

## MEMO

**TO:** The Board of Directors

**FROM:** Patrick Mitchell  
Director, Division of Insurance and Research

**DATE:** June 21, 2022

**RE:** Notice of Proposed Rulemaking on Assessments, Revised Deposit Insurance Assessment Rates

### RECOMMENDATION

Staff recommend that the FDIC's Board of Directors (Board) adopt and authorize publication of the attached notice of proposed rulemaking (NPR or proposal) with an opportunity for public comment through August 20, 2022. The NPR would increase initial base deposit insurance assessment rates by 2 basis points, beginning with the first quarterly assessment period of 2023. Staff are separately and concurrently recommending adoption and publication of an Amended Restoration Plan, which incorporates the increase in initial base assessment rates in order to raise the reserve ratio to the minimum threshold of 1.35 percent by the statutory deadline of September 30, 2028.<sup>1</sup>

The proposed assessment rate schedules would remain in effect unless and until the reserve ratio meets or exceeds 2 percent, absent further Board action. The proposed change in assessment rates is further intended to support growth in the Deposit Insurance Fund (DIF or fund) in progressing toward the 2 percent Designated Reserve Ratio (DRR) to reduce the likelihood that the FDIC would need to consider a potentially procyclical assessment rate increase, and to increase the likelihood of the DIF remaining positive through potential future periods of significant losses due to bank failures, consistent with the FDIC's long-term fund management plan.<sup>2</sup>

### BACKGROUND

#### Restoration Plan

Extraordinary growth in insured deposits during the first and second quarters of 2020 caused the DIF reserve ratio to decline below the statutory minimum of 1.35 percent.<sup>3</sup> As of June 30, 2020, the reserve ratio had fallen below the statutory minimum and stood at 1.30 percent. The Federal Deposit Insurance Act (FDI Act) requires that the Board adopt a restoration plan when the DIF reserve ratio falls below 1.35 percent or is

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<sup>1</sup> See 12 U.S.C. 1817(b)(3)(E). The reserve ratio is calculated as the ratio of the net worth of the DIF to the value of the aggregate estimated insured deposits at the end of a given quarter. See 12 U.S.C. 1813(y)(3).

<sup>2</sup> See 75 FR 66273 (Oct. 27, 2010) and 76 FR 10672 (Feb. 25, 2011).

<sup>3</sup> See 12 U.S.C. 1817(b)(3)(B).

Concur:

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Harrel M. Pettway  
General Counsel

expected to within 6 months.<sup>4</sup> On September 15, 2020, the Board adopted a Restoration Plan to restore the DIF reserve ratio to at least 1.35 percent by September 30, 2028.<sup>5</sup> The Restoration Plan requires the FDIC to update its analysis and projections for the fund balance and reserve ratio at least semiannually, which enables the FDIC to evaluate whether the reserve ratio is likely to reach 1.35 percent within the 8-year period.

In its June 21, 2022, semiannual update to the Board, staff projections of the reserve ratio under different scenarios reflected that the reserve ratio is at risk of not reaching 1.35 percent by September 30, 2028, the end of the statutory 8-year period. The scenarios are based on updated data and analysis and incorporate different rates of insured deposit growth and weighted average assessment rates. As part of its update on analysis and projections for the fund, staff are separately and concurrently recommending the adoption and publication of an Amended Restoration Plan that incorporates the proposed increase in initial base assessment rates.

### **Designated Reserve Ratio**

The FDI Act requires that the Board designate a reserve ratio for the DIF and publish the DRR before the beginning of each calendar year.<sup>6</sup> The Board must set the DRR in accordance with its analysis of certain statutory factors: risk of losses to the DIF; economic conditions generally affecting insured depository institutions; preventing sharp swings in assessment rates; and any other factors that the Board determines to be appropriate.<sup>7</sup>

In 2010, the FDIC proposed and later adopted a comprehensive, long-term management plan for the DIF with the following goals: (1) reduce the pro-cyclicality in the existing risk-based assessment system by allowing moderate, steady assessment rates throughout economic and credit cycles; and (2) maintain a positive fund balance even during a banking crisis by setting an appropriate target fund size and a strategy for assessment rates and dividends.<sup>8</sup> Based on the FDIC's experience through two banking crises, the analysis concluded that a long-term moderate, steady assessment rate of 5.29 basis points would have been sufficient to prevent the fund from becoming negative during the crises.<sup>9</sup> The FDIC also found that the fund reserve ratio would have had to exceed 2 percent before the onset of the last two crises to achieve these results.

The FDIC's comprehensive, long-term fund management plan combines the moderate, steady assessment rate with a DRR of 2 percent. The Board set the DRR at 2 percent in 2010 and has voted annually since 2010 to maintain the 2 percent DRR, most recently in December 2021.<sup>10</sup> The FDIC views the DRR as a long-range, minimum goal that will allow the fund to grow sufficiently large during times of favorable banking conditions, increasing the likelihood that the DIF will remain positive throughout periods of significant losses due to bank failures. Additionally, in lieu of dividends, the long-term plan prescribes progressively lower assessment rates that will become effective when the reserve ratio exceeds 2 percent and 2.5 percent. Because analysis shows that a reserve ratio higher than 2 percent increases the chance that the fund will remain positive

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<sup>4</sup> See 12 U.S.C. 1817(b)(3)(E).

<sup>5</sup> See 85 FR 59306 (Sept. 21, 2020). Under the FDI Act, a restoration plan must restore the reserve ratio to at least 1.35 percent within 8 years of establishing the plan, absent extraordinary circumstances. 12 U.S.C. 1817(b)(3)(E)(ii).

<sup>6</sup> Section 7(b)(3)(A) of the FDI Act, 12 U.S.C. 1817(b)(3)(A). The DRR is expressed as a percentage of estimated insured deposits.

