FDIC Federal Deposit Insurance Corporation

MEMO

TO: The Board of Directors

FROM: Diane Ellis
Director, Division of Insurance and Research

DATE: June 15, 2021

RE: Restoration Plan Semiannual Update

SUMMARY

The Federal Deposit Insurance Act (the FDI Act) requires that the FDIC's Board of Directors (Board) adopt a restoration plan when the Deposit Insurance Fund (the DIF or the fund) reserve ratio falls below 1.35 percent or is expected to within 6 months.[1] As of June 30, 2020, the reserve ratio had fallen below the statutory minimum and stood at 1.30 percent. On September 15, 2020, the Board adopted a Restoration Plan (Plan) to restore the DIF to at least 1.35 percent by September 30, 2028.[2] The Plan requires the FDIC to update its analysis and projections for the DIF balance and reserve ratio at least semiannually. This memorandum is the first semiannual update following the establishment of the Plan.

Under the Plan, detailed below, the FDIC is monitoring deposit balance trends, potential losses, and other factors that affect the reserve ratio. While subject to uncertainty, based on a range of reasonable estimates of future losses and assuming that depositor behavior normalizes in the medium- to long-term, staff continue to project that the reserve ratio would return to 1.35 percent before the end of the statutory 8-year period beginning upon the implementation of the Plan.

Extraordinary growth in insured deposits during the first and second quarters of 2020 caused the reserve ratio to decline below the statutory minimum as of June 30, 2020. Since the Board adopted the Plan, insured deposit growth decelerated compared to the extraordinary growth experienced in the first half of 2020, but remained above average, with significant growth in insured deposits during the first quarter of 2021 due to subsequent additional fiscal stimulus and continued elevated savings rates. Over the three quarters since the Plan was adopted, insured deposits grew by $683.2 billion (or 7.7 percent), more than twice the average growth experienced in a typical three-quarter period, resulting in a reserve ratio of 1.25 percent as of March 31, 2021.

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[1] 12 U.S.C. § 1817(b)(3)(E).

[2] *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).

With the successful rollout of vaccines, declining infections and improving economic conditions, the growth in insured deposits associated with the pandemic may recede as depositor behavior returns to normal and individuals and businesses redirect deposits toward consumption and higher-yielding investments. Although some uncertainty persists, the overall economic outlook has strengthened in recent months and appears more favorable than last September, and the banking system continues to appear better positioned to withstand losses when compared to prior periods of stress.

As described below, while insured deposit balances may remain elevated to some extent in the near-term, staff expect the surge of insured deposits—those deposits resulting from extraordinary growth associated with the pandemic—to eventually recede and insured deposit growth rates to normalize in the medium- to long-term. While the timing and magnitude of any such recession in surge insured deposits and the normalization of insured deposit growth rates are uncertain, staff expect more clarity in the future and will continue to monitor these deposit trends. Staff will continue to update the Board semiannually, or more frequently as conditions warrant, to determine if changes to the Plan are necessary.

BACKGROUND

As of June 30, 2020, the reserve ratio had fallen below the statutory minimum and stood at 1.30 percent, eight basis points below the reserve ratio as of March 31, 2020.[3] The decline in the reserve ratio during the first half of 2020 was solely a result of extraordinary insured deposit growth. On September 15, 2020, the Board adopted a Plan that would restore the DIF to at least 1.35 percent by September 30, 2028, and maintain the assessment rate schedule in place at the time.

Since adoption of the Plan, both the DIF balance and insured deposits have continued to grow through the first quarter of 2021, but insured deposits have grown at a faster rate than the DIF, resulting in a reserve ratio of 1.25 percent as of March 31, 2021. Table 1 shows the components of the reserve ratio for the second quarter of 2020 and each quarter since the Board adopted the Plan, through the first quarter of 2021. Over this period, the DIF balance grew and did not experience material losses. Assessment revenue remained steady at about $2.0 billion each quarter, and a reduction in loss provisions associated with past and anticipated failures also contributed to growth in the DIF balance. As of March 31, 2021, the DIF balance totaled a record $119.4 billion, up $4.7 billion from the end of the second quarter of 2020. Meanwhile, since the Board adopted the Plan, insured deposits grew by an estimated $683.2 billion. This continued extraordinary growth in insured deposits resulted in a five basis point decline in the reserve ratio from the second quarter of 2020, with more than half of that decline occurring in the first quarter of 2021.

