FDIC Federal Deposit Insurance Corporation

MEMO

TO: The Board of Directors

FROM: Patrick Mitchell
Director, Division of Insurance and Research

DATE: November 16, 2023

RE: Restoration Plan Semiannual Update

RECOMMENDATION

Increased loss provisions associated with the failures of Silicon Valley Bank, Signature Bank, and First Republic Bank that reduced the Deposit Insurance Fund (the DIF or the Fund) balance coupled with strong growth in insured deposits, resulted in the reserve ratio declining 15 basis points from 1.25 percent as of December 31, 2022, to 1.10 percent as of June 30, 2023.[1] Despite the decline in the reserve ratio, 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, set by statute, though the precise timing is unknown and depends on a number of factors, discussed below.[2] Accordingly, staff recommend no changes to the Amended Restoration Plan at this time 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.[3] 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.[4]

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

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[1] The decline in the DIF balance does not include the cost of 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).

[2] 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).

[3] *See* 12 U.S.C. § 1817(b)(3)(B) and (E).

[4] *See* 85 FR 59306 (Sept. 21, 2020).

Board amended the Restoration Plan (Amended Restoration Plan, or Plan).[5] 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.[6] 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 Amended Restoration Plan. This memorandum is the second semiannual update of 2023. Under the Plan, the FDIC is monitoring potential losses, deposit balance trends, and other factors that affect the reserve ratio.

SEMIANNUAL UPDATE FOR NOVEMBER 2023

Table 1 shows the components of the reserve ratio from the fourth quarter of 2022, the most recent date of the analysis and projections presented in the last semiannual update, through the second quarter of 2023, the most recent date that data on both the fund balance and insured deposits is available.

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

	4Q 2022	1Q 2023	2Q 2023
Beginning Fund Balance	$125.5	$128.2	$116.1
Plus: Net Assessment Revenue	$2.1	$3.3	$3.1
Plus: Net Investment Contributions and Other Income[a]	$1.1	$1.5	$0.3
Less: Loss Provisions	*	$16.4	$2.0
Less: Operating Expenses	$0.5	$0.5	$0.5
Ending Fund Balance[b]	$128.2	$116.1	$117.0
Estimated Insured Deposits	$10,277