<sup>7</sup> Section 7(b)(3)(C) of the FDI Act, 12 U.S.C. 1817(b)(3)(C).

<sup>8</sup> See 75 FR 66272 (Oct. 27, 2010) and 76 FR 10672 (Feb. 25, 2011).

<sup>9</sup> See 75 FR at 66273 and 76 FR at 10675.

<sup>10</sup> See 75 FR 79286 (Dec. 20, 2010), codified at 12 CFR 327.4(g). See also 86 FR 71638 (Dec. 17, 2021).

during a crisis, the 2 percent DRR should not be treated as a cap on the size of the fund.<sup>11</sup>

### **Deposit Insurance Assessments**

Pursuant to Section 7 of the FDI Act, the FDIC has established a risk-based assessment system through which it charges all insured depository institutions (IDIs) an assessment amount for deposit insurance.<sup>12</sup>

Under the FDIC's regulations, an IDI's assessment is equal to its assessment base multiplied by its risk-based assessment rate.<sup>13</sup> Generally, an IDI's assessment base equals its average consolidated total assets minus its average tangible equity.<sup>14</sup> An IDI's assessment rate is determined each quarter based on supervisory ratings and information collected on the Consolidated Reports of Condition and Income (Call Report) or the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002), as appropriate. An IDI's assessment rate is calculated using different methods based on whether the IDI is a small, large, or highly complex institution.<sup>15</sup>

### **Current Assessment Rate Schedules**

In 2011, consistent with the FDIC's long-term fund management plan, the FDIC adopted lower, moderate assessment rates that would go into effect when the DIF reserve ratio reached 1.15 percent.<sup>16</sup> In 2016, the FDIC amended its rules to refine the deposit insurance assessment system for established small IDIs (i.e., small IDIs that have been federally insured for at least five years) and preserved the lower overall range of initial base assessment rates adopted in 2011 pursuant to the long-term fund management plan.<sup>17</sup> Those rates are currently in effect and are detailed below. In addition, the Board is authorized to uniformly increase or decrease the total base assessment rate schedule up to a maximum of 2 basis points or a fraction thereof, as the Board deems necessary, without further rulemaking.<sup>18</sup>

Current initial and total base assessment rates for established small institutions and large and highly complex institutions are set forth in Table 1 below.<sup>19</sup> An institution's total base assessment rate may vary from the institution's initial base assessment rate as a result of possible adjustments for certain liabilities that can increase or reduce loss to the DIF in the event the institution fails.<sup>20</sup>

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<sup>11</sup> See 75 FR at 66273 and 75 FR at 79287.

<sup>12</sup> See 12 U.S.C. 1817(b). As used in this proposed rule, the term "bank" is synonymous with the term "insured depository institution" as it is used in section 3(c)(2) of the FDI Act, 12 U.S.C. 1813(c)(2).

<sup>13</sup> See 12 CFR 327.3(b)(1).

<sup>14</sup> See 12 CFR 327.5.

<sup>15</sup> See 12 CFR 327.16(a) and (b). For assessment purposes, a small bank is generally defined as an institution with less than \$10 billion in total assets, a large bank is generally defined as an institution with \$10 billion or more in total assets, and a highly complex bank is generally defined as an institution that has \$50 billion or more in total assets and is controlled by a parent holding company that has \$500 billion or more in total assets, or is a processing bank or trust company. As used in this proposed rule, the term "small bank" is synonymous with the term "small institution" and the term "large bank" is synonymous with the term "large institution" or "highly complex institution," as the terms are defined in 12 CFR 327.8(e), (f), and (g), respectively.

<sup>16</sup> See 76 FR at 10683-10688.

<sup>17</sup> See 81 FR 32180, 32189-32191 (May 20, 2016).

<sup>18</sup> See 12 CFR 327.10(f)(3). However, the lowest initial base assessment rate cannot be negative.

<sup>19</sup> See 12 CFR 327.10(b)(2). An established insured depository institution is a bank or savings association that has been federally insured for at least five years as of the last day of any quarter for which it is being assessed. See 12 CFR 327.8(k).

<sup>20</sup> See 12 CFR 327.16(e).

**Table 1 – Current Total Base Assessment Rate Schedule (After Adjustments) Applicable to Established Small Institutions and Large and Highly Complex Institutions<sup>1, 2</sup>**

	Established Small Institutions			Large & Highly Complex Institutions
	CAMELS Composite			
	1 or 2	3	4 or 5	
Initial Base Assessment Rate	3 to 16	6 to 30	16 to 30	3 to 30
Unsecured Debt Adjustment <sup>3</sup>	-5 to 0	-5 to 0	-5 to 0	-5 to 0
Brokered Deposit Adjustment	N/A	N/A	N/A	0 to 10
Total Base Assessment Rate	1.5 to 16	3 to 30	11 to 30	1.5 to 40

<sup>1</sup> The depository institution debt adjustment, which is not included in the table, can increase total base assessment rates above the maximum assessment rates shown in the table.

<sup>2</sup> All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

<sup>3</sup> The unsecured debt adjustment cannot exceed the lesser of 5 basis points or 50 percent of an insured depository institution’s initial base assessment rate; thus, for example, an insured depository institution with an initial base assessment rate of 3 basis points will have a maximum unsecured debt adjustment of 1.5 basis points and cannot have a total base assessment rate of lower than 1.5 basis points.

The assessment rates currently applicable to established small institutions and large and highly complex institutions in Table 1 above would remain in effect unless and until the reserve ratio meets or exceeds 2 percent.<sup>21</sup>

**DISCUSSION OF THE PROPOSAL**

**Overview**

Staff recommend that the Board, under its general rulemaking authority in Section 9 of the FDI Act, and its specific authority under Section 7 of the FDI Act to set assessments, adopt and authorize for publication this proposal that would increase initial base deposit insurance assessment rates by 2 basis points, beginning with the first quarterly assessment period of 2023.<sup>22</sup>

The proposed change is intended to achieve two objectives. First, the proposal is intended to increase assessment revenue in order to raise the reserve ratio to the minimum threshold of 1.35 percent within 8 years of the Restoration Plan’s initial establishment, as required by statute, and consistent with the Amended Restoration Plan.

