FDIC Federal Deposit Insurance Corporation

MEMO

TO: The Board of Directors

FROM: Patrick Mitchell
Director, Division of Insurance and Research

DATE: October 17, 2024

RE: Restoration Plan Semiannual Update

RECOMMENDATION

During the first half of 2024, growth in the Deposit Insurance Fund (the DIF or the Fund) balance and slower-than-average insured deposit growth resulted in a 6 basis point increase in the reserve ratio, from 1.15 percent as of December 31, 2023, to 1.21 percent as of June 30, 2024.[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 Board amended the Restoration Plan (Amended Restoration Plan, or Plan).[4] In conjunction with the Amended

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[1] The reserve ratio is calculated as the ratio of the net worth of the DIF (fund balance) to the value of aggregate estimated insured deposits at the end of a given quarter. See 12 U.S.C. 1813(y)(3).
[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.
[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).

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 second 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 OCTOBER 2024

Table 1 shows the components of the reserve ratio from the fourth quarter of 2023, the most recent date of the analysis and projections presented in the prior semiannual update, through the second quarter of 2024, the most recent data available.

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

	Q4 2023	Q1 2024	Q2 2024
Beginning Fund Balance	$119.3	$121.8	$125.3
Plus: Assessments Earned[b]	$3.1	$3.2	$3.2
Plus: Net Investment Contributions and Other Income[c]	$0.8	$0.8	$1.0
Less: Loss Provisions[b]	$0.9	*	($0.3)
Less: Operating Expenses	$0.6	$0.6	$0.6
Ending Fund Balance[d]	$121.8	$125.3	$129.2
Estimated Insured Deposits	$10,621.3	$10,743.5	$10,646.6
Q-O-Q Growth in Est. Insured Deposits	0.5%	1.1%	(0.9%)
Ending Reserve Ratio	1.15%	1.17%	1.21%

* Absolute value less than $50 million.
[a] Source: FDIC Quarterly Banking Profile for Second Quarter 2024, Table 1-C. Insurance Fund Balances and Selected Indicators.
[b] Assessments earned and loss provisions do not include amounts collected toward or the receivable associated with the special assessment to recover estimated losses attributable to protecting uninsured depositors pursuant to the systemic risk determination announced in March 2023.
[c] Net investment contributions include interest earned on investments and unrealized gains/losses on available-for-sale securities, while other income includes realized net gains on sale of investments, and all other income, net of expenses.
[d] Components of fund balance changes may not sum to totals due to rounding.

As of June 30, 2024, the DIF balance totaled $129.2 billion, up $7.5 billion from December 31, 2023. The DIF balance at the end of the second quarter of 2024 exceeded its previous peak of $128.2 billion in the fourth quarter of 2022, just prior to the failure of three large regional banks. The increase in the DIF balance was primarily driven by assessments earned. Growth in the DIF balance and slower-than-average insured deposit growth in the first half of 2024 resulted in an increase in the reserve ratio of 6 basis points from 1.15 percent as of December 31, 2023, to 1.21 percent as of June 30, 2024.

[5] *See* 87 FR 39388 (July 1, 2022) and 87 FR 64314 (Oct. 24, 2022).

Insured deposit growth continued to slow through the first half of 2024, driven by slower growth in reciprocal deposits relative to the second half of 2023, a decline in insured brokered deposits, and a sustained, slower-than-average growth in other insured deposits. Insured deposits increased by 1.2 percent in the quarter ending March 31, 2024, and decreased by 0.9 percent in the quarter ending June 30, 2024. This was the first quarterly decline in insured deposits since the second quarter of 2022. As of June 30, 2024, annual insured deposit growth was 0.8 percent, lower than the long-term historical average of 4.5 percent experienced from 2000 to 2019 and the slowest annual growth reported since 2013.

Assessments earned was the main contributor to growth in the DIF in the first half of 2024. Assessments earned during the first half of 2024 was $6.5 billion, slightly above the $6.3 billion earned in the second half of 2023.[6] The weighted average assessment rate rose slightly to approximately 6.2 basis points for the assessment period ending June 30, 2024, from the weighted average rate of 6.1 basis points for the periods ending December 31, 2023, and March 31, 2024.

Net investment contributions and other income added $1.9 billion to the DIF balance in the first half of 2024, driven by interest income. Interest earned on investments totaled $1.8 billion. Unrealized gains on investment securities further increased the DIF balance by $27 million and other income added $51 million.

