



# FDIC's Shrinking Deposit Insurance Fund - A Testimony of Current Accounting Standards

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12th of August 2009

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As late as in the end of April just before the release of the bank stress tests, Ms. Bair Chairman of the FDIC said they would not need any additional bailouts from the U.S Treasury within the immediate future according to [The Bulletin](#). After three new bank failures last Friday, the FDIC's Deposit Insurance Fund (DIF) diminished by another \$185 million for a total remaining balance of \$648.1 million. After just passing half-year 2009 the FDIC have already used up roughly \$16 billion of the fund.

Attached in the document you can find [a spreadsheet with a complete table showing banks that have been insured by the FDIC and have failed under the period 2000-2009](#). The list is arranged by the closing date. Most importantly one will find the recorded assets at the closing date and the estimated losses covered by FDIC's DIF.

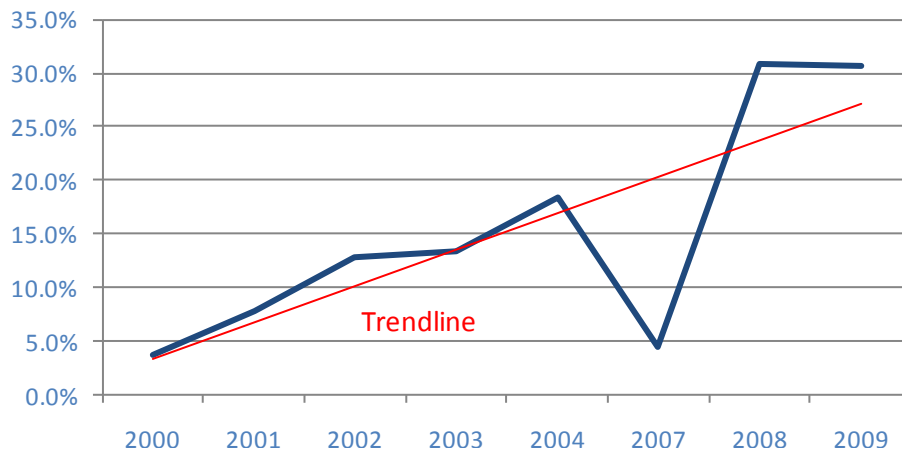
Not surprisingly the rate of bank failures has increased during the last two years. Throughout the period 2000-2002 FDIC handled 17 banking failures with the majority (11) occurring during the recovery period in 2002. In 2008 and so far in 2009 FDIC has assisted some 90 banks through closure. The much larger number of failed banks can easily be explained by the type of recession we are currently facing compared with the tech-bubble.

On January 1<sup>st</sup> 2009 FDIC reported they had \$17,276 million in their deposit insurance fund (DIF) and according to press releases for each failed bank, the estimated total costs for FDIC's DIF during Q1 amounted to \$2,146 million, leaving \$14,997 million in the fund. However, according to the latest FDIC Quarterly report the fund counted \$13,007 million at the start of Q2, thus a difference of \$1,990 million. In other words the estimated spending on failed banks during Q1 was \$2,147 million, but the bill ended up around \$4,137 million instead (and probably still counting).

This is why Q2 is even more interesting, since the estimated costs are \$11,504 million, thus leaving only \$833 million in the fund for supporting failing banks in the future. Moreover the real total cost for Q109 turned out to be almost twice the amount of the estimates the second quarter showed. If that will be even close to reality for Q209 the FDIC's DIF will (very) soon be out of funds completely.

However, we have detected that DIF costs/bank assets have steadily increased under the period of discussion.

### Yearly Avg. DIF Costs/Bank Assets\*



\*Banks are only included if the FDIC have reported both DIF costs and bank assets.