[3] The reserve ratio is calculated as the ratio of the net worth of the Deposit Insurance Fund (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).

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

	2Q 2020	3Q 2020	4Q 2020	1Q 2021
Beginning Fund Balance	$113.2	$114.7	$116.4	$117.9
Plus: Net Assessment Revenue	$1.8	$2.0	$1.9	$1.9
Plus: Investment Income[a]	$0.1	$0.1	*	*
Less: Loss Provisions	*	($0.1)	*	($0.1)
Less: Operating Expenses	$0.5	$0.5	$0.5	$0.5
Ending Fund Balance[b]	$114.7	$116.4	$117.9	$119.4
Estimated Insured Deposits	$8,835.4	$8,926.0	$9,119.8	$9,518.6
Q-O-Q Growth in Est. Insured Deposits	8.04%	1.03%	2.17%	4.37%
Ending Reserve Ratio	1.30%	1.30%	1.29%	1.25%

* = Absolute value less than $50 million.

[a] Includes unrealized gains/losses on available-for-sale securities.

[b] Components of fund balance changes may not sum to totals due to rounding.

Insured deposits grew by 1.0 percent during the third quarter of 2020. This growth was in line with the average quarterly growth rate of 1.0 percent experienced during third quarters between 2015 and 2019. Subsequent growth during the fourth quarter of 2020 was 2.2 percent, which was elevated in comparison to the 1.4 percent average quarterly growth rate experienced during fourth quarters between 2015 and 2019. These quarterly average growth rates, illustrated in Chart 1, reflect longstanding seasonal trends in insured deposit growth.

In the first quarter of 2021, additional fiscal stimulus in response to the Coronavirus 2019 (COVID-19) pandemic and continued elevated personal savings boosted insured deposit growth to 4.4 percent over the previous quarter, nearly double the 2.3 percent quarterly average growth rate for first quarters between 2015 and 2019. Since the beginning of 2020, the industry has now experienced three of the four highest insured deposit quarterly growth rates since quarterly reporting began in 1991, excluding quarters when deposit insurance coverage was expanded.[4] Second quarter 2020 is the highest quarterly growth rate experienced (8.0 percent) while first quarter 2020 is tied with fourth quarter 2008 for the second-highest (4.5 percent) and first quarter 2021 is a close fourth-highest (4.4 percent).[5]

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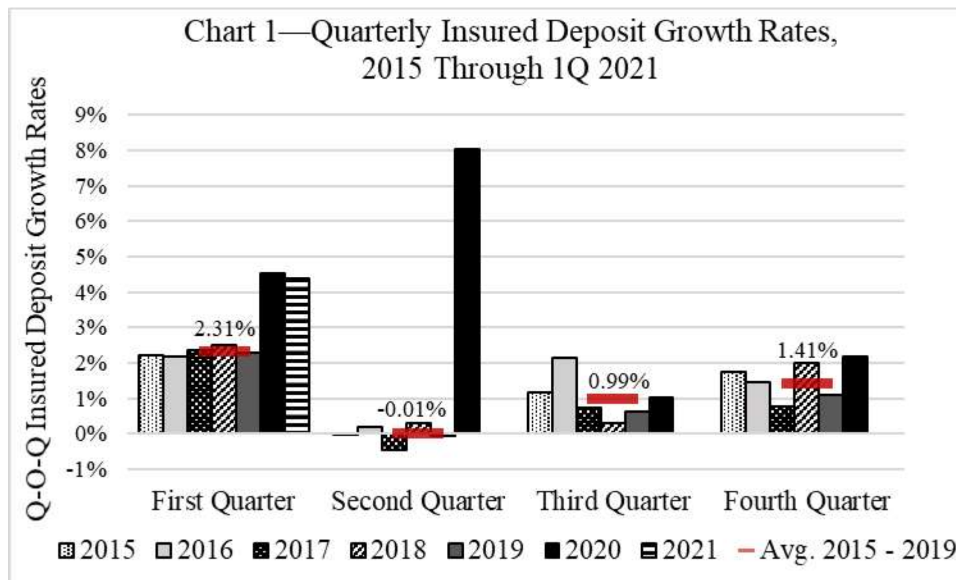
[4] In the third quarter of 2009, insured deposit growth was 10.3 percent following the FDIC's adoption of a final rule amending its deposit insurance regulations to reflect the extension of the temporary increase in standard maximum deposit insurance coverage from $100,000 to $250,000 from December 31, 2009 through December 31, 2013. In the fourth quarter of 2010, insured deposit growth was 16.2 percent when unlimited coverage for noninterest-bearing transaction accounts was provided through December 31, 2012 and to reflect a permanent increase in standard maximum deposit insurance coverage from $100,000 to $250,000 pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[5] Although the Emergency Economic Stabilization Act of 2008 temporarily increased the standard maximum deposit insurance amount from $100,000 to $250,000, it directed the FDIC not to consider the temporary coverage increase in setting assessments, so the FDIC did not include the additional insured deposits as insured deposits for purposes of calculating the fund reserve ratio. *See* Public Law 110–343 (Oct. 3, 2008). The FDIC also guaranteed in full all domestic noninterest-bearing transaction deposits held at participating banks as part of its Transaction Account Guarantee Program from October 2008 through year-end 2010, but these guaranteed