Second, the proposed change in assessment rates is further intended to support growth in the DIF in progressing toward the 2 percent DRR and would bring the average assessment rate close to the moderate, steady assessment rate that would have been required to maintain a positive DIF balance from 1950 to 2010,

<sup>21</sup> In lieu of dividends, and pursuant to the FDIC’s authority to set assessments, the progressively lower initial base and total base assessment rates set forth in 12 CFR 327.10(c) and (d) will come into effect without further action by the FDIC Board when the fund reserve ratio at the end of the prior assessment period reaches 2 percent and 2.5 percent, respectively.

<sup>22</sup> See 12 U.S.C. 1817 and 1819.



identified as part of the long-term, comprehensive fund management plan in 2011.<sup>23</sup> Therefore, the proposed assessment rate schedules would remain in effect unless and until the reserve ratio meets or exceeds 2 percent, absent further Board action. This continued growth in the DIF is intended to reduce the likelihood that the FDIC would need to consider a potentially pro-cyclical assessment rate increase, and to increase the likelihood of the DIF remaining positive through potential future periods of significant losses due to bank failures. In lieu of dividends, the progressively lower assessment rate schedules currently in the regulation will remain unchanged and will come into effect without further action by the Board when the fund reserve ratio at the end of the prior assessment period reaches 2 percent and 2.5 percent, respectively.<sup>24</sup> Staff are not recommending changes to the rate schedules that come into effect when the reserve ratio reaches 2 and 2.5 percent.

Staff recommend that the Board retain flexibility to adopt higher or lower total base assessment rates, provided that the Board cannot increase or decrease rates from one quarter to the next by more than 2 basis points, and cumulative increases and decreases cannot be more than 2 basis points higher or lower than the total base assessment rates set forth in the assessment rate schedules.<sup>25</sup> Retention of this flexibility would continue to allow the Board to act in a timely manner to fulfill its mandate to raise the reserve ratio, particularly in light of the uncertainty related to insured deposit growth and the economic outlook.

### **Proposed Assessment Rate Schedules**

Pursuant to the FDIC's authority to set assessments, the proposed initial and total base assessment rates applicable to established small institutions and large and highly complex institutions set forth in Table 2 below would take effect beginning with the first quarterly assessment period of 2023. An institution's total base assessment rate may vary from the institution's initial base assessment rate as a result of possible adjustments for certain liabilities that can increase or reduce loss to the DIF in the event the institution fails.<sup>26</sup> These adjustments do not reflect a change and are consistent with the current assessment regulations.

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<sup>23</sup> See 75 FR at 66273 and 76 FR at 10675.

<sup>24</sup> See 12 CFR 327.10(c) and (d).

<sup>25</sup> See 12 CFR 327.10(f).

<sup>26</sup> See 12 CFR 327.16(e).

**Table 2 – Proposed Total Base Assessment Rate Schedule (After Adjustments)<sup>1</sup> Beginning the First Assessment Period of 2023, Where the Reserve Ratio as of the End of the Prior Assessment Period Is Less Than 2 Percent<sup>2</sup>**

	Established Small Institutions			Large & Highly Complex Institutions
	CAMELS Composite			
	1 or 2	3	4 or 5	
Initial Base Assessment Rate	5 to 18	8 to 32	18 to 32	5 to 32
Unsecured Debt Adjustment <sup>3</sup>	-5 to 0	-5 to 0	-5 to 0	-5 to 0
Brokered Deposit Adjustment	N/A	N/A	N/A	0 to 10
Total Base Assessment Rate	2.5 to 18	4 to 32	13 to 32	2.5 to 42

<sup>1</sup> The depository institution debt adjustment, which is not included in the table, can increase total base assessment rates above the maximum assessment rates shown in the table.

<sup>2</sup> All amounts are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

<sup>3</sup> The unsecured debt adjustment cannot exceed the lesser of 5 basis points or 50 percent of an insured depository institution’s initial base assessment rate; thus, for example, an insured depository institution with an initial base assessment rate of 5 basis points will have a maximum unsecured debt adjustment of 2.5 basis points and cannot have a total base assessment rate of lower than 2.5 basis points.

The proposed rates applicable to established small institutions and large and highly complex institutions in Table 2 above would remain in effect unless and until the reserve ratio meets or exceeds 2 percent, absent further Board action. In lieu of dividends, and pursuant to the FDIC’s authority to set assessments, progressively lower initial and total base assessment rate schedules applicable to established small institutions and large and highly complex institutions as currently set forth in 12 CFR 327.10(c) and (d) will come into effect without further action by the Board when the fund reserve ratio at the end of the prior assessment period reaches 2 percent and 2.5 percent, respectively.<sup>27</sup> Staff are not recommending changes to these progressively lower assessment rate schedules.

**Conforming, Technical, and Other Amendments to the Assessment Regulations**

Staff recommend that the Board propose conforming amendments in Sections 327.10 and 327.16 of the FDIC’s assessment regulations to effectuate the modifications described above. These conforming amendments would ensure that the proposed uniform increase in initial base deposit insurance assessment rates of 2 basis points is properly incorporated into the assessment regulation provisions governing the calculation of an IDI’s quarterly deposit insurance assessment. Staff also recommend additional amendments to update and conform Appendix A to Subpart A of Part 327—Method to Derive Pricing Multipliers and Uniform Amount in accordance with the current assessment regulations. As a technical change, staff recommend rescinding in its entirety Section 327.9—Assessment Pricing Methods, and certain rate schedules in Section 327.10, as such section and rate schedules are no longer in effect.