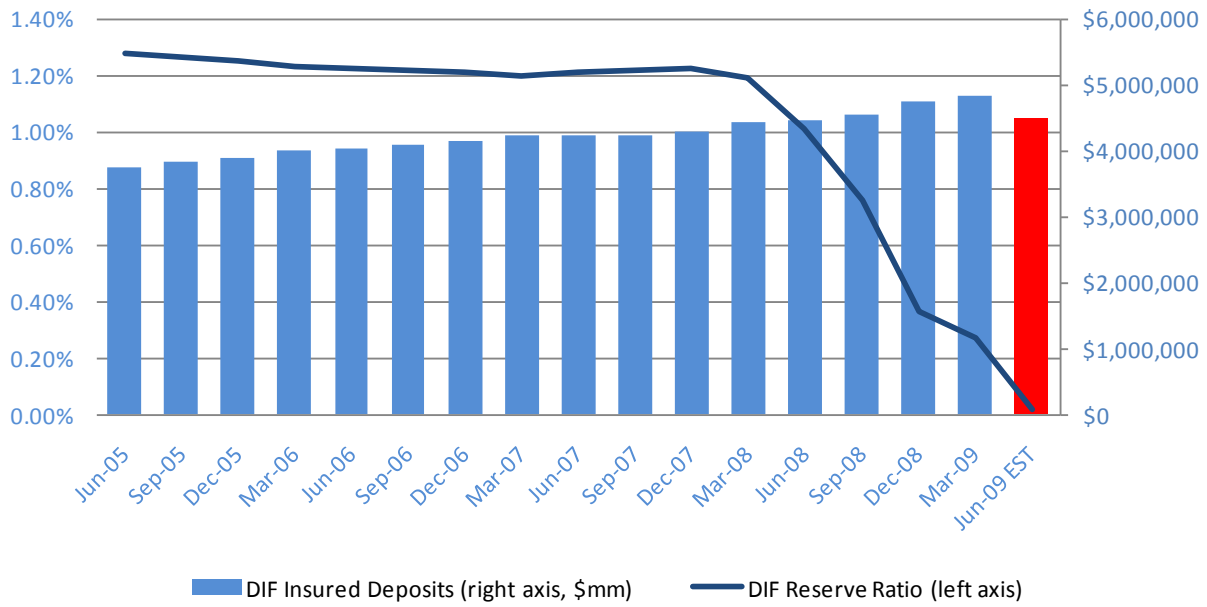
We believe the main reason for this observation lies in a de facto relaxation of accounting standards, even before the [FASB 157 amendment](#) on March 15<sup>th</sup> earlier this year. Basically the relaxation allows banks to only write-off parts of their losses due to market impairment and they may themselves decide a fair price that the asset could have been sold for during normal market conditions to keep in their books. Allowing banks to control how they mark-to-market their assets, will likely backfire and when they ultimately end up failing, imply greater closure costs for the FDIC. From the graph above one can infer that the average yearly DIF costs/bank assets have increased at an alarming rate to almost reach 31% in 2008 and 2009.

So, what does that imply? Basically it means that when valuating any U.S bank, their assets should probably be marked down significantly relative to their book value, much because of how they nowadays are allowed to manipulate their balance sheets in order to appear more solvent than they in fact are.

E.g. if we look at the ten biggest banks in the U.S and assume conservatively that their accounting standards are comparable to the most truthful 15% of banks that have failed under FDIC and we sort on the 15<sup>th</sup> percentile, it would result in a \$75.3 billion (10.78% of combined assets \$698.53) write-down. In other words, if banks would quit operating in their dream-world where accounting standards obviously are next to absent and join the real world that would leave serious gaps in their balance sheets of some \$75.3 billion. For clarification, the 15<sup>th</sup> percentile of DIF costs/bank assets equals 10.78%.

Below is a graph showing the DIF capital as a percentage of total bank deposits insured by the FDIC. Note that this graph is based on the old insurance limit with a maximum coverage of \$100.000/account. This limit has been changed to cover up to \$250.000/account until January 1<sup>st</sup> 2014. Estimates say that the change increases the deposits covered under FDIC insurance to approximately \$6 trillion in total.

## FDIC Reserve Ratio & Insured Deposits



The current reserve ratio of 0.014%<sup>1</sup> strongly indicates how bad this crisis has affected U.S financial institutions. However, this is not the entire story. If we take a closer look at non-current loans and charge-offs from banks one realizes that the FDIC still has a lot of work to be done. Combined non-current loans and charge-offs amounted to nearly \$100 billion in Q109 compared to \$15 billion/quarter pre-crisis. Moreover, according to analysts at the [Royal Bank of Canada](#) the U.S still has banking failures in the thousands to face before the crisis is over.

In turn that should result in the FDIC requesting the pre-approved funding signed by the Congress in May 2009, including \$100 billion from the U.S Treasury Department.

<sup>1</sup> Computed with decreasing insured deposits (\$4500 billion in June 2009 EST from \$48315 billion in March 2009) and the current DIF balance of \$648 million.