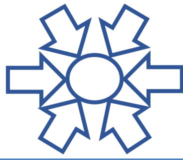

Financial Services Management

DIF Special Assessment

Cite

FDIC, NPR, Special Assessment Pursuant to Systemic Risk Determination

Recommended Distribution:

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Websites:

https://www.fdic.gov/news/board-matters/2023/2023-05-11-notice-dis-a-fr.pdf

Impact Assessment

- Many large banks subject to the new special assessment will face near-term capital and income challenges, exacerbating stress at weaker banks and broader procyclicality in the construct of bank regulation.
- Some IDIs may seek to reduce DIF premiums by reducing deposit balances, limiting balance-sheet growth by also cutting credit offerings and/or funneling larger deposits into asset-management products with limited financial-intermediation benefit.
- Because the special assessment is retroactive, it does not directly affect the cost of accepting additional uninsured deposits, but many banks may be unwilling to do so out of fears that the new charge will be reflected in a broader rewrite of risk based DIF premiums.
- Premium assessments on uninsured deposits are likely to blur the difference between insured and uninsured liabilities, furthering market expectations of de facto unlimited deposit insurance.

Overview

As the law requires and the FDIC Chairman promised after SVB and Signature Bank were declared systemic,[1] the FDIC has now proposed a special assessment to compensate the Deposit Insurance Fund (DIF) for the cost of backing the two banks' uninsured deposits. The FDIC has proposed to do so via an assessment covering IDIs with uninsured-deposit holdings above $5 billion. This thus exempts most smaller banks, with the FDIC adopting this approach on grounds that it justly penalizes IDIs that benefited the most from these systemic rescues. The new assessment would be applied over at least eight quarters beginning in January of 2024, with the FDIC's analysis persuading it that the capital and income costs of this targeted approach are sustainable at covered insured depository institutions (IDIs).

[1] See *Client Report,* **REFORM217**, March 28, 2023.

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Impact

As detailed below, the FDIC is proposing an additional annual premium of 12.5 basis points over 2024 and 25 charged against uninsured deposits held at IDIs as of the end of 2022. IDIs or banking organizations where total uninsured deposits were less than $5 billion at this time would be exempted, with the FDIC believing that this approach would gather the $15.8 billion needed to recoup the losses associated with payouts related to uninsured deposits at SVB and Signature Bank; should losses vary from this estimate, the FDIC would retain the authority to vary the assessment and impose a one-time special assessment when the banks' receiverships end to ensure that the DIF is fully reimbursed. No refund is proposed should the special assessment exceed the FDIC's losses attributable to uninsured deposits because the FDIC reads the law as requiring that any excess collections go into the DIF.

The NPR's description of governing law indicates that the FDIC is required to cover all losses due to a systemic designation from a special assessment, but the proposal would do so only for losses attributed to uninsured deposits under a methodology detailed in the NPR. As a result, even though small banks are not covered by the assessment, they would still bear some of the cost of the resolutions, but the bulk of its cost would be derived from institutions that the FDIC believes were most benefited by the systemic designation's protection against depositor expectations of losses at other banks. The FDIC does not directly assert that uninsured deposits caused SVB and Signature's failure, only that the designation had the effect of protecting uninsured deposits across the banking system. In its report on Signature's failure,[2] the FDIC attributed it principally to bad management, the cause also cited by the FRB in its report on SVB.[3]

The FDIC estimates that 113 IDIs holding 83 percent of industry assets would be subject to this premium. Taken separately and especially together, these premium increases will raise deposit costs above those already adversely affecting bank profitability due to the Fed's sharp and rapid interest-rate increases. To be sure, virtually all community and mid-size banks will pay little or nothing of this special assessment, but premium charges may still rise for them over time, an outcome that led CFPB Director and FDIC board member Chopra to urge when this rule was proposed that the FDIC also revise risk-based pricing so that premiums fall still more heavily on the largest banks than mandated under the 2011 rule.[4]

Importantly, these two failures are not the only ones with which the FDIC has coped in recent months. First Republic Bank was closed by the FDIC on May 1 in concert with arranging the sale of the IDI to JPMorgan in a transaction involving numerous FDIC backstops estimated to cost the FDIC $13 billion. While very costly, this resolution was not systemic and therefore does not fall under provisions in law mandating this special assessment. The FDIC will consider the extent to which premiums will need to rise above their recently hiked levels for this and any other failures when it next assesses the DIF against relevant

2 See *Client Report,* **REFORM222**, May 1, 2023.

3 See *Client Report,* **REFORM221**, May 1, 2023.

4 See **DEPOSITINSURANCE94**, *Financial Services Management*, January 4, 2011.

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statutory designated reserve ratio (DRR) levels.[5] Higher overall premiums in concert with these special assessments could have considerable structural implications, especially at a time of rising rates and increased financial and macroeconomic fragility.

