Financial Services Management

Deposit-Insurance Premium Assessments

Cite

FDIC, Final Rules, Assessments: Revised Deposit Insurance Assessment Rates

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https://www.fdic.gov/news/board-matters/2022/2022-10-18-notice-dis-a-fr.pdf

Impact Assessment

- DIF premiums will almost double, likely raising at least some asset costs.
- The largest banks may 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.
- If macroeconomic conditions and/or bank earnings worsen, then FDIC premiums will rise procyclically and weaken both banks and growth.
- A better-reserved DIF reduces the odds of another taxpayer bailout.
- DIF-premium adjustments now have a limited automatic-stabilization mechanism that may raise or lower them without further public notice or comment.

Overview

The FDIC has finalized its proposal largely unchanged 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.[1] Even after the DIF reaches its minimum ratio, the added assessments will continue to restore the fund to what the FDIC believes to be a necessary, more ample reserve ratio. This will increase costs at insured depository institutions (IDIs), in some cases 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

[1] See **DEPOSITINSURANCE114**, *Financial Services Management*, June 28, 2022.

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 will 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 rule comes at a time of heightened macroeconomic stress and fears of a near-term recession. Premium increases do not take effect until next year and it will then take time thereafter to replenish the DIF. Thus, depending on externalities, the FDIC rule may impose near-term costs on IDIs facing challenges not factored into the rule 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.

However, if deposit growth slows, then the higher premiums may be unnecessary and any procyclical effect unduly costly. Many comments questioned the FDIC's deposit-growth assumptions, but the final rule stands by them in part because it says some analyses considered deposits in general, not just the insured deposits against which the DRR is calculated. The final rule also notes that insured-deposit growth can vary significantly from that for overall deposits.

The agency also disputes assertions that "excess deposits" now in the banking system will quickly exit due to higher interest rates and other factors. The FDIC also rejects comments disputing other scenario assumptions (e.g., no DIF investment income), noting also that DIF losses may increase beyond those in its current scenario.

The rule raises base premiums an average of two basis points. The weighted average assessment rate for all IDIs is now 3.8 bps, meaning that a 2-bps increase is approximately a fifty percent hike in DIF assessment costs. The agency calculates that the new assessments will 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, 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 rule 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 favor those scoring 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 rule at a meeting on October 18.[2] Assessments would begin for the first quarter of 2023.

Although the final rule does not include the express DIF "automatic stabilizer" advocated by CFPB Director Chopra, the final rule gives the FDIC authority to raise or lower premiums by as much as two basis points without a formal rulemaking, giving it considerably more flexibility even though it may be even more difficult for IDIs to plan ahead for critical asset/liability management.

Analysis

Other than making technical changes to current rules, the final rule does nothing but raise the base assessment rate by 2 bps.

2 See *Client Report* **DEPOSITINSURANCE115**, October 18, 2022.