assessments would not immediately affect bank earnings. Each institution would record the entire amount of its prepaid assessment as a prepaid expense (an asset) as of December 30, 2009, the date the payment would be made.

As of December 31, 2009, and each quarter thereafter, each institution would record an expense (charge to earnings) for its regular quarterly assessment and an offsetting credit to the prepaid assessment until the asset is exhausted.

Once the asset is exhausted, the institution would resume paying and accounting for quarterly deposit insurance assessments as they currently do. They would record an accrued expense payable each quarter for the assessment payment, which would be made to the FDIC at the end of the following quarter.

7. How would the FDIC account for the prepayment?

Although the FDIC's immediate liquidity needs would be resolved by the inflow of approximately \$45 billion in cash from prepaid assessments, unlike a special assessment, prepaid assessments would not immediately benefit the DIF revenue or the DIF balance.

The DIF would initially account for the amount collected as both an asset (cash) and an offsetting liability (deferred revenue). Revenue is not recognized immediately because the DIF does not earn the right to the assessment premium funds until the end of the quarterly period of insurance coverage.

At the end of each quarter, when the FDIC estimates the amount that each institution will be assessed for deposit insurance that period, the DIF would recognize revenue and simultaneously reduce the deferred revenue liability, thereby gradually reducing the liability until each institution's premium prepayment is exhausted.

8. Isn't this the same as borrowing from the industry without charging interest?

Some may view borrowings and prepayment of assessments as conceptually similar, but there are some important differences. A borrowing would be voluntary and require the DIF to pay interest. Prepaid assessments would be mandatory and there would be no interest component.

9. How many banks would be exempt from paying the assessment up front?

The FDIC would exercise its discretion as supervisor and insurer to exempt an institution from the prepayment requirement if the FDIC determines that the prepayment would significantly impair the institution's liquidity or would otherwise create significant hardship. Actual numbers or names of institutions to be exempted from the prepaid assessment requirement would not be made publicly available.

Based upon currently available data, staff does not expect the number of exemptions to significantly affect the amount of prepaid assessments that the FDIC would receive.

10. If a bank's total deposits or actual assessment rate decreases during the next three years, would the FDIC refund a portion of their prepaid assessment?

No. The FDIC would not refund or collect any additional prepaid assessments based upon changes in an institution's actual assessment rate or the actual decrease in or growth of deposits during the

next three years. However, any prepaid assessment that is not exhausted by December 30, 2014, would be returned to the institution at that time.

11. When is the DIF expected to go negative?

FDIC estimates that the DIF balance as of September 30, 2009 will be negative.

12. When was the last time the insurance fund had a negative balance, and why?

The only previous time the FDIC reported a negative fund balance was during the last banking crisis in the late 1980s and early 1990s. The FDIC reported a negative fund balance as of December 31, 1991 of approximately -\$7.0 billion due to setting aside a large (\$16.3 billion) reserve for future failures. The fund remained negative for five quarters, until March 31, 1993, when the fund balance was approximately \$1.2 billion.

13. If the DIF goes negative, does this mean that the FDIC will no longer be able to protect insured depositors?

No. What is happening today is a non-event for depositors. Deposit insurance coverage is unaffected by the DIF balance.

When a bank fails, the FDIC protects depositors using its cash resources. Today, the FDIC is taking steps to bolster its industry-funded cash resources. The FDIC also has other cash resources available, including up to a \$500 billion borrowing line with the U.S. Treasury.

FDIC's deposit insurance guarantee is backed by the full faith and credit of the United States government, and no depositor ever has or ever will lose a penny of insured deposits.

14. Has the FDIC ever required prepaid assessments or borrowed from the Treasury before?

The FDIC has never required banks to prepay assessments for more than one semiannual period. To meet its liquidity needs, the FDIC borrowed from the Federal Financing Bank (FFB) during the second quarter of 1991. Borrowings from the FFB peaked at \$15.2 billion as of June 1992. The Fund began to repay the FFB during the third quarter of 1992 and borrowings were fully repaid (along with \$802.4 million in interest) by September 1993.

15. How much does the FDIC expect to spend on bank failures, and how much money would the proposed prepaid assessment raise?

The FDIC is projecting that the DIF will incur approximately \$100 billion in failure costs over the period 2009 through 2013. Some of this amount has already been realized, and most of these losses are expected to occur before year-end 2010. In fact, between actual failures that have already occurred and expenses for failures expected over the next year that have been set aside in the DIF's Contingent Loss Reserve (CLR), well over half of this amount will already be reflected in the September 2009 Fund balance.

The proposed prepaid assessment would be expected to raise approximately \$45 billion.