FDIC Federal Deposit Insurance Corporation

MEMO

TO: The Board of Directors

FROM: Patrick Mitchell
Director, Division of Insurance and Research

DATE: April 25, 2024

RE: Restoration Plan Semiannual Update

RECOMMENDATION

During the second half of 2023, growth in the Deposit Insurance Fund (the DIF or the Fund) balance outpaced insured deposit growth, resulting in a 4 basis point increase in the reserve ratio, from 1.11 percent as of June 30, 2023, to 1.15 percent as of December 31, 2023.[1] Staff project that the reserve ratio remains on track to reach the statutory minimum of 1.35 percent ahead of the deadline of September 30, 2028, though the precise timing is unknown and depends on a number of factors, discussed below. Accordingly, staff recommend no changes to the Amended Restoration Plan and will continue to update the Board semiannually, or more frequently as conditions warrant, to determine if changes to the Amended Restoration Plan are necessary.

BACKGROUND

The Federal Deposit Insurance Act (the FDI Act) requires that the FDIC's Board of Directors (Board) adopt a restoration plan when the DIF reserve ratio falls below the statutory minimum of 1.35 percent or is expected to within 6 months.[2] Extraordinary growth in insured deposits during the first half of 2020 resulting from actions taken by monetary and fiscal authorities, and by individuals, businesses, and financial market participants in response to the Coronavirus 2019 (COVID-19) pandemic caused the DIF reserve ratio to decline below the statutory minimum of 1.35 percent as of June 30, 2020. On September 15, 2020, the Board adopted a Restoration Plan to restore the DIF to at least 1.35 percent within eight years, as required by statute, and to maintain the assessment rate schedules in place at the time.[3]

On June 21, 2022, based on projections of the reserve ratio under different scenarios indicating that the reserve ratio was at risk of not reaching the statutory minimum of 1.35 percent by September 30, 2028, the

[1] The reserve ratio is calculated as the ratio of the net worth of the DIF (fund balance) to the value of the aggregate estimated insured deposits at the end of a given quarter. See 12 U.S.C. 1813(y)(3); *See* FDIC Restoration Plan Semiannual Update, November 16, 2023. Available at: https://www.fdic.gov/news/board-matters/2023/2023-11-16-notational-mem-e.pdf.
[2] *See* 12 U.S.C. § 1817(b)(3)(B) and (E).
[3] *See* 85 FR 59306 (Sept. 21, 2020). Under the FDI Act, the restoration plan must restore the reserve ratio to at least 1.35 percent within 8 years of establishing the restoration plan, absent extraordinary circumstances. The FDIC will use data as of September 30, 2028, the first quarter-end date for which the reserve ratio will be known after September 15, 2028, the end date of the 8-year period.

Board amended the Restoration Plan (Amended Restoration Plan, or Plan).[4] In conjunction with the Amended Restoration Plan, the Board proposed, and subsequently finalized, an increase in initial base deposit insurance assessment rate schedules of 2 basis points, to improve the likelihood that the reserve ratio would be restored to at least 1.35 percent by September 30, 2028.[5] The revised assessment rate schedules became effective January 1, 2023, and were applicable beginning the first quarterly assessment period of 2023.

The Amended Restoration Plan requires the FDIC to update its analysis and projections for the DIF balance and reserve ratio at least semiannually and, if necessary, recommend modifications to the Plan. This memorandum is the first semiannual update of 2024. Under the Amended Restoration Plan, the FDIC is monitoring potential losses, deposit balance trends, and other factors that affect the reserve ratio.

SEMIANNUAL UPDATE FOR APRIL 2024

Table 1 shows the components of the reserve ratio from the second quarter of 2023, the most recent date of the analysis and projections presented in the last semiannual update, through the fourth quarter of 2023, the most recent data available.

Table 1–Fund Balance,
Estimated Insured Deposits, and Reserve Ratio[a]
[dollar amounts in billions]

	2Q 2023	3Q 2023	4Q 2023
Beginning Fund Balance	$116.1	$117.0	$119.3
Plus: Assessment Revenue	$3.1	$3.2	$3.1
Plus: Net Investment Contributions and Other Income[b]	$0.3	$0.9	$0.8
Less: Loss Provisions	$2.0	$1.2	$0.9
Less: Operating Expenses	$0.5	$0.5	$0.6
Ending Fund Balance[c]	$117.0	$119.3	$121.8
Estimated Insured Deposits	$10,566.1	$10,572.7	$10,621.3
Q-O-Q Growth in Est. Insured Deposits	0.9%	0.1%	0.5%
Ending Reserve Ratio	1.11%	1.13%	1.15%

[a]Source: FDIC Quarterly Banking Profile for Fourth Quarter 2023, Table 1-C. Insurance Fund Balances and Selected Indicators.
[b]Net investment contributions include interest earned on investments and unrealized gains/losses on available-for-sale securities, while other income includes realized gains on sale of investments, and all other income, net of expenses.
[c]Components of fund balance changes may not sum to totals due to rounding.