As a result of this extraordinary growth, annual insured deposit growth from year-end 2019 through year-end 2020 was 16.6 percent, more than three times the long-term average annual growth rate of 4.5 percent from 1991 through 2019.

THE RESTORATION PLAN

Under the FDI Act, when the reserve ratio falls below 1.35 percent the FDIC must establish and implement a restoration plan to restore the reserve ratio to at least 1.35 percent within 8 years of establishing the plan, absent extraordinary circumstances.[6] On September 15, 2020, the Board adopted a Restoration Plan to restore the DIF to at least 1.35 percent by September 30, 2028.[7]

The 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 increase of the reserve ratio is likely to reach 1.35 percent within the 8-year period. This memorandum is the first semiannual update following establishment of the Plan.

While subject to uncertainty, based on a range of reasonable estimates of future losses and assuming a return to normal depositor behavior over the medium- to long-term, the Plan described below would restore the

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deposits and associated fee income were reported separately from and did not affect insured deposits for the purposes of calculating the reserve ratio.

[6] 12 U.S.C. § 1817(b)(3)(E).

[7] *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).

reserve ratio to the required minimum level by September 30, 2028, within the timeframe required by law. The Plan provides that:

1. The FDIC will continue to monitor deposit trends, potential losses, and other factors that affect the reserve ratio.

2. The FDIC will maintain the current schedule of assessment rates for all insured depository institutions (IDIs).

3. At least semiannually, staff will update the Board on its analysis and projections for the fund balance and reserve ratio and, if necessary, recommend any modifications to the Plan, such as increasing assessment rates.

To determine whether the reserve ratio has reached the statutory minimum, the FDIC will rely on the reserve ratio as of September 30, 2028.[8]

SEMIANNUAL UPDATE

As stipulated by the Plan, below is an updated analysis with respect to each element of the Plan.

Deposit trends

The extraordinary growth in insured deposits during the first half of 2020 was largely a result of actions taken by monetary and fiscal authorities, and by individuals, businesses, and financial market participants in response to the COVID-19 pandemic. Deposit growth initially intensified in March 2020 upon the outbreak of the COVID-19 pandemic. As COVID-19 infections spread throughout the United States, individual states or major metropolitan areas ordered millions of Americans to stay home, severely reducing their ability to engage in usual commerce and forcing many businesses to close temporarily or furlough employees. Faced with economic disruption, market volatility, and uncertainty, businesses drew on their lines of credit and conserved cash, increasing deposits.