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<sup>27</sup> See 12 CFR 327.10(c) and (d).

## ANALYSIS

The following summarizes the factors considered in recommending a uniform increase in initial base assessment rates of 2 basis points.<sup>28</sup>

### *Assessment Revenue Needs*

Under the Restoration Plan, staff is monitoring deposit balance trends, potential losses, and other factors that affect the reserve ratio. During the first quarter of 2022, growth in insured deposits outpaced growth in the DIF, resulting in a decline in the reserve ratio of 4 basis points to 1.23 percent as of March 31, 2022.

While assessment revenue was the primary contributor to growth in the DIF, the weighted average assessment rate for all IDIs was approximately 3.7 basis points for the assessment period ending March 31, 2022, compared to approximately 4.0 basis points when the Restoration Plan was established. In the first quarter of 2022, unrealized losses on available-for-sale securities in the DIF portfolio contributed to a relatively flat DIF balance, driven by rising yields as market participants reacted to expectations of increased inflation and tighter monetary policy. The DIF has experienced low losses from bank failures, with no banks failing in 2021 and thus far in 2022. As of March 31, 2022, the DIF balance totaled \$123.0 billion, up \$3.7 billion from one year earlier.

In recognition that sustained elevated insured deposit balance trends, lower than anticipated weighted average assessment rates, and other factors have affected the ability of the reserve ratio to return to 1.35 percent before September 30, 2028, staff propose to increase initial base deposit insurance assessment rates uniformly by 2 basis points. While subject to uncertainty, based on updated analysis of deposit balance trends, potential losses, and other factors that affect the reserve ratio, staff project that the increase in assessment rates would increase the likelihood that the reserve ratio returns to 1.35 percent before September 30, 2028.

The proposed assessment rate schedules would remain in effect unless and until the reserve ratio meets or exceeds 2 percent. The proposed increase is further intended to support growth in the DIF in progressing toward the 2 percent DRR and would bring the average assessment rate close to the moderate, steady assessment rate that would have been required to maintain a positive DIF balance from 1950 to 2010, identified as part of the long-term, comprehensive fund management plan in 2011.<sup>29</sup> The assessment rate schedules adopted as part of the long-term, comprehensive plan came into effect once the reserve ratio reached 1.15 percent in 2016. Since then, the industry weighted average assessment rate has been consistently and significantly below the moderate, steady assessment rate that would have been required to maintain a positive DIF balance from 1950 to 2010, averaging 3.8 basis points and ranging between 3.5 and 4.1 basis points through 2019.<sup>30</sup> Over the four most recent quarters the weighted average assessment rate ranged between 3.6 and 3.7

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<sup>28</sup> In setting assessment rates, the Board is required by statute to consider:

- (i) The estimated operating expenses of the DIF.
  - (ii) The estimated case resolution expenses and income of the DIF.
  - (iii) The projected effects of the payment of assessment on the capital and earnings of IDIs.
  - (iv) The risk factors and other factors taken into account pursuant to section 7(b)(1) of the FDI Act (12 U.S.C. 1817(b)(1)) under the risk-based assessment system, including the requirement under such section to maintain a risk-based system.
  - (v) Other factors the Board has determined to be appropriate.
- Section 7(b)(2) of the FDI Act, 12 U.S.C. 1817(b)(2)(B).

<sup>29</sup> See 75 FR at 66273 and 76 FR at 10675.

<sup>30</sup> Weighted average assessment rates do not reflect large bank surcharges, which were collected beginning December 30, 2016, and ending December 30, 2018, or small bank credits, which were applied beginning June 30, 2019, and ending June 30, 2020.

basis points.

The proposed increase in assessment rates would bring the average assessment rate of 3.7 basis points as of March 31, 2022, close to the moderate, steady assessment rate that would have been required to maintain a positive DIF balance from 1950 to 2010. Sustaining this additional assessment revenue would support continued growth in the DIF, thereby reducing the likelihood that the FDIC would need to consider a potentially pro-cyclical assessment rate increase and increasing the likelihood of the DIF remaining positive through potential future periods of significant losses due to bank failures. In lieu of dividends, progressively lower assessment rate schedules will come into effect without further action by the Board when the reserve ratio at the end of the prior assessment period reaches 2 percent and 2.5 percent, respectively.<sup>31</sup>

The proposed 2 basis point increase in assessment rates would increase the likelihood for reaching the statutory minimum reserve ratio by September 30, 2028 and accelerate the timeline for achieving the long-term goal of a 2 percent DRR without imposing excessive burden on the industry. The proposal would have a modest effect on banking industry income, resulting in an estimated annual reduction averaging less than 2 percent. The banking industry remained resilient moving into the second half of 2022 despite the extraordinary challenges of the pandemic, and is well-positioned to absorb such a rate increase.

Overall, it is staff's view that the recommended assessment rate increase appropriately balances several considerations, including the goal of reaching the statutory minimum reserve ratio reasonably promptly, the goal of strengthening the fund to reduce the risk of pro-cyclical assessments in the event of a future downturn or industry stress, and the projected effects on bank earnings at a time when the banking industry is better positioned to absorb an assessment rate increase.

#### *Deposit Balance Trends*

Over the past four quarters, insured deposits exhibited annual growth that was slightly above historical averages. Insured deposits grew by 1.59 percent in the fourth quarter of 2021, slightly above the pre-pandemic quarterly average of 1.40 percent. In the first quarter of 2022, insured deposits grew by 2.48 percent, slightly above the quarterly average of 2.32 percent. This moderation in insured deposit growth, relative to the first half of 2020 and the first quarter of 2021, was attributable in part to a decline in support from fiscal stimulus programs and increases in consumer spending. Over the last year, insured deposits have grown by 4.9 percent, which is slightly elevated compared to the pre-pandemic average of 4.5 percent.

