May 12, 2023

FDIC Proposed Special Assessments for SVB and Signature Bank Resolutions

Proposed Rule Would Impose Assessments Based Solely on Estimated Uninsured Deposits as of December 31, 2022, Establish First Quarterly Assessment Period Beginning on January 1, 2024

SUMMARY

On May 11, 2023, the Board of Directors of the Federal Deposit Insurance Corporation ("*FDIC*") approved a notice of proposed rulemaking ("*Proposed Rule*")[1] that would impose special assessments to recover the loss to the Deposit Insurance Fund ("*DIF*") in connection with the use of the "systemic risk" exception to the least-cost resolution test ("*Systemic Risk Determination*") in connection with the resolutions of Silicon Valley Bank ("*SVB*") and Signature Bank ("*Signature*").[2] The total amount to be collected under the special assessments would be equal to the losses to the DIF attributable to the protection of uninsured depositors at SVB and Signature, which the FDIC currently estimates to be $15.8 billion.[3] The Proposed Rule notes that the special assessments "will be adjusted as the loss estimate changes."[4]

Under the Proposed Rule, the "assessment base" would be equal to an insured depository institution's ("*IDI*")[5] estimated uninsured deposits as of December 31, 2022, adjusted to exclude the first $5 billion in estimated uninsured deposits.[6] The special assessments would be collected at an annual rate of approximately 12.5 basis points over eight quarterly assessment periods, and the first quarterly assessment period would begin on January 1, 2024 (with the first assessment payment due by June 28, 2024).

Comments on the Proposed Rule are due 60 days after its publication in the *Federal Register*.

CALIBRATION OF SPECIAL ASSESSMENTS

Under provisions added to the Federal Deposit Insurance Act in 2009, the FDIC is required to establish assessment rates "sufficient to cover the losses incurred as a result of [a Systemic Risk Determination]."[7]

The FDIC has wide discretion to design the special assessment under this statutory framework, but is required to consider three broad factors—(i) the types of entities that benefit from the Systemic Risk Determination, (ii) economic conditions, and (iii) the effects on the industry—as well as any other factors that it deems "appropriate and relevant to the action taken or the assistance provided."[8]

The FDIC considered each of the required factors, but appears to have focused principally on its conclusion that large banks and regional banks should bear the burden of the assessment.[9] The Proposed Rule states that "[i]n general, large banks and regional banks, and particularly those with large amounts of uninsured deposits, were the banks most exposed to and likely would have been the most affected by uninsured deposit runs."[10] Further, the Proposed Rule states that larger banks "benefitted the most from the stability provided to the banking industry" under the Systemic Risk Determination.[11] These conclusions were central to the FDIC's approach to defining the proposed assessment base.

The Proposed Rule observes that, on average, the largest banking organizations fund a larger share of their assets with uninsured deposits relative to smaller banking organizations.[12] Specifically, it cites the following data, as of December 31, 2022:[13]

Asset Size of Banking Organization	Average Share of Assets Funded by Uninsured Deposits
$1 billion to $5 billion	28.1 percent
$5 billion to $10 billion	28.9 percent
$10 billion to $50 billion	32.1 percent
$50 billion to $250 billion	34.2 percent
Greater than $250 billion	35.8 percent

The Proposed Rule identifies six alternative approaches (discussed further below) that the FDIC considered in determining the proposed assessment base and the payment of the resulting special assessments. The FDIC explains that it selected the approach reflected in the Proposed Rule for several reasons, including:

- ***Avoidance of "Cliff Effect"*:** The Proposed Rule notes that, because IDIs and banking organizations with more than $5 billion in uninsured deposits would pay special assessments "based on the marginal amounts of uninsured deposits they reported," the framework would help to mitigate a "cliff effect" that might otherwise apply "if a different method, such as an asset size threshold, were used to determine applicability."[14]
- ***Similar Assessments for Comparable Banking Organizations Regardless of Corporate Structure*:** The $5 billion exclusion would also "ensure that banking organizations with similar amounts of estimated uninsured deposits pay a similar special assessment," even if they utilize a different corporate structure (*i.e.*, one IDI subsidiary versus multiple subsidiaries).[15]
- ***Exemption for Smaller IDIs, Regardless of Uninsured Deposit Levels*:** Under the Proposed Rule, most small IDIs and IDIs that are part of a small banking organization would not pay anything under

the proposed special assessments.[16] This would be true even for small IDIs that rely heavily on uninsured deposits.[17]