Monetary and fiscal stimulus applied additional upward pressure on deposit growth. Beginning in March 2020, the Board of Governors of the Federal Reserve System (Federal Reserve) announced a series of emergency actions, including large-scale asset purchases and emergency lending facilities, resulting in an approximately $2.0 trillion increase in IDI reserve balances and total deposits. As part of the $2.2 trillion Coronavirus Aid, Relief, and Economic Security Act (CARES Act), signed into law on March 27, 2020, the U.S. government provided direct support to individuals and businesses through business loans, expanded unemployment insurance, and provided nearly $300 billion in direct stimulus payments to individuals, fueling deposit growth and lifting the personal savings rate.[9] Since the Board adopted the Plan, insured deposits grew

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[8] The reserve ratio is based on total estimated insured deposits at the end of a given quarter. The FDIC will rely on the reserve ratio 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.

[9] Among other programs, the CARES Act established the Paycheck Protection Program (PPP), which facilitated credit to small businesses through loans backed by the full faith and credit of the U.S. government; provided Economic Impact Payments of up to $1,200 per adult and $500 per child, with eligibility based on income; expanded the amount of and eligibility for unemployment benefits; and provided funding for state, local, and tribal governments. *See* Public Law 116–136 (Mar. 27, 2020).

by 1.0 percent during the third quarter of 2020 and by 2.2 percent during the fourth quarter of 2020, a significant deceleration from the extraordinary growth experienced in the first half of 2020, but still above average.

During the first quarter of 2021, insured deposits increased by 4.4 percent, driven by two additional rounds of fiscal stimulus. Through the $900 billion Consolidated Appropriations Act, 2021,[10] signed into law on December 27, 2020, and the $1.9 trillion American Rescue Plan Act of 2021,[11] signed into law on March 11, 2021, the U.S. government provided further enhanced support to individuals and businesses, applying upward pressure on deposit growth. Since the Board adopted the Plan, through March 31, 2021, insured deposits grew by an estimated $683.2 billion (or 7.7 percent), more than twice the average growth experienced in a typical three-quarter period. This continued extraordinary growth in insured deposits resulted in a five basis point decline in the reserve ratio from the second quarter of 2020.

Higher personal savings contributed notably to higher deposit levels, reflecting stronger precautionary savings, changed consumer behavior during the pandemic, and higher income from fiscal stimulus. In total, personal savings for the last five quarters through first quarter 2021 was $3.9 trillion, up from $1.6 trillion during the previous five quarters through fourth quarter 2019. This represents a $2.3 trillion increase in savings since 2020. In comparison, deposits rose $1.7 trillion during this time period. Not all personal savings ends up in deposit accounts, as some may go towards debt payments and financial investments. During this period, the monthly personal savings rate varied with fiscal stimulus payments. The savings rate spiked to 33.7 percent in April 2020, up from the pre-pandemic average rate of 7.5 percent, and declined through much of the year, ending at 13.5 percent by December. As many individuals received additional stimulus payments, personal savings climbed again in January 2021 to 20.0 percent. The rate declined to 13.9 percent in February 2021, but spiked again to 27.6 percent in March 2021 as many individuals received another round of stimulus payments and indicated continued preference to save. In March 2021, the average share of stimulus payments that households indicated they would save, given a weak labor market and the uncertain outlook for the pandemic, rose slightly from 37 percent in January to 41 percent.[12] The outlook for savings remains uncertain. Consumer spending has risen markedly in 2021 as economic conditions have improved. The extent to which the high levels of saving might facilitate more spending in the future, and the extent of pent-up consumer demand that will go toward future spending, remains to be seen.

Going forward, staff expect a return to normal depositor behavior in the medium- to long-term as economic conditions improve, the precautionary behavior exhibited by depositors subsides, and individuals and businesses redirect some deposits toward consumption and higher-yielding investments. Early deposit data monitoring indicates that seven weeks into the second quarter of 2021, estimated domestic deposits (including both insured and uninsured deposits) for domestically chartered commercial banks decreased by 0.2 percent

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[10] The Consolidated Appropriations Act, 2021 allocated $284 billion in additional funding for the PPP, approximately $166 billion in Economic Impact Payments (up to $600 per adult and $600 per child, with eligibility based on income), and expanded unemployment benefits. *See* Public Law 116-260 (Dec. 27, 2020).

[11] The American Rescue Plan Act of 2021 allocated $7.25 billion in additional funding for the PPP, approximately $410 billion in Economic Impact Payments (up to $1,400 per adult and $1,400 per dependent, with eligibility based on income), expanded unemployment benefits, expanded certain tax credits, and provided additional funding for state, local, and tribal governments. *See* Public Law 117-2 (Mar. 11, 2021).

