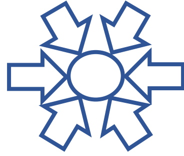

FedFin Client Report

Tuesday, October 18, 2022

FDIC Hikes Premiums, Presses Resolvability

Client Report: DEPOSITINSURANCE115

Executive Summary

The FDIC board today voted 3-0 to increase DIF assessment rates by 2bps, finalizing its proposal (see FSM Report **DEPOSITINSURANCE114**) and rejecting industry arguments on grounds that a small DIF premium increase now would make a more damaging procyclical assessment increase under adverse economic conditions less likely. Unsurprisingly, the FDIC also joined the Fed in approving the ANPR that bears its name, with Acting Comptroller Hsu praising the ANPR's balance between protecting financial stability and competition among the largest banks. CFPB Director Chopra used his remarks to advance his campaign against big banks and mergers, calling for an overall review of FDIC premiums to charge the largest banks more and an end to "lax" merger approvals. This report summarizes today's meeting; in-depth reports on the final rule and ANPR will follow.

Analysis

Assessment Rate

FDIC staff recommended adopting the proposed assessment rate increase without change, which the board then unanimously did. Staff and board members dismissed comments that argued that a slight decline in deposit rates in Q2 and the possibility of higher interest rates resulting in higher DIF returns on investment may diminish the necessity of the hike. They claimed that deposit rate declines are typical for Q2, highlighting that aggregate deposit rates still remain elevated and that increases in investment returns are already factored into their projections. Staff also presented two updates of these projections, predicting that in the best-case scenario absent an assessment rate increase, the ratio would reach its statutory minimum of 1.35% just before the 2028 deadline, giving the FDIC little flexibility.

Acting FDIC Chairman Martin Gruenberg echoed staff statements, urging the finalization of the rule given economic and geopolitical uncertainty. He argued that action now decreases the likelihood of higher and more procyclical assessment rate increases and gives the FDIC an additional eight years to reach its ratio requirement. He also claimed that the industry is strong and well positioned to absorb this "modest" change. Acting Comptroller Hsu agreed

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with the Chairman's points, saying the rule protects financial stability. CFPB Director Chopra supported the rule but questioned whether the 2% target was high enough and cautioned that a longer-term policy to determine how assessment rates are set is still needed. He argued that banks posing the most risk to the fund should pay more and smaller banks less, a mechanism is needed to ensure rate changes are not procyclical, and a framework that systematically sets assessment rates is necessary, suggesting that the board move towards automatic changes.

Resolvability

FDIC staff recommended adoption of the ANPR, emphasizing not only the significant growth of banks with over $100 billion in assets since the GFC – a number that currently stands at 26 – but also their increased reliance on uninsured deposits. Staff also argued that the universe of potential acquirers of failed large IDIs is extremely limited and that sufficient loss-absorbing resources at a failed IDI would allow the FDIC to preserve franchise value and create a bridge-bank.

Acting Chairman Gruenberg reiterated staff concerns about the lack of comparable resolution requirements for non-GSIBs, the small pool of potential acquirers for failed large IDIs, and reliance on uninsured deposits for operational funding. He also highlighted the range of other significant large bank complexities that exacerbate resolvability concerns, including material operations, assets, liabilities and services outside the bank chain. He argued that bridge-bank resolvability options can work as long as they do not negate the franchise value of the failed institution in a manner less costly for the DIF than bank liquidation and depositor payoff, saying also that gone-concern resources at large IDIs are one way of accomplishing this. He also reviewed key questions for comment in the ANPR, noting in particular the question of how resolution options can be expanded without resorting to the sale of the failed institution to another large banking organization or GISB.

Acting Comptroller Hsu, referencing his Wharton April remarks on mergers and large bank resolvability, reiterated his concerns over the lack of competitiveness at the largest banks and the need to prevent a new class of TBTF firms from emerging amongst non-GSIBs.

Director Chopra highlighted the "enormous" DIF costs ensuing from IndyMac's resolution and argued that WaMu's successful resolution was only a matter of luck and astute JPMorgan due diligence. In his questions, he asked FDIC staff to describe the universe of potential acquirers in the event of a failed D-SIB; staff reiterated that there are few and that the right conditions are not always in place for a speedy resolution through purchase and assumption. He also claimed that failure of a large retail bank would have a huge impact on retail depositors and that a G-SIB sale is unattractive because of disruptions caused by system integration, basing the latter on "CFPB experience." He also urged recognition of the true size and scope of D-SIBs. In additional concluding remarks, Director Chopra provided cautionary recommendations: urging regulators not to continue what he called the "lax and opaque merger and review process" and calling for tough prudential regulation for large regional banks.

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