While insured deposit growth has largely normalized, aggregate balances remain significantly elevated. In the previous semiannual update to the Board, staff estimated that excess insured deposits that flowed into banks as the result of actions taken by monetary and fiscal authorities, and by individuals, businesses, and financial market participants in response to the Coronavirus Disease (COVID-19) pandemic totaled approximately \$1.13 trillion. This estimate reflects the amount of insured deposits as of September 30, 2021, in excess of the amount that would have resulted if insured deposits had grown at the pre-pandemic average rate of 4.5 percent since December 31, 2019.<sup>32</sup> Rather than receding, as previously expected, these excess insured deposits have grown by about \$200 billion through March 31, 2022.

The outlook for insured deposits remains uncertain and depends on several factors, including the outlook for consumer spending and incomes. A year has passed since the latest quarter of extraordinary growth

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<sup>31</sup> See 12 CFR 327.10(c) and (d).

<sup>32</sup> By September 30, 2021, deposit balances would have fully reflected the more significant actions taken by monetary and fiscal authorities in response to the COVID-19 pandemic. September 2021 was also the first month that the personal savings rate declined to a level within the range reported during the year prior to the pandemic.

in insured deposits prompted by the last round of fiscal stimulus, but those deposits have yet to exhibit any indication of receding. Staff will continue to closely monitor depositor behavior and the effects on insured deposits.

#### *Case Resolution Expenses (Insurance Fund Losses)*

Losses from past and future bank failures affect the reserve ratio by lowering the fund balance. In recent years, the DIF has experienced low losses from IDI failures. On average, four IDIs per year failed between 2016 and 2021, at an average annual cost to the fund of about \$208 million. No banks have failed thus far in 2022, marking 19 consecutive months without a bank failure and the seventh year in a row with few or no failures. Based on currently available information about banks expected to fail in the near term; analyses of longer-term prospects for troubled banks; and trends in CAMELS ratings, failure rates, and loss rates; staff project that failures for the five-year period from 2022 to 2026 would cost the fund approximately \$1.8 billion.

The total number of institutions on the FDIC's Problem Bank List was 40 at the end of the first quarter of 2022, the lowest level since publication of the FDIC's Quarterly Banking Profile began in 1984.<sup>33</sup> The number of troubled banks is currently expected to remain at low levels.

Future losses to the DIF remain uncertain, although some sources of uncertainty have changed since the Restoration Plan was adopted in September of 2020. The uncertainties include, among others, the variable trends in COVID-19 infections, rising inflation and interest rates, the possibility of recession, supply chain pressures, geopolitical tensions, and evolving consumer and depositor behavior, any of which could have longer-term effects on the condition and performance of the banking industry. However, the banking industry has remained a source of strength for the economy, in part, because its stronger capital position has better positioned banks to withstand losses compared to 2008.

#### *Operating Expenses and Investment Income*

Operating expenses remain steady, while low investment returns coupled with elevated unrealized losses on securities held by the DIF have limited growth in the fund balance, particularly in the first quarter of 2022.

Operating expenses partially offset increases in the DIF balance. Operating expenses have remained steady, ranging between \$450 and \$475 million per quarter since the Restoration Plan was first adopted in September 2020, totaling \$453 million as of March 31, 2022.

Growth in the fund balance has been limited by a prolonged period of low investment returns on securities held by the DIF. Recently, as a result of the rising interest rate environment and market expectations leading up to such rate increases, the DIF has also experienced elevated unrealized losses on securities. Unrealized losses on available-for-sale securities in the DIF portfolio contributed to a relatively flat DIF balance in the first quarter of 2022. Unrealized losses were primarily due to rising yields as market participants reacted to expectations of increased inflation and tighter monetary policy. Future market movements may temporarily increase unrealized losses in the near term, to the extent that market participants have not already priced in these actions. However, staff expect that these unrealized losses will be outpaced by higher investment returns over the longer-term as future cash proceeds are reinvested at higher rates.

#### *Projections for the Fund Balance and Reserve Ratio*

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<sup>33</sup> "Problem" institutions are institutions with a CAMELS composite rating of "4" or "5" due to financial, operational, or managerial weaknesses that threaten their continued financial viability.

In its consideration of proposed rates, staff sought to increase the likelihood that the reserve ratio would reach the statutory minimum of 1.35 percent by the statutory deadline of September 30, 2028, and to support growth in the DIF in progressing toward the long-term goal of a 2 percent DRR. With these objectives in mind, staff updated its analysis and projections for the fund balance and reserve ratio to estimate how changes in insured deposit growth and assessment rates affect when the reserve ratio would reach the statutory minimum of 1.35 percent and the DRR of 2 percent.

Based on this analysis, staff project that, absent an increase in assessment rates, the reserve ratio is at risk of not reaching the statutory minimum of 1.35 percent by the statutory deadline of September 30, 2028. In estimating how soon the reserve ratio would reach 1.35 percent, staff developed two scenarios that assume different levels of insured deposit growth and average assessment rates, both of which staff view as reasonable based on current and historical data. For insured deposit growth, staff assumed annual growth rates of 4.0 percent and 3.5 percent, respectively. These insured deposit growth rates represent a range of excess insured deposits resulting from the pandemic being retained. The assumption of a 4.0 percent annual growth rate reflects retention of all of the estimated \$1.13 trillion of excess deposits in insured accounts, with this amount not contributing to further growth, while the remaining balance of insured deposits continues to grow at the pre-pandemic average annual rate of 4.5 percent.

Alternatively, a 3.5 percent annual growth rate assumption reflects banks retaining about 60 percent of the estimated excess insured deposits resulting from the pandemic, with this amount not contributing to further growth, while the remaining balance of insured deposits as of March 31, 2022, grows at the pre-pandemic average annual rate of 4.5 percent.