[12] Armantier, Olivier, Leo Goldman, Gizem Koşar, and Wilbert van der Klaauw. "An Update on How Households Are Using Stimulus Checks." *Liberty Street Economics*, Federal Reserve Bank of New York (Apr. 7, 2021). Available at https://libertystreeteconomics.newyorkfed.org/2021/04/an-update-on-how-households-are-using-stimulus-checks.html.

since March 31, 2021, and decreased by 0.4 percent for the week between May 19, 2021 and May 26, 2021.[13] The economic outlook has strengthened in recent months, but remains uncertain. Following a 3.5 percent decline in gross domestic product (GDP) in 2020, the May 2021 Blue Chip consensus forecast for GDP growth is 6.6 percent in 2021, and 4.4 percent in 2022. Personal consumption expenditures declined 3.9 percent in 2020 but this measure is expected to increase 7.7 percent in 2021 and 4.4 percent in 2022. The positive outlook for economic growth reflects expectation of increased consumer and business spending and a continued improvement in the labor market, which reduces the incentive for precautionary savings.

Despite the positive outlook, economic conditions remain weak and the outlook for deposit growth remains uncertain. The unemployment rate remains elevated at 6.1 percent in April 2021 with uneven recovery across industries. Any unexpected economic weakness or concerns about slower than expected economic recovery, and any resurgence of infections or reinstatement of restrictive measures to mitigate infections, may cause businesses and consumers to maintain caution in spending, and keep deposit levels elevated. Similarly, unexpected financial market stress could prompt another round of investor risk aversion that could lead to an increase in insured deposits. A significant increase in fiscal spending or further stimulus could also provide uncertainty to normalizing the level of insured deposits.

The impact on deposit balances of a continued period of uncertainty is difficult to predict. Surge insured deposits associated with the pandemic may recede as the economy recovers and spending normalizes, or they may remain elevated if businesses and consumers continue to hold back spending. Under the Plan, the FDIC will continue to monitor these deposit balance trends and their impact on the ability of the reserve ratio to return to 1.35 percent within 8 years of establishing the Plan.

Potential 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, five IDIs per year failed between 2015 and 2020, at an average annual cost to the fund of about $355 million.[14] Four banks failed in 2020, marking the sixth year in a row with few or no failures. No banks have failed thus far in 2021.

The total number of institutions on the FDIC's Problem Bank List was 55 at the end of the first quarter of 2021, down significantly from the peak of 888 institutions in March 2011.[15] The number of troubled banks is currently expected to remain at low levels through 2021. At March 31, 2021, the contingent loss reserve for anticipated failures was $65 million, down from $107 million one year earlier.

Future losses to the DIF remain uncertain as the length of the pandemic and the resulting potential economic and banking effects are still unclear, although prospects appear significantly more favorable compared to when the Plan was adopted in September of 2020. The uncertainties include, among others, the length of time necessary for a full economic recovery, how quickly businesses reopen and return to pre-

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[13] Percent change for estimated weekly aggregate domestic deposits, which includes insured and uninsured deposits, at domestically chartered commercial banks only. This statistic is based on data that are reported weekly by a sample of banks and does not include deposits at other IDIs, including savings institutions. Federal Reserve, H.8 Data Release, Assets and Liabilities of Commercial Banks in the United States, data as of June 4, 2021, available at https://www.federalreserve.gov/releases/h8/current/default.htm.

[14] FDIC, Annual Report 2020, Assets and Deposits of Failed or Assisted Insured Institutions and Losses to the Deposit Insurance Fund, 1934 – 2020, page 145, available at https://www.fdic.gov/about/financial-reports/reports/2020annualreport/2020ar-final.pdf.

[15] "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.

pandemic operations, and evolving consumer behavior, which could have longer-term effects on the condition and performance of the banking industry.

The banking industry has remained a source of strength for the economy, in part, because the stronger capital position of banks has better positioned them to withstand losses compared to 2008. As of March 31, 2021, capital remained above regulatory minimums and the industry ratios for tier 1 risk-based capital and total risk-based capital exceeded the ratios reported at year-end 2007 by several percentage points.

