Consumers likely to find increased bank costs

Federal insurers have big shortfalls

By Michael Kranish, Globe Staff | July 2, 2009

WASHINGTON - An array of government-created insurance agencies - which have long charged bargain-rate premiums to banks, credit unions, and brokerages - are seeking to make up for massive shortfalls in their insurance funds by raising fees and premiums, many of which are likely to be passed on to consumers.

The billions of dollars in new fees are the result of decisions by Congress and the agencies to allow the insurance funds and premiums to be capped at levels that proved far too low, according to Jeffrey R. Brown, a finance professor at the University of Illinois at Urbana-Champaign who has studied the issue.

"This is what happens when you put the government in charge of an insurance program," Brown said. "Politically, they don't run them the way the need to be run."

Another specialist, American Enterprise Institute scholar Andrew G. Biggs, agreed, saying, "The common thread is that government is just congenitally incapable of pricing insurance properly."

Now, the increased premiums are likely to be passed along to consumers in the form of higher banking fees, lower interest rates for savings accounts, higher interest charges for loans, and increased brokerage fees for stock trades, according to officials at the agencies. Some institutions might also lay off workers or cut services.

The sharp increases in fees are necessary largely because of Congress's decisions over the years to heed lobbying by industry groups and maintain a system under which some of the insurance agencies charged little or nothing in premiums, according to a Globe survey.

The Federal Deposit Insurance Corp., which insures bank accounts for up to $250,000, charged no premiums to most banks for 10 years.

The National Credit Union Administration, which insures deposits up to $250,000 at more than 7,000 credit unions, also charged no premiums for 10 years, and even paid rebates in two of those years.

The Securities Investor Protection Corp., which insures that brokers invest money as promised, charged brokerages only $150 per year for $500,000-per-account coverage.

The Pension Benefit Guaranty Corp., which insures the pensions of 44 million Americans, charged only one-sixth the amount that a private company might have sought in premiums, according to one study.

In every agency, the financial crisis that began in 2008 exposed inadequate reserves.

The funding crisis at the National Credit Union Administration illustrates the extent of the underfunding.

The agency insures accounts of nearly 90 million people at credit unions for up to $250,000. To pay for that insurance, credit unions were required to keep 1 percent of their insured deposits in a fund held by the federal agency. The agency also had congressional authority to assess a premium of up to 0.5 percent of their insured deposits. But the agency decided against charging those premiums during the last 10 years because it determined that the insurance fund met the level recommended by Congress, an agency spokesman said.

Indeed, the agency sent $51 million in rebates back to credit unions as recently as 2007 because it believed it had too much money in its insurance fund.

In recent months, however, the federal insurance fund for credit unions has been decimated. Nearly $6 billion out of the $8 billion has been spent to pay for losses or insure deposits at troubled institutions. As a result, the
agency is now borrowing an additional $6 billion from the Treasury, and making up for the loss by charging every credit union a new fee that amounts to nearly 1 percent of insured deposits. After an outcry from credit unions, Congress last month agreed to spread out the new fee over a seven-year period.

John McKechnie, a spokesman for the National Credit Union Administration, said that during the 10-year period when his agency charged no premiums, few complaints were heard. "When the sun was shining, nobody wanted to pay more," he said. Asked how consumers will be affected by the new fee, he predicted the cost will be passed along in the form of slightly lower interest rates to depositors with savings accounts, among other measures.

Similarly, the Federal Deposit Insurance Corp., which charged no premiums to most banks from 1996 to 2006, saw its insurance fund plummet in value this year. Congress had long refused to grant permission to the agency to substantially raise its premiums, despite pleas from agency officials.

In 2001, the agency's then-chairman, Donna Tanoue, testified before Congress that the system was in danger. She reported that 900 newly chartered banks "have never paid premiums."

It wasn't until 2006 that the agency received congressional approval to raise premiums on all banks. But in the aftermath of the 2008-09 financial meltdown, the agency declared that the fund was near the breaking point and announced it would sharply raise premiums on all banks. The agency has said it may need to borrow up to $500 billion from the government to take over failed banks, up from the existing borrowing authority of $30 billion.

Congress recently gave the agency the authority to raise fees to make up for the shortfall. But after complaints from the banking lobby, the agency cushioned the blow by announcing that it would charge higher fees on banks that are considered the riskiest, and lower fees on those considered safest.

The Securities Investor Protection Corp., a private, nonprofit firm created by Congress that charged brokerages only $150 per year to insure each account for up to $500,000, now faces the possibility that its insurance fund might be depleted by the Bernard Madoff scandal alone. As a result, it recently raised its rate to 0.25 percent of each brokerage firm's net operating revenues, meaning the annual charge at some brokerage could increase from a flat $150 to millions of dollars.

Representative Barney Frank, the chairman of the House Financial Services Committee, which has oversight of the banking, credit union, and brokerage insurance agencies, defended the decision by Congress to allow the bank and credit union agencies to charge little or nothing in premiums for many years. He said that members of Congress were convinced that there was enough money in the insurance funds.

Frank bristled when asked whether Congress is in the position of authorizing hikes in premiums now to make up for past mistakes. "What harm has come from the fact that we didn't have the premiums then?" he asked. He said that Congress has found ways to spread out the impact of the new fees, minimizing the burdens on consumers.

Frank's view was challenged by Biggs, the American Enterprise scholar, who previously served as a House aide and a deputy commissioner of the Social Security Administration.

"I think ultimately it has to come to Congress," Biggs said. "The goal is to get things right before you have a crisis. What you'd like is foresight from your representatives and their staff."

Biggs said that Congress should undertake a broad review of the insurance agencies. He said two top priorities should be to set premiums that are closer to what would be charged by private insurers, and to insulate Congress from industry lobbyists pushing for the lowest-possible fees.

The Pension Benefit Guaranty Corp. has not said how it will make up for a $33 billion deficit in its insurance fund. The agency, which insures the pensions of 44 million Americans, has failed in past efforts to get congressional approval to charge higher premiums on private pension plans that have the riskiest investments.

As a result, one study found that its premiums are one-sixth of what would be privately charged for the same insurance.
The agency is examining whether to follow the lead of other government-created insurance agencies and seek congressional approval to raise premiums beyond the current allowance for inflation adjustment.

But action has been delayed because President Obama has not nominated a director, and the agency's board, made up of three Cabinet secretaries, has not met for 16 months.

Michael Kranish can be reached at kranish@globe.com