The two scenarios also apply different assumptions for average annual assessment rates. The weighted average assessment rate for all banks during 2019, prior to the pandemic, was about 3.5 basis points and rose to 4.0 basis points, on average, during 2020. The weighted average assessment rate for all IDIs was approximately 3.7 basis points for the assessment period ending March 31, 2022. For the scenario in which all excess insured deposits are retained, staff assumed a lower assessment rate of 3.5 basis points, and for the scenario in which some excess insured deposits recede, staff assumed an assessment rate of 4.0 basis points.

In developing the proposal, staff projected the date that the reserve ratio would likely reach the statutory minimum of 1.35 percent in each scenario, shown in Table 3 below. Under Scenario A, which assumes annual insured deposit growth of 4.0 percent and an average annual assessment rate of 3.5 basis points, staff project that the reserve ratio would reach 1.35 percent in the third quarter of 2034, after the statutory deadline of September 30, 2028.

**Table 3 – Scenario Analysis:  
Expected Time to Reach a 1.35 Percent Reserve Ratio**

	Annual Insured Deposit Growth Rate [Percent]	Average Annual Assessment Rate [Basis Points]	Date the Reserve Ratio Reaches 1.35 Percent	As of 1Q 2023, Average Annual Assessment Rate Increases by...	
				1 BPS	2 BPS
Scenario A	4.0	3.5	3Q 2034	3Q 2026	4Q 2024
Scenario B	3.5	4.0	2Q 2027	2Q 2025	2Q 2024

In Scenario B, which assumed annual insured deposit growth of 3.5 percent and an average annual

assessment rate of 4.0 basis points, staff project that the reserve ratio would reach 1.35 percent in the second quarter of 2027. Even under these relatively favorable conditions, which assume lower insured deposit growth and a higher average assessment rate than experienced over the last year, the reserve ratio reaches the statutory minimum of 1.35 percent close to the statutory deadline. While staff project that reserve ratio would reach the statutory minimum before the deadline in this Scenario, any number of uncertain factors—including unexpected losses, accelerated insured deposit growth, or lower weighted average assessment rates due to improving risk profiles of institutions—could materialize between now and the second quarter of 2027, and easily prevent the reserve ratio from reaching the minimum by the statutory deadline.

Both Scenarios apply assumptions for insured deposit growth and average assessment rates that staff view as reasonable based on current and historical data, and that do not widely differ from each other in magnitude. These relatively minor changes in the underlying assumptions result in considerably different outcomes, as the reserve ratio is projected to reach the statutory minimum of 1.35 percent in 2034 in Scenario A, compared to 7 years earlier in Scenario B. The disparity between outcomes under these Scenarios demonstrates the sensitivity of the projections to slight variations in any key variable.

Given these uncertainties, staff projected the DIF balance and associated reserve ratio under each Scenario, applying an increase in average assessment rates beginning in the first assessment period of 2023. Under Scenario A, a 1 basis point increase in the average assessment rate is projected to result in the reserve ratio reaching the minimum in the third quarter of 2026, and a 2 basis point increase is projected to result in the reserve ratio reaching the minimum in the fourth quarter of 2024. Under Scenario B, a 1 basis point increase in the average assessment rate is projected to result in the reserve ratio reaching the minimum in the second quarter of 2025, and a 2 basis point increase is projected to result in the reserve ratio reaching the minimum in the second quarter of 2024.

While staff project that the reserve ratio would reach the minimum before the statutory deadline under Scenario B with no increase in assessment rates, or under Scenario A with a 1 basis point increase in the average assessment rate, these outcomes are still over 4 years away and carry higher risk that the Board would have to increase assessment rates in the face of a future downturn or industry stress.

In contrast, the proposed increase of 2 basis points would improve the likelihood that the reserve ratio will reach the minimum ahead of the statutory deadline, building in a buffer in the event of uncertainties as described above that could stall or counter growth in the reserve ratio. Under both scenarios described above, an increase in assessment rates of 2 basis points is projected to result in the reserve ratio reaching the statutory minimum reserve ratio of 1.35 percent approximately two years from now.

Reaching the minimum reserve ratio of 1.35 percent ahead of the statutory deadline would mean that the FDIC would exit its Restoration Plan. If the reserve ratio subsequently declined below the statutory minimum, the FDIC would establish a new restoration plan and would have an additional eight years to restore the reserve ratio.

Staff also analyzed the effects of an increase in assessment rates in supporting growth in the DIF in progressing toward the 2 percent DRR. For this analysis, staff assumed a near-term annual insured deposit growth rate of 3.5 percent and a weighted average assessment rate of 4.0 basis points.<sup>34</sup> These assumptions reflect the ranges of insured deposit growth and assessment rates used in Scenario B, described above, and result in the shortest projected timeline to reach a 2 percent reserve ratio. As illustrated in Chart 1, even under these relatively favorable conditions, absent an increase in assessment rates, the projected reserve ratio would