While many banks built substantial levels of reserves for potential losses in 2020, banks significantly reduced the pace of additional loan loss provisioning for most loan categories, with the industry reporting an aggregate negative provision in the first quarter of 2021 as the economic outlook strengthened and the expectation for future credit losses declined significantly. However, some heightened credit risk remains, particularly related to businesses most actutely affected by the pandemic such as hospitality, travel, and certain commercial real estate sectors. Despite the reduction in the pace of provisioning, loan loss allowances remain well above pre-pandemic levels for all loan categories, and banks continue to build allowances for commercial real estate loans.

To anticipate declines in capital that could trigger losses from IDI failures, the FDIC also monitors other measures, such as earnings, asset quality, and supervisory ratings. While economic stress related to COVID-19 and a prolonged period of low interest rates has impacted IDI earnings and lowered net interest margins to record lows, asset quality and supervisory ratings generally remain strong. Asset quality indicators have deteriorated modestly but remain considerably better than those reported during prior recessions. As of March 31, 2021, 1.14 percent of loan and lease balances were noncurrent, up from a year ago, but well below the peak of 5.46 percent in the first quarter of 2010.

The banking industry remains resilient entering 2021 despite the extraordinary challenges of the pandemic. Strong liquidity and capital levels at the start of 2021 should help to mitigate potential credit stress across loan portfolios. 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.

Other factors that affect the reserve ratio

The FDIC also monitors other factors that affect the reserve ratio, including changes in IDI risk profiles, which influence assessment rates; growth in the assessment base; DIF investment income and unrealized gains and losses on investments; and operating expenses. For the assessment period ending March 31, 2021, the weighted average assessment rate for all IDIs is approximately 3.8 basis points, down from 4.1 basis points for the assessment period ended December 31, 2020.[16] Growth in the assessment base has contributed to increasing assessment revenue and growth in the DIF balance. Operating expenses remained steady, while low investment returns on securities held by the DIF have limited growth in the fund balance. In future quarters, the weighted average assessment rate may increase or decrease based on the risk profiles of institutions, and a recession of surge deposits could reduce growth in the assessment base. A decrease in either average assessment rates or in the growth of the assessment base would slow growth in the DIF balance and, thus, the reserve ratio through reduced assessment income.

[16] The quarterly weighted average assessment rate was calculated based on FDIC data as of June 1, 2021, and is subject to change due to amendments made for the next three years to IDIs' quarterly Consolidated Reports of Condition and Income or quarterly Reports of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (as applicable).

Current schedule of assessment rates

In developing the Plan, staff projected the DIF balance and associated reserve ratio at the end of the 8-year period beginning upon implementation of the Plan. Staff updated its analysis using data through March 31, 2021, and assuming different rates of insured deposit growth. While subject to uncertainty, staff believe that the reserve ratio would reach the minimum level by the statutory deadline while maintaining the current assessment rate schedule.

Table 2 depicts the amount of losses that the DIF could absorb and still reach 1.35 percent within the 8-year period.[17] For example, if insured deposits grow at an annual rate of 2.5 percent over the next 7.5 years, the DIF could absorb losses of up to $18.1 billion and still reach the minimum reserve ratio requirement by September 30, 2028. Alternatively, if insured deposits grow at an annual rate of 4.5 percent over the next 7.5 years, the DIF would need an additional $5.9 billion for the reserve ratio to reach the 1.35 percent minimum.

Table 2–Projected Reserve Ratio at September 30, 2028 Assuming Different Rates of Insured Deposit Growth

Annual Insured Deposit Growth Rate [percent]	Industry Insured Deposits [billions of dollars]	DIF Reserve Ratio [percent]	DIF Balance needed to reach 1.35 percent reserve ratio [billions of dollars]	Amount available to absorb losses and reach 1.35 percent reserve ratio [billions of dollars]
2.5	11,455	1.50	154.1	18.1
3.0	11,881	1.45	159.8	12.4
3.5	12,320	1.40	165.7	6.5
4.0	12,774	1.35	171.8	0.4
4.5	13,242	1.30	178.1	(5.9)

It is reasonable that annual insured deposit growth could average less than 4.5 percent over the next 7.5 years for two main reasons. First, annualized growth has been less than 4.5 percent or negative during most (58 percent) quarters since quarterly reporting was adopted in 1991. Most importantly, as previously discussed, deposit growth could experience declines in the near-term after direct stimulus payments are fully disbursed, as economic conditions continue to improve, and as the consumption and investment patterns of individuals and households exhibit less precautionary behavior. Additionally, surge insured deposits may recede as the economy recovers and spending normalizes, and any flow of surge insured deposits out of the banking system would offset insured deposit growth to some extent.