As of December 31, 2023, the DIF balance totaled $121.8 billion, up $4.8 billion from June 30, 2023. The increase in the DIF balance was primarily driven by assessment revenue. Growth in the DIF balance in the second half of 2023 outpaced insured deposit growth, resulting in an increase in the reserve ratio of 4 basis points from 1.11 percent as of June 30, 2023, to 1.15 percent as of December 31, 2023.

Insured deposit growth slowed in the second half of 2023, as growth in insured brokered deposits and reciprocal deposits moderated relative to the first half of 2023 and other insured deposit balances continued to

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[4] *See* FDIC Restoration Plan Semiannual Update, June 21, 2022. Available at: https://www.fdic.gov/news/board-matters/2022/2022-06-21-notice-sum-b-mem.pdf. *See also* 87 FR 39518 (July 1, 2022).
[5] *See* 87 FR 39388 (July 1, 2022) and 87 FR 64314 (Oct. 24, 2022).

decline. Following a 0.9 percent increase in the quarter ending June 30, 2023, insured deposits increased by 0.1 percent in the quarter ending September 30, 2023, and by 0.5 percent in the quarter ending December 31, 2023. As of December 31, 2023, annual insured deposit growth was 3.6 percent, lower than the long-term historical average of 4.5 percent experienced from 2000 to 2019.

Assessment revenue was the main contributor to growth in the DIF in the second half of 2023. Assessment revenue during the second half of 2023 was $6.3 billion, slightly below the revenue earned in the first half of 2023.[6] The weighted average assessment rate remained at approximately 6.1 basis points for the assessment periods ending September 30, 2023, and December 31, 2023.

Net investment contributions and other income added $1.7 billion to the DIF balance in the second half of 2023. Interest earned on investments totaled $1.4 billion, mainly reflecting higher yields. Net gains on investment securities further increased the DIF balance by $0.3 billion.

Loss provisions of $2.1 billion partially offset the increase in the DIF balance during the second half of 2023. Additional loss provisions were primarily driven by a $1.6 billion increase in the estimated losses associated with the three large regional bank failures that occurred in the first half of 2023.[7] Loss provisions were also impacted by two bank failures that occurred in the second half of 2023. The two banks that failed in the second half of 2023 were Heartland Tri-State Bank on July 28, 2023, and Citizens Bank on November 3, 2023.[8] The FDIC estimates the cost to the DIF from these two failures to be $69 million.

As stipulated by the Amended Restoration Plan, below is an updated analysis with respect to potential losses, deposit balance trends, and other factors that affect the reserve ratio.

Potential losses

Losses from past bank failures and reserves related to anticipated future bank failures affect the reserve ratio by lowering the fund balance. Until 2023, the DIF experienced low losses from bank failures. On average, three banks per year failed between 2016 and 2022, at an average annual cost to the fund of about $177 million.[9] Five banks failed in 2023, with estimated losses to the DIF of $19.9 billion, excluding losses that will be recovered through the special assessment. No banks have failed thus far in 2024.

Based on currently available information about troubled banks, trends in CAMELS ratings, failure rates, and loss rates, FDIC staff project that failures for the five-year period ending in 2028 would cost the DIF