- ***Avoiding Incentives to Reduce Uninsured Deposits*:** The FDIC sought to avoid creating incentives for banks to reduce uninsured deposits and opportunities for banks to alter the assessments imposed by basing the assessment entirely on December 31, 2022 uninsured deposit amounts, so as to prevent "unintended market dislocations and reduced liquidity in the banking sector."[18]

By assessing this base at a rate of approximately 12.5 basis points annually—or 3.13 basis points quarterly—the FDIC expects to collect approximately $2 billion per quarter over the eight-quarter assessment period. The Proposed Rule states that spreading the special assessments over this period would "preserve liquidity at IDIs" and result in "consistent and predictable assessments."[19] The Proposed Rule notes, however, that if the estimated or actual loss exceeds the amount collected at the end of the collection period, the FDIC would "extend the collection period over one or more quarters as needed in order to collect the difference between the amount collected and the estimated or actual loss at the end of the eight-quarter collection period, after providing notice of at least 30 days before the first payment of any extended special assessment is due."[20] Conversely, if the FDIC expects the actual loss to be lower than the amount it expects to collect from the special assessments, the FDIC would "cease collection of special assessments before the end of the initial eight-quarter collection period, in the quarter after it has collected enough to recover actual or estimated losses."[21] The FDIC would provide notice of the cessation at least 30 days before the next payment is due.[22] As required by the statute, any excess funds collected through special assessments would be placed in the DIF.[23]

The final loss amount will not be known until the termination of the FDIC receiverships to which the Systemic Risk Determination applied and, accordingly, that amount is likely to be determined after the collection of the initial special assessments and any extended special assessments. The Proposed Rule provides that the FDIC would impose a one-time final shortfall special assessment if losses at the termination of the receiverships exceed the amount collected through the initial special assessments.[24]

The Proposed Rule provides that each banking organization "should account for the special assessment in accordance with U.S. generally accepted accounting principles" ("*GAAP*") and notes that an "estimated loss from a loss contingency shall be accrued by a charge to income if information indicates that it is probable that a liability has been incurred and the amount of loss is reasonably estimable."[25] Accordingly, a banking organization would recognize in its Call Report and other financial statements the "accrual of a liability and estimated loss (*i.e.*, expense) from a loss contingency for the special assessment when the institution determines that the conditions for accrual under GAAP have been met."[26] The Proposed Rule does not, however, discuss the specific timing for this determination. The Proposed Rule confirms that the special assessments would be a "tax-deductible operating expense for all institutions,"[27] but the Proposed Rule

does not provide any guidance as to the timing of the deduction, including whether the timing of the deduction would align with the timing of the expense recognition under GAAP.

EXPECTED EFFECTS AND ALTERNATIVES CONSIDERED

The FDIC estimates that 113 banking organizations would be subject to the special assessments, including 48 banking organizations with more than $50 billion in total assets and 65 banking organizations with between $5 billion and $50 billion in total assets.[28] The FDIC analyzed the effect of the Proposed Rule on banking organizations' capital and earnings and estimates that the after-tax impact of the special assessments would decrease the dollar amount of tier 1 capital of banking organizations subject to the special assessments by 61 basis points, but that no banking organizations would fall below the minimum 4 percent tier 1 leverage capital requirement as a result.[29] In addition, the FDIC estimates that the special assessments would result in an average one-quarter reduction in income of 17.5 percent for banking organizations subject to the special assessments.[30] However, as indicated by its own data,[31] some banks would experience substantially higher reductions.

As noted above, the FDIC considered six alternative calibrations for the special assessments: (i) a one-time special assessment of the full amount using the same assessment base; (ii) special assessments based on asset size; (iii) special assessments based on all uninsured deposits without the $5 billion deduction; (iv) special assessments based on each IDI's percentage of uninsured deposits relative to total deposits; (v) special assessments split between uninsured deposits as of December 31, 2022 and uninsured deposits as of December 31, 2023; and (vi) special assessment rates applied to an IDI's regular quarterly deposit insurance assessment base, with or without applying a $5 billion deduction. Although the FDIC considered each to be "potentially effective and reasonably feasible," it opted against them because it concluded that the calibration under the Proposed Rule "reflects an appropriate balancing of applying special assessments to the types of entities that benefitted most from the protection of uninsured depositors provided under the determination of systemic risk while ensuring equitable, transparent, and consistent treatment based on amounts of uninsured deposits at the time of the determination of systemic risk."[32]

FDIC BOARD MEMBER STATEMENTS

The FDIC Board of Directors approved the issuance of the Proposed Rule by a vote of 3 to 2, with Chairman Gruenberg, Acting Comptroller Hsu, and Director Chopra voting in favor and Vice Chairman Hill and Director McKernan voting against.

