DIF Premium Assessments

Cite

FDIC, Notice of Proposed Rulemaking (NPR), Assessments: Revised Deposit Insurance Assessment Rates

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Impact Assessment

- DIF premiums would come close to double, raising asset costs.
- The largest banks could see higher FDIC premiums of as much as five percent of income. This could alter business strategy, especially with regard to adding higher-cost assets such as consumer loans.
- Unless macroeconomic conditions and/or bank earnings sharply worsen, FDIC premiums would rise less procyclically than might otherwise be necessary to meet statutory deadlines.
- A better-reserved DIF reduces the odds of another taxpayer bailout.

Overview

The FDIC is proposing to raise base Deposit Insurance Fund (DIF) assessments by two basis points (BPS) to replenish the DIF by the statutory deadline to reflect deposit inflows that the FDIC no longer expects to be temporary. Even after the DIF reaches its minimum ratio, the added assessments would continue to restore the fund to a more ample reserve. This will increase costs at insured depository institutions (IDIs), in some cases likely by sizeable amounts likely to alter business strategy in ways that might dampen economic growth. However, scant DIF resources under acute stress might trigger not only the need for another taxpayer infusion into the FDIC, but also demands for more stringent regulatory and resolution standards.

Impact

Under the recovery plan set in 2020, the FDIC is required to ensure that the DIF has a reserve ratio of 1.35% no later than September 30, 2028, following its decision in 2020 not to raise premiums when banks were suddenly awash with deposits during the COVID-19 financial crisis. The agency also wants to get back on track to a two percent designated reserve ratio (DRR), stating that the new, higher rates would remain in effect until this DRR is achieved. Although this proposal strengthens the FDIC over more time than a single special assessment and does so via an increase the FDIC believes is well within IDI capacity, the proposal comes at a time of heightened macroeconomic stress and fears of a near-term recession. Premium increases would not take effect until next year and it would take time thereafter to replenish the DIF. Thus, depending on externalities, the FDIC proposal might impose near-term costs on IDIs facing challenges not factored into the FDIC's proposal before the benefits of these added costs materially strengthen the DIF. Still, further delay to address this could well lead to even higher DIF-premium increases before the 2028 deadline unless the FDIC decides to override it.

As noted, the NPR would raise base premiums an average of two basis points. The weighted average assessment rate for all IDIs is now 3.7 bps, meaning that a 2 bps increase is approximately a fifty percent hike in DIF assessment costs. The agency calculates that the new assessments would reduce industry income only by about two percent, a hit it believes IDIs can easily absorb under current profit conditions. Tier 1 capital would drop by only 0.1 percent on average. However, these results will vary significantly based on how the assessment scheme affects individual banks. Under a series of changes made to DIF assessments after the Dodd-Frank Act,[1] assessments are based on a bank's assets, not its insured or domestic deposits, varying also by the bank's size and risk under the FDIC's schedule. Based on this framework, the bulk of the cost of the higher premiums will be borne by the largest banks, with the NPR estimating impact of just below five percent of income for these IDIs. This may create a meaningful incentive for them to reduce assets or alter exposures to those that score best for premium-assessment purposes. This could reduce growth and increase economic inequality to the extent bank lending drops, especially if this drop is for higher-risk consumer loans key to sustaining lower-income household consumption capacity and financial security under recessionary conditions.

What's Next

The FDIC board unanimously agreed to this proposal at its meeting on June 21. Comments are due by August 20. Assessments would begin for the first quarter of 2023.

At the board meeting, CFPB Director Chopra and Acting Comptroller Hsu asked for comments on how the proposal could affect small and mid-sized banks, an issue not formally noted in the FDIC's own list of issues on which comment is requested. Mr. Chopra also floated another idea: departing from the current system in which the FDIC must decide when to raise premiums to an approach based on "automatic stabilizers," which would be triggers activated by specific drops or increases in the DRR rather than by judgment calls about when deposit growth may be problematic or bank profits sufficient to handle higher premiums. It is unclear how such stabilizers would work under crisis conditions if they mandated premium hikes rather than more gradual restoration plans under crisis conditions such as those in March of 2020. However, some form of trigger might have led the FDIC to begin DIF recapitalization more quickly in 2020 or 2021 when the macroeconomic recovery seemed assured, interest rates were low, and IDI condition very robust.

[1] See **DEPOSITINSURANCE96**, *Financial Services Management*, February 15, 2011.

Analysis

Other than making technical changes to current rules, the NPR does nothing but raise the base assessment rate by 2 bps. But, while standing by this idea, the NPR does present alternatives to it. These would:

- Keep assessment rates as is;
- Raise the base assessment only one basis point; or
- Impose a one-time special assessment of 4.5 bps.

Comment is solicited on these options as well as on the extent to which the FDIC has properly balanced an array of competing considerations in the context of its statutory obligations.

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