[6] Assessment revenue does not include the receivable associated with the special assessment.
[7] As with all failed bank losses, loss estimates are periodically adjusted as the FDIC, as receiver of the failed banks, sells assets, satisfies liabilities, and incurs receivership expenses. The DIF loss provision does not include the portion of additional losses attributable to protecting uninsured deposits pursuant to the systemic risk determination announced following the failures of Silicon Valley Bank and Signature Bank in March 2023, as the FDIC is required by statute to recover those losses through special assessments. *See* 12 U.S.C. § 1823(c)(4)(G)(ii). *See also* 88 FR 83329 (Nov. 29, 2023) (Special Assessment Pursuant to Systemic Risk Determination).
[8] FDIC PR-58-2023. "Dream First Bank, National Association, of Syracuse, Kansas, Assumes All of the Deposits of Heartland Tri-State Bank of Elkhart, Kansas," July 28, 2023, available at: https://www.fdic.gov/news/press-releases/2023/pr23058.html. FDIC PR-91-2023. "Iowa Trust & Savings Bank, Emmetsburg, Iowa, Assumes All of the Deposits of Citizens Bank, Sac City, Iowa," November 3, 2023, available at: https://www.fdic.gov/news/press-releases/2023/pr23091.html.
[9] FDIC, Annual Report 2023, Assets and Deposits of Failed or Assisted Insured Institutions and Losses to the Deposit Insurance Fund, 1934-2023, page 188, available at: https://www.fdic.gov/about/financial-reports/reports/2023annualreport/2023-arfinal.pdf.

approximately $4.4 billion. The total number of institutions on the FDIC's Problem Bank List was 52 at the end of the fourth quarter of 2023, which is up from 43 at the end of the second quarter of 2023.[10] Despite the increase, problem banks represented 1.1 percent of all banks, near the low end of the typical range of 1 to 2 percent of all banks during non-crisis periods.

The U.S. economy sustained growth in the second half of 2023 that exceeded expectations. U.S. GDP slowed to 3.4 percent at a real seasonally adjusted annualized rate in the fourth quarter of 2023, after 4.9 percent growth in the third quarter of 2023.[11] The March Blue Chip Economic Indicators consensus forecast for GDP growth is 2.3 percent for full year 2024.[12] Downside risks to the economic outlook include the continued effects of inflation, volatility in market interest rates, and geopolitical uncertainty. A weaker economy may reduce bank profitability, weaken credit quality and capital, and limit loan growth.

The banking industry has exhibited resilience after a period of liquidity stress in early 2023. The industry's net income declined modestly in 2023 but remained well above pre-pandemic levels. In addition, asset quality metrics remained favorable overall at year-end 2023, and liquidity levels stabilized in the fourth quarter of 2023 as total deposits increased for the first time in seven quarters. Challenges exist for the industry, however. For one, deterioration is evident in commercial real estate (CRE) loans and credit card portfolios. While the noncurrent loan rate is still below the pre-pandemic average, the increase in both noncurrent loan balances and net charge-off balances was driven by credit cards and CRE loans. In addition, funding and earnings pressures continue to challenge the industry. After increasing slightly in the third quarter of 2023, the industry's net interest margin declined modestly in the fourth quarter of 2023, explained in part by deposit costs rising at a faster rate than loan yields. The banking industry continues to face significant downside risks from the continued effects of inflation, volatility in market interest rates, and geopolitical uncertainty.

As evidenced in the bank failures in 2023, unrealized losses can also significantly reduce a bank's liquidity position in the event of unexpected cash outflows that could force the bank to sell securities and realize losses, reducing its regulatory capital. Unrealized losses in the banking industry's securities portfolios remain elevated, although they are at the lowest since the second quarter of 2022.

The downside risks described above could present challenges and have longer-term effects on the condition and performance of the economy and the banking industry, which could exacerbate the risk of losses to the DIF. However, the increase in assessment rate schedules that became effective on January 1, 2023, will continue to strengthen the DIF, increasing the likelihood that the reserve ratio will reach the statutory minimum of 1.35 percent by the statutory deadline and promoting public confidence in federal deposit insurance. Under the Plan, the FDIC will continue to monitor these and other data to project potential losses to the DIF and to assess their impact on the ability of the reserve ratio to return to 1.35 percent within 8 years of establishing the Plan.

Deposit trends

Insured deposit growth slowed in the second half of 2023, with industry balances increasing 0.1 percent in the third quarter of 2023 and 0.5 percent in the fourth quarter of 2023. Annual insured deposit growth has been below the long-run average rate of 4.5 percent in four out of the last five quarters, declining to 3.6 percent as of December 31, 2023.[13] Insured deposit growth was driven by growth in brokered and reciprocal deposits. Fully insured brokered deposits and non-brokered reciprocal deposits increased $388.0 billion and $138.1

[10] Banks on the FDIC's Problem Bank List have a CAMELS composite rating of "4" or "5" due to financial, operational, or managerial weaknesses, or a combination of such issues.
[11] Bureau of Economic Analysis.
[12] March 2024 Blue Chip Economic Forecast.
[13] Long-term historical average is based on data from 2000 through 2019.

billion, respectively, year-over-year as of December 31, 2023. This growth was offset by a decline in other insured deposits, resulting in an increase in total insured deposits of $370.8 billion year-over-year.