Banks that fall under the new special assessment and/or additional higher premiums may seek to reduce the cost of FDIC insurance at a time when likely regulatory-capital increases also make it less profitable to use increasingly high-cost deposits for new loans or most other assets. Large banks are often encouraging large depositors to convert funds into investments in bank sponsored MMFs or other vehicles, moving funds outside the banking system and often into investments with limited direct benefits for economic growth and credit availability for under-served communities.

The FDIC's cost-benefit analysis of the proposal does not take these structural effects into account, assuming that banks bear all the cost of the newly higher special assessment. The analysis also does not anticipate how the special assessment would factor into higher DIF premiums now and to come to affect bank earnings, capital, or competitiveness. The estimate specific to the special assessment also makes assumption about how pre-tax costs affect bank capital based on additional assumptions about dividend policy and how banks suffering particularly sharp capital reductions due to the premium are likely to behave, further assuming that capital effects are phased in over eight quarters. While this may be technically the case, investors generally look at the total cost of new requirements and resulting profit implications in order to make immediate judgments about a bank's market capitalization. To the extent the special assessment is particularly costly for specific banks, these banks may see significant drops in market capitalization, making it more difficult to raise capital in response. The agency finds that the assessment on average would reduce Tier 1 capital at affected banks by 61 bps, an amount deemed minimal even though it is 15.25 percent of the four percent minimum ratio against which banks are judged adequately capitalized perhaps because the FDIC also finds that no covered bank ceases to be adequately capitalized. The impact on covered bank net income effects is assumed to occur in one quarter for a reason left unstated in the proposal, which finds an average 17.5 percent reduction on average – a significant amount especially for less-profitable banks at a time of growing recession and credit-loss concerns. 34 percent of affected now-profitable banks are likely to have adverse income effects of greater than twenty percent, suggesting that structural, profitability, and capital impact could be considerable for at least 38 large banks.

[5] See **DEPOSITINSURANCE116**, *Financial Services Management*, June 28, 2022.

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What's Next

The FDIC voted 3-2 to approve this proposal on May 11. Comment is due sixty days after Federal Register publication, with the proposal delaying assessments until the first quarter of 2024 and then charging them for the eight quarters it believes necessary to make up the DIF's shortfall related to the systemic designation.

Analysis

A. Framework

As noted, the FDIC proposes to charge an annual 12.5 percent premium on any bank with uninsured deposits over $5 billion as measured at the end of 2022. This approach was chosen by the FDIC because it means that banks with the largest amount of uninsured deposits pay the largest amounts of the special assessment. As a result, large banks for which uninsured deposits were a relatively small share of total deposits and thus arguably a reasonable risk would pay a higher special assessment than smaller banks with significant uninsured-deposit funding as a percentage of total deposits.

The FDIC reserves the right to impose a special one-time assessment if losses when the bridge banks are finally closed exceed the estimate on which the premium is calculated; it does not appear that any over-assessment would be refunded to covered IDIs. The proposal details how anticipated losses were determined for the purposes of the premium calculation. It does not appear that any losses due to the receiverships not due to uninsured deposits are covered by this premium, leaving an additional loss of approximately $3 billion that would be covered by the DIF. As noted, the FDIC has discretion with regard to the timing and construct of any special assessments although it must impose at least one to offset the cost of a systemic failure. Those in this NPR are deemed to be those germane to protecting uninsured deposits even though the FDIC absorbed other costs (e.g., risk-shares) to complete these resolutions.

B. Alternatives

Alternatives to the proposal described above detailed in the NPR include:

- A rapid one-time assessment, an idea rejected due to likely impact during a period of economic fragility;
- Setting the premium by asset size based on the FDIC's view that larger banks benefited the most from restored financial stability due to the systemic designation, especially if they had large uninsured-deposit balances. This idea was rejected to avoid a size-related cliff effect;
- An assessment base equal to all uninsured deposits without the $5 billion deduction, rejected because the FDIC believes the law requires it to penalize entities that benefited from the rescue and this even-handed approach would not do so;
- Setting premiums based on uninsured deposits as a percentage of total deposits, rejected because institutions of very different asset sizes would pay the same assessment without penalizing the larger banks that the FDIC believes benefited regardless of how much uninsured deposits they held in

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total amount or as a share of total deposits;

- Charge IDIs fifty percent of the special assessment in year one and the remainder in year two. Rejected because the FDIC's full loss will not be quickly known. Variations on this timing option are also considered and rejected; and
- Apply the special assessment to regular assessment rates. If done without the $5 billion exemption, this would result in premiums of 4.57 bps with the $5 billion exception and 3.76 bps without it. The FDIC rejected this because it would not adequately penalize IDIs with large amounts of uninsured deposits and favor trust and custody banks due to the nature of the risk-based premium schedule.

C. Request for Comment

Comment is sought on these alternatives and on the proposal as a whole. Along with:

- Whether to calculate uninsured deposits at year-end 2022 as proposed;
- Another assessment measure;
- The $5 billion exception;
- The eight-quarter collection period;
- Exempting other deposits; and
- The shortfall calculation.

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