For purposes of this analysis, staff assumed that the extraordinary growth resulting from the surge in insured deposits at the onset of the pandemic in 2020 and in the first quarter of 2021 would elevate the long-term average annual insured deposit growth rate from December 31, 2019, through September 30, 2028, to 5.0 percent. In comparison, insured deposits have on average grown at an annual rate of 4.5 percent since the 1990s. To achieve the assumed average annual growth rate of 5.0 percent, insured deposits would grow at an annual rate of approximately 3.13 percent over the next 7.5 years, reflecting a return to normal consumer behavior and factoring in an offset to the growth rate to reflect some flow of surge insured deposits out of the

[17] For simplicity, the analysis shown in Table 2 assumes that: (1) the assessment base grows 4.5 percent, annually; (2) the average assessment rate remains at 4.0 basis points; (3) interest income on the deposit insurance fund balance is zero; and (4) operating expenses grow at 1 percent per year.

banking system. Under this scenario, Table 2 above shows that losses would have to approach $12.4 billion to prevent the reserve ratio from reaching 1.35 percent by the end of the 8-year period.

Due to the uncertainties discussed earlier, losses from bank failures remain difficult to project. However, the banking industry is well capitalized, the number of banks on the problem bank list remains low, and the banking industry has remained resilient through the economic uncertainties posed by the pandemic. As the effects of the pandemic on the banking industry and the economic outlook continue to become more apparent, staff will reassess its analysis of insured deposit growth, potential losses, and other factors that affect the reserve ratio.

Future updates

This memorandum is the first semiannual update following the adoption of the Plan. While subject to uncertainty, based on a range of reasonable estimates of future losses and assuming that depositor behavior normalizes in the medium- to long-term, staff continue to project that the reserve ratio would return to 1.35 percent before the end of the 8-year period beginning upon the implementation of the Plan. As economic conditions improve, surge insured deposits associated with the pandemic may recede as the precautionary behavior exhibited by depositors subsides and individuals and businesses redirect deposits toward consumption and higher-yielding investments. The economic outlook has strengthened in recent months and appears more favorable than last September, and the banking system continues to appear better positioned to withstand losses when compared to prior periods of stress. However, several factors, such as slower than expected economic growth, market volatility, or additional fiscal and monetary stimulus could result in increased insured deposit growth or losses to the fund.

Under the Plan, staff will continue to update its projections for the fund balance and reserve ratio at least semiannually while the Plan is in effect and to recommend rate adjustments as necessary. Staff continue to believe that frequent updates are necessary because loss and reserve ratio projections made so far into the future are subject to considerable uncertainty.

Losses could differ from projected amounts if economic conditions worsen or financial stresses facing IDIs prove more or less severe. For example, DIF loss projections may increase if the quality of IDI assets quickly deteriorates or capital markets become severely constrained, and income could be affected by the factors described previously. Insured deposit growth could be higher or lower based on future economic conditions and the response of fiscal and monetary authorities and depositors. Changes in IDI risk profiles or a reduction in the aggregate assessment base, which could be driven by a future flow of surge deposits out of the banking system, could reduce assessment revenue and constrain growth in the DIF.

Future updates to the Board may include changes in assumptions that result in different assessment revenue needs. Consequently, in order to fulfill the statutory requirement that the Plan provide that the fund return to a reserve ratio to 1.35 percent before the end of the 8-year period beginning upon the implementation of the Plan, absent extraordinary circumstances, the FDIC may need to adopt higher assessment rates than

those included in the current assessment rate schedule. Under assessment regulations, any increase in assessment rates greater than two basis points would require notice and comment.[18]

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[18] *See* 12 C.F.R. § 327.10(f).