The outlook for insured deposit growth remains uncertain and depends on several factors, including economic conditions, interest rates, and trends in credit and liquidity. Stronger economic conditions may lead to higher loan and deposit growth. On the other hand, lower banking system reserves associated with tighter monetary policy would contribute to lower deposits. In addition, elevated market interest rates may inhibit growth of insured deposits if savings are directed to higher-yielding alternatives, particularly money market mutual funds. However, as experience from 2023 has indicated, banks could replace insured deposit outflows with other insured deposit funding sources, such as brokered CDs, which would mitigate the net effect on insured deposit growth. Staff will continue to closely monitor depositor behavior and the effects on insured deposits.

Other factors that affect the reserve ratio

The FDIC also monitors other factors that affect the reserve ratio, including changes in bank risk profiles, which influence assessment rates; growth in the assessment base; DIF investment income and realized and unrealized gains and losses on investments; and operating expenses.

Assessment revenue continues to be the main contributor to growth in the DIF balance. The weighted average assessment rate for all banks was approximately 6.1 basis points for the assessment period ending December 31, 2023, higher than the 4.0 basis points weighted average assessment rate at the time the Restoration Plan was first established. The increase in average assessment rates since the time the Restoration Plan was first established largely reflects the 2 basis point increase in initial base deposit insurance assessment rate schedules, which became effective on January 1, 2023. The higher assessment rate schedules will continue to contribute to assessment revenue going forward. Meanwhile, the assessment base decreased by 0.6 percent from one year ago, partially offsetting the increase in the average assessment rate on assessment revenue.[14]

Net investment contributions and other income totaled $0.9 billion in the third quarter of 2023 and $0.8 billion in the fourth quarter of 2023. Interest income from DIF investments drove net investment contributions in both quarters, adding $0.8 billion in the third quarter before decreasing slightly to $0.6 billion in the fourth quarter. Interest income decreased in the fourth quarter as declines in the aggregate par value of the DIF portfolio outweighed the impact of increasing yields. In the second half of 2023, realized losses of $722 million partially offset unrealized gains of $978 million. While subject to changing market expectations of interest rates and other factors, staff expect net investment contributions to increase in the near term as the DIF balance increases and the yield on the DIF portfolio remains elevated.

Projections for fund balance and reserve ratio

Staff continues to project that the reserve ratio is likely to reach the statutory minimum of 1.35 percent ahead of the statutory deadline. While subject to uncertainty, staff project that the reserve ratio would reach 1.35 percent in 2026, assuming insured deposits grow at or near the historical average rate, losses to the DIF associated with bank failures do not materially exceed staff estimates, and net investment contributions do not materially deviate from current market expectations. However, it is possible that the reserve ratio could remain below 1.35 percent beyond 2026 if losses for past and future bank failures increase beyond staff estimates, or insured deposit growth significantly exceeds staff estimates. Reaching the statutory minimum reasonably promptly and in advance of the statutory deadline strengthens the DIF so that it can better withstand unexpected losses and reduces the likelihood of pro-cyclical assessments.

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[14] An IDI's assessment base generally equals its average consolidated total assets minus its average tangible equity. *See* 12 CFR 327.5.

FUTURE UPDATES

This memorandum is the first semiannual update in 2024. Staff project that the reserve ratio will reach the statutory minimum of 1.35 percent within the deadline set by statute, though the precise timing is uncertain and depends on a number of factors. Accordingly, staff recommend no changes to the Plan.

As noted in prior semiannual updates to the Board, loss and reserve ratio projections made far into the future are subject to considerable uncertainty. Losses to the DIF could be higher or lower than anticipated if economic conditions worsen or downside risks facing banks prove more or less severe. Insured deposit growth could be higher or lower based on future economic conditions. Net investment contributions could be positive or negative in the near-term, and the magnitude of such movement is highly uncertain and depends on the timing and magnitude of interest rate changes as well as DIF liquidity needs.

Under the Amended Restoration Plan, staff will continue to monitor potential losses, deposit balance trends, and other factors that affect the reserve ratio, and update projections for the fund balance and reserve ratio at least semiannually while the Plan is in effect. Staff continue to believe that frequent updates are warranted to incorporate updated information and expectations and because loss and reserve ratio projections made far into the future are subject to considerable uncertainty.

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