In remarks describing his support for the Proposed Rule, Chairman Gruenberg argued that the proposal "applies the special assessment to the types of banking organizations that benefitted most from the protection of uninsured depositors, while ensuring equitable, transparent, and consistent treatment based

on amounts of uninsured deposits."[33] Similarly, Acting Comptroller Hsu argued that the "more uninsured deposits a bank had, the more of a beneficiary it was of the government's action, and the more of the cost of the special assessment it should bear."[34]

Explaining his opposition to the Proposed Rule, Vice Chairman Hill argued that the "biggest problem with using total uninsured deposits as a metric to gauge who was helped most by the systemic risk exception is that both the banks who experienced the greatest outflows *and* the banks who experienced the greatest inflows all had high volumes of uninsured deposits."[35] Director McKernan argued that a preferable approach would have been to "distinguish[] between absolute and relative measures of uninsured deposits" and to consider banks' capital levels after adjusting for unrealized losses.[36]

In addition to expressing his support for the Proposed Rule, Director Chopra argued that "we need to stop subsidizing the largest and riskiest banks by giving out free deposit insurance," including by "[f]ixing our deposit insurance pricing structure" in a manner such that "[l]arge, riskier banks... pay more and small, simpler banks... pay less."[37]

OBSERVATIONS AND IMPLICATIONS

As noted above, the FDIC has wide discretion to design the special assessment under the statutory framework, after considering the three specified statutory factors. Notably, because the Proposed Rule marks the first time that the FDIC has proposed a special assessment following a Systemic Risk Determination, there was no precedent from which the FDIC could draw in designing the assessment methodology.[38]

Members of the FDIC Board of Directors expressed differing views regarding the manner in which the special assessments should be applied. Although all five agreed that uninsured deposits played a role in the failures of SVB and Signature, they expressed diverging views regarding whether it would be appropriate to use gross uninsured deposits as the sole basis for the special assessments.

The FDIC seeks comment on all aspects of the Proposed Rule, including whether the special assessments should be calculated as proposed and whether the FDIC should consider alternative methodologies for calculating the special assessments that would result in financial reporting in accordance with GAAP and could result in different timing for the impact to earnings and capital.

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ENDNOTES

[1] *Special Assessments Pursuant to Systemic Risk Determination*, *available at* https://www.fdic.gov/news/board-matters/2023/2023-05-11-notice-dis-a-fr.pdf.

[2] 12 U.S.C. § 1823(c)(4)(G). Absent a Systemic Risk Determination, the FDIC is required to resolve an IDI in the manner that is "least costly" to the DIF. 12 U.S.C. § 1823(c)(4)(A). In order to make a Systemic Risk Determination, the FDIC's Board of Directors and the Board of Governors of the Federal Reserve System must determine that (i) resolution under the FDIC's least-cost resolution test would have "serious adverse effects on economic conditions or financial stability" and (ii) action or assistance by the FDIC not authorized under the least-cost resolution test would "avoid or mitigate such adverse effects." 12 U.S.C. § 1823(c)(4)(G).

[3] Proposed Rule, at 6.

[4] Proposed Rule, at 10. On April 18, 2023, the FDIC estimated that the losses to the DIF attributable to the protection of uninsured depositors at SVB and Signature was $19.2 billion. *See* Press Release, *FDIC Releases Semiannual Update on the Deposit Insurance Fund Restoration Plan* (Apr. 18, 2023), *available at* https://www.fdic.gov/news/press-releases/2023/pr23030.html. The Proposed Rule notes that the revised cost estimate derives from (i) a decrease in the amount of liabilities assumed by First-Citizens Bank & Trust Company from the sale of Silicon Valley Bridge Bank, (ii) higher anticipated recoveries from certain other assets in receivership, and (iii) an increase in the market value of receivership securities. *See* Proposed Rule, at 9-10.