Negative loss provisions of $0.3 billion increased the DIF balance during the first half of 2024. The decrease in loss provisions was primarily driven by a $0.3 billion decrease in the estimated losses associated with the three large regional bank failures that occurred in the first half of 2023.[7]

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. Such losses can vary from year to year. Between 2016 and 2022, the DIF experienced low losses from bank failures. On average, three banks per year failed over this period, at an average annual cost to the fund of about $177 million.[8] Five banks failed in 2023, with estimated losses to the DIF of $19.7 billion, excluding losses that will be recovered through the special assessment. There has been one bank failure thus far in 2024 at an estimated cost to the DIF of $667 million.[9]

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[6] Assessments earned and loss provisions do not include amounts collected toward or the receivable associated with the special assessment to recover estimated losses attributable to protecting uninsured depositors pursuant to the systemic risk determination announced following the failures of Silicon Valley Bank and Signature Bank in March 2023. The FDIC is required by statute to recover such losses through a special assessment. See 12 U.S.C. § 1823(c)(4)(G)(ii). See also 88 FR 83329 (Nov. 29, 2023), Final Rule on the Special Assessment Pursuant to Systemic Risk Determination. Assessments earned and loss provisions exclude adjustments to such estimated losses.

[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.

[8] 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.

[9] FDIC PR-30-2024. "Fulton Bank, N.A. of Lancaster, Pennsylvania Assumes Substantially All Deposits of Republic First Bank, Philadelphia," April 26, 2024, available at: https://www.fdic.gov/news/press-releases/2024/fulton-bank-na-lancaster-pennsylvania-assumes-substantially-all-deposits.

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 approximately $4.1 billion. The total number of institutions on the FDIC's Problem Bank List was 66 at the end of the second quarter of 2024, which is up from 52 at the end of the fourth quarter of 2023.[10] Despite the increase, problem banks represented 1.5 percent of all banks, which is in the normal range of 1 to 2 percent of all banks during non-crisis periods.

The U.S. economy remained resilient in the first half of 2024. U.S. GDP rose to 3.0 percent at a real seasonally adjusted annualized rate in the second quarter of 2024 after 1.4 percent growth in the first quarter of 2024.[11] The September Blue Chip Economic Indicators consensus forecast for GDP growth is 2.6 percent for full year 2024.[12] Downside risks to the economic outlook include the effects of high inflation and interest rates and geopolitical risks. A weaker economy may reduce bank profitability, weaken credit quality and capital, and limit loan growth.

The banking industry has remained resilient through the first half of 2024. Net income increased in the second quarter of 2024 and asset quality metrics remained generally favorable despite continued weakness in commercial real estate (CRE) loans, credit card, and multifamily portfolios. While the noncurrent loan rate is still below the pre-pandemic average, the industry's CRE and multifamily noncurrent ratios increased in the second quarter, and the credit card noncurrent rate remained elevated. In addition, funding and earnings pressures continue to challenge the industry. The industry's net interest margin (NIM) declined in the first half of 2024 and remains below the pre-pandemic average NIM. The banking industry continues to face significant downside risks from uncertainty in the economic outlook, market interest rates, and geopolitical events, as well as continuing weakness in some bank loan portfolios.

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.

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 continued to slow in the first half of 2024, driven by slower growth in reciprocal deposits relative to the second half of 2023, a decline in fully insured brokered deposits for the first time since the second half of 2021, and sustained slower growth in other insured deposit balances.[13] Quarterly trends in insured deposit growth were below pre-pandemic averages, with industry balances increasing 1.2 percent

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[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] September 2024 Blue Chip Economic Forecast.
[13] Fully insured brokered deposits do not include brokered reciprocal deposits.

between December 31, 2023, and March 31, 2024, below average first quarter growth of 2.2 percent.[14] Between March 31, 2024, and June 30, 2024, insured deposits declined 0.9 percent, compared to roughly flat growth typically seen in the second quarter. Annual insured deposit growth has been below the long-run historical average rate of 4.5 percent in six out of the last seven quarters.[15] Annual insured deposit growth declined to 0.8 percent as of June 30, 2024, the slowest year-over-year growth rate reported by the industry since 2013.

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 or a reduction in interest rates 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. Changes in interest rates could also contribute to shifts in the composition of deposits. 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.

Assessments earned continues to be the main contributor to growth in the DIF balance. The weighted average assessment rate for all banks was approximately 6.18 basis points for the assessment period ending June 30, 2024. The weighted average assessment rate is up slightly from approximately 6.10 basis points a year ago, reflecting some increase in risk. Recent weighted assessment rates are 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 until the reserve ratio reaches 2 percent.

Net investment contributions and other income totaled $1.9 billion in the first half of 2024. Interest income from DIF investments drove net investment contributions in both quarters in the first half of 2024, adding $0.8 billion in the first quarter and $1.0 billion in the second quarter. Unrealized gains on investment securities further increased the DIF balance by $27 million and other income added $51 million. While subject to changing market expectations of interest rates and other factors, staff expect net investment contributions to remain relatively steady in the near term as the DIF balance increases and the yield on the DIF portfolio gradually declines in line with market expectations.

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 that, consistent with current trends, insured deposits grow below the historical average rate in the near-term, 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

[14] Pre-pandemic average is based on data from 2014 through 2019.
[15] Long-term historical average is based on data from 2000 through 2019.

strengthens the DIF so that it can better withstand unexpected losses and reduces the likelihood of pro-cyclical assessments.

FUTURE UPDATES

This memorandum is the second 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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