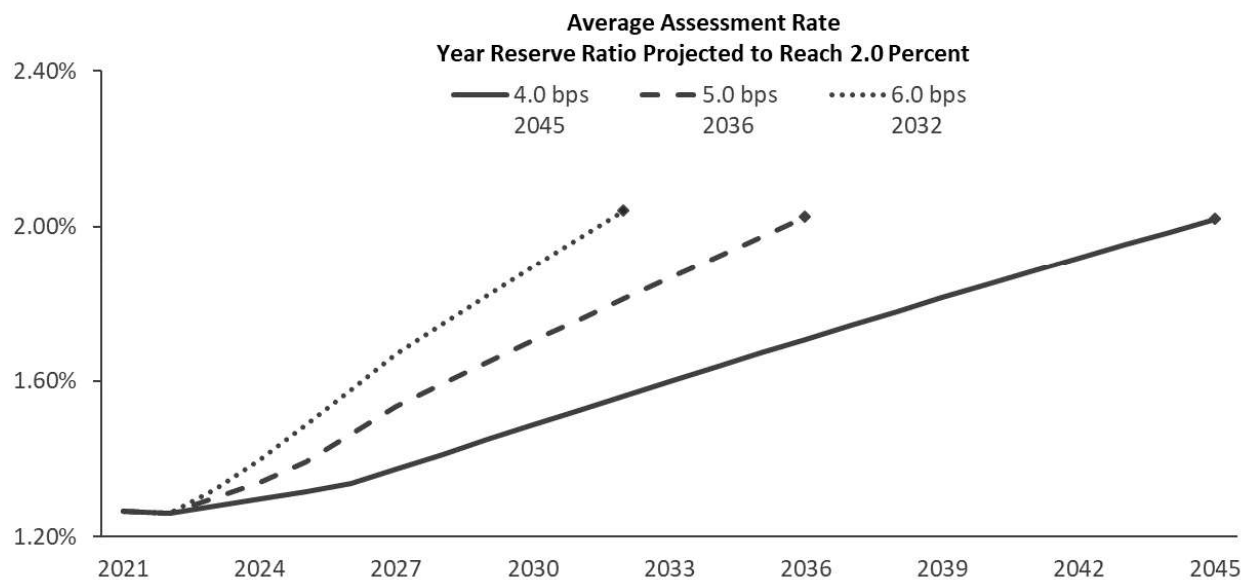
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<sup>34</sup> After September 30, 2028, the deadline to restore the reserve ratio to the 1.35 percent minimum, insured deposits are assumed to grow at the pre-pandemic annual average of 4.5 percent.

not reach 2 percent until 2045, over twenty years from now.<sup>35</sup> When the FDIC proposed the long-term, comprehensive fund management plan in 2010, it estimated that the reserve ratio would reach 2 percent in 2027.<sup>36</sup>

Using the same assumptions, an increase in assessment rates would significantly accelerate the timeline for achieving a 2 percent DRR. An increase in assessment rates of 1 basis point resulted in the projected reserve ratio reaching 2 percent in 2036, nine years faster. Applying a 2 basis point increase in assessment rates accelerated the timeline by an additional four years, to 2032.

Chart 1 – Expected Time to Reach a 2 Percent Reserve Ratio



The proposed 2 basis point increase in assessment rates would bring the average assessment rate of 3.7 basis points, as of March 31, 2022, close to the moderate steady assessment rate that would have been required to maintain a positive DIF balance from 1950 to 2010, and identified as part of the long-term, comprehensive fund management plan in 2011.<sup>37</sup> Upon achieving the 2 percent DRR, progressively lower assessment rate schedules would take effect. The proposed 2 basis point increase would accelerate the timeline for achieving the 2 percent DRR significantly, would reduce the likelihood that the FDIC would need to consider a potentially procyclical assessment rate increase, and would increase the likelihood of the DIF remaining positive through potential future periods of significant losses due to bank failures, consistent with the FDIC’s long-term fund

<sup>35</sup> The analysis shown in Chart 1 is based on the assumptions used in Scenario B through the projected quarter that the reserve ratio meets or exceeds 1.35 percent. Afterward, the analysis assumes: (1) net income on investments by the Fund based on market-implied forward rates; (2) the assessment base grows 4.5 percent, annually; (3) operating expenses grow at 1 percent per year; and (4) failures for the five-year period from 2022 to 2026 cost approximately \$1.8 billion, with a historically low level of losses each year thereafter. The uniform increase in assessment rates of 1 or 2 basis points from the current rate schedule is assumed to take effect on January 1, 2023.

<sup>36</sup> See 75 FR at 66281.

<sup>37</sup> See 75 FR at 66273 and 76 FR at 10675.



management plan.

#### *Capital and Earnings Analysis and Expected Effects*

Staff estimated that a uniform increase in initial base assessment rates of 2 basis points would contribute approximately \$4.5 billion in assessment revenue in 2023. To estimate the effects of the proposed increase relative to a bank's capital, the analysis considers the effective after-tax cost of assessments in calculating the effect on capital, and assumes that an institution will maintain its dividend rate (that is, dividends as a fraction of net income) unchanged from the weighted average rate reported over the four quarters ending March 31, 2022.<sup>38</sup> Given the assumptions in the analysis, and based on data as of March 31, 2022, for the industry as a whole, staff estimate that, on average, a uniform increase in assessment rates of 2 basis points would decrease Tier 1 capital by an estimated 0.1 percent.<sup>39</sup> The proposed increase is estimated to cause no banks whose ratio of equity to assets would have equaled or exceeded 4 percent under the current assessment rate schedule to fall below that percentage (becoming undercapitalized), and no banks whose ratio of equity to assets would have exceeded 2 percent under the current rate schedule to fall below that percentage, becoming critically undercapitalized.

The effect of the change in assessments on an institution's income is measured by the change in deposit insurance assessments as a percent of income before assessments and taxes (hereafter referred to as "income"). Staff analyzed the impact of assessment changes on institutions that were profitable in the period covering the 12 months before March 31, 2022. The banking industry reported an increase in full year 2021 income primarily due to negative provision expense in all four quarters of the year. From April 1, 2021, through March 31, 2022, most (4,615 out of 4,789) IDIs were profitable.

Given the assumptions in the analysis, for the industry as a whole, staff estimate that the annual increase in assessments would average 1.0 percent of income, which includes an average of 0.9 percent for small banks and an average of 1.0 percent for large and highly complex institutions.<sup>40</sup> Approximately 95 percent of profitable institutions are projected to have an increase in assessments of less than 5 percent of income, with 95 percent of profitable small institutions and 100 percent of profitable large and highly complex institutions projected to have an increase of less than 5 percent of income. Another 5 percent of profitable institutions—all profitable small institutions—are projected to have an increase in assessments equal to or in excess of 5 percent of income.