[5] Insured branches of foreign banking organizations would also be subject to the Proposed Rule.

[6] Proposed Rule, at 7. If an IDI is part of a holding company, the $5 billion deduction would be "apportioned based on its estimated uninsured deposits as a percentage of total estimated uninsured deposits held by all IDI affiliates in the banking organization." *Id.*

[7] 12 U.S.C. § 1823(c)(4)(G)(ii)(III).

[8] *Id.*

[9] *See* Proposed Rule, at 26-35.

[10] *Id.* at 12.

[11] *Id.* The Proposed Rule does not provide any data or analysis supporting these conclusions.

[12] *See id.* at 13.

[13] *See id.* IDIs with less than $1 billion in total assets were not required to report estimated uninsured deposits.

[14] *Id.* at 16.

[15] *Id.* at 18.

[16] *See id.* at 17.

[17] *See id.* at 39.

[18] *Id.* at 41.

[19] *Id.* at 19.

[20] *Id.* at 20.

[21] *Id.* at 19.

[22] *See id.*

ENDNOTES (CONTINUED)

[23] *See* 12 U.S.C. § 1823(c)(4)(G)(ii)(III).

[24] *See* Proposed Rule, at 21.

[25] *Id.* at 25.

[26] *Id.*

[27] *Id.* at 30.

[28] *See id.* at 29.

[29] *See id.* at 31.

[30] *See id.* at 33.

[31] *See id.* The FDIC estimates that the special assessments would result in a one-quarter reduction in income of more than 30 percent for 13 banking organizations with approximately $4.5 trillion in total assets and a one-quarter reduction in income of between 20 percent and 30 percent for 25 banking organizations with approximately $10.7 trillion in total assets. By contrast, the FDIC estimates that the special assessments would result in a one-quarter reduction in income of less than 20 percent for 74 banking organizations with approximately $4 trillion in total assets.

[32] *Id.* at 43.

[33] Statement by Chairman Martin J. Gruenberg on the Notice of Proposed Rulemaking on Special Assessment Pursuant to Systemic Risk Determination (May 11, 2023), *available at* https://www.fdic.gov/news/speeches/2023/spmay1123a.html.

[34] Acting Comptroller Issues Statement in Support of FDIC Notice of Proposed Rulemaking on Special Assessments (May 11, 2023), *available at* https://occ.gov/news-issuances/news-releases/2023/nr-occ-2023-43.html.

[35] Statement of Vice Chairman Travis Hill on the Special Assessment Notice of Proposed Rulemaking (May 11, 2023), *available at* https://www.fdic.gov/news/speeches/2023/spmay1123b.html (emphasis in original). Elaborating on this point, he observed that the five banks that would pay the most relative to their regular quarterly assessments, which would collectively pay nearly half of the entire special assessment under the Proposed Rule, all experienced deposit inflows immediately after the failure of SVB. *See id.*

[36] Statement by Jonathan McKernan, Member, FDIC Board of Directors on the Proposed Special Assessment (May 11, 2023), *available at* https://www.fdic.gov/news/speeches/2023/spmay1123c.html. He also emphasized that, contrary to the suggestion that the Systemic Risk Determination amounted to the FDIC backing all uninsured deposits, the FDIC "does not have the statutory authority to backstop all banks' uninsured deposits, whether implicitly or explicitly." *Id.*

[37] Statement of CFPB Director Rohit Chopra, Member, FDIC Board of Directors, on the Proposed Special Deposit Insurance Assessment on Large Banks (May 11, 2023), *available at* https://www.consumerfinance.gov/about-us/newsroom/statement-of-cfpb-director-rohit-chopra-member-fdic-board-of-directors-on-the-proposed-special-deposit-insurance-assessment-on-large-banks/. He also raised concerns that the failure of First Republic Bank will be a "direct hit to the [DIF] that is not being recouped through this special assessment."

[38] *See* Cong. Research Serv., IF12378, *Bank Failures: The FDIC's Systemic Risk Exception* (Apr. 11, 2023), *available at* https://crsreports.congress.gov/product/pdf/IF/IF12378. Although the FDIC made or planned to make a Systemic Risk Determination five times following the enactment of this authority in 1991, only one instance resulted in losses to the DIF; a special assessment was not levied in that case because these costs were considered jointly with another program that resulted in positive net income. *See id.*

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