#### *Strengthening the DIF*

As discussed above, an increase in assessment rates of 2 basis points is unlikely to have large material

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<sup>38</sup> For purposes of this analysis, equity to assets is used as the measure of capital adequacy. In the event that the ratio of equity to assets falls below 4 percent, however, this assumption is modified such that an institution retains the amount necessary to reach a 4 percent minimum and distributes any remaining funds according to the dividend payout rate. The analysis uses 4 percent as the threshold because IDIs generally need to maintain a leverage ratio of 4.0 percent or greater, among other requirements, to be considered "adequately capitalized" under Prompt Corrective Action Standards. 12 CFR 324.403.

<sup>39</sup> Estimates and projections related to the proposed uniform increase in assessment rates of 2 basis points assume that: (1) insured deposit growth is 4 percent annually, seasonally distributed in line with average growth rates from 2015 through 2019; (2) the average assessment rate before any rate increase is 3.5 basis points; (3) losses to the DIF from bank failures through 3Q 2028 total \$2.36 billion; (4) the assessment base grows 4.5 percent, annually; (5) interest income on the deposit insurance fund balance is zero; and (6) operating expenses grow at 1 percent per year.

<sup>40</sup> Earnings or income are annual income before assessments and taxes. Annual income is assumed to equal income from April 1, 2021, through March 31, 2022.

effects on any individual institution. However, the resulting increase in assessment revenue, combined across all institutions, would grow the DIF by over \$4 billion a year. This growth would strengthen the DIF's ability to withstand potential future periods of significant losses due to bank failures and reduce the likelihood that the FDIC would need to increase assessment rates during a future banking crisis. Accelerating the time in which the reserve ratio would reach the statutory minimum of 1.35 percent and the DRR of 2 percent would allow the banking industry to remain a source of strength for the economy during a potential future downturn and would continue to ensure public confidence in federal deposit insurance.

## **ALTERNATIVES**

Staff considered several reasonable and possible alternatives. On balance, staff view the current proposal as the most appropriate and most straightforward manner in which to achieve the objectives of the Amended Restoration Plan and the long-term fund management plan.

The first alternative would be to maintain the current schedule of assessment rates. Under this alternative, the reserve ratio would be at risk of not reaching the statutory minimum of 1.35 percent by the deadline of September 30, 2028, as growth in the fund resulting from current assessment rates could be offset if unexpected losses materialize, insured deposit growth accelerates, or risk profiles of institutions continue to improve resulting in lower assessment rates. Additionally, relative to the other alternatives and the current proposal, maintaining the current schedule of assessment rates would not result in any acceleration of growth in the DIF in progressing toward the FDIC's long-term goal of a 2 percent DRR. Absent an increase in assessment rates and assuming annual insured deposit growth of 3.5 percent and a weighted average assessment rate of 4.0 basis points, staff projected that the reserve ratio would achieve the 2 percent DRR in 2045, thirteen years later than if the FDIC were to apply an increase in assessment rates of 2 basis points beginning in 2023.

A second alternative would be to increase initial base assessment rates uniformly by 1 basis point. Staff project that a 1 basis point increase in the average assessment rate would result in the reserve ratio reaching the minimum in 2025 or 2026, based on its scenario analysis. Staff rejected this alternative in favor of a 2 basis point increase because these dates are close to the statutory deadline and provide a limited buffer to absorb unexpected losses, accelerated insured deposit growth, or lower average assessment rates that could materialize over this period. The alternative increases the likelihood that the FDIC would need to consider a potentially pro-cyclical increase in assessment rates should the banking industry enter a period of stress. Additionally, a 1 basis point increase is projected to result in the reserve ratio achieving the 2 percent DRR in 2036, about 4 years later than if the FDIC were to apply an increase in assessment rates of 2 basis points.

A third alternative would be to impose a one-time special assessment of 4.5 basis points, applicable to the assessment base of all IDIs. Utilizing data as of March 31, 2022, and assuming an effective date of January 1, 2023, staff estimate that a one-time special assessment of 4.5 basis points would contribute approximately \$9.8 billion in assessment revenue and the reserve ratio would reach 1.35 percent the quarter following the effective date (i.e., the second assessment period of 2023). While a one-time special assessment of 4.5 basis points is projected to increase the DIF reserve ratio to 1.35 percent the most quickly and precisely, and would significantly mitigate the potential that the FDIC would need to consider a potentially pro-cyclical increase in assessment rates, it is estimated to result in a quarterly assessment expense that is more than 8 times greater than the proposal. Staff estimate that, on average, a one-time special assessment of 4.5 basis points would decrease Tier 1 capital by an estimated 0.4 percent and reduce the annual earnings of IDIs by approximately 2.3 percent, in aggregate. Additionally, the risk would remain that the reserve ratio could fall back below the statutory minimum shortly after being restored to 1.35 percent, resulting in the establishment of a new restoration plan. Finally, a one-time special assessment would not meaningfully accelerate the timeline for achieving the 2 percent DRR.

On balance, in staff's view, the proposed increase of 2 basis points in initial base assessment rates appropriately balances several considerations, including the goal of reaching the statutory minimum reserve ratio reasonably promptly, accelerating the timeline for achieving a 2 percent DRR, strengthening the fund to reduce the risk that the FDIC would need to consider a potentially pro-cyclical assessment increase in the event of a future downturn or industry stress, and the projected effects on bank earnings at a time when the banking industry is better positioned to absorb an assessment rate increase.

**COMMENT PERIOD, EFFECTIVE DATE, AND APPLICATION DATE**

Staff recommend issuing this proposal with an opportunity for public comment through August 20, 2022. Following the comment period, staff expect that a final rule would be issued with an effective date of January 1, 2023, and applicable to the first quarterly assessment period of 2023 (i.e., January 1 – March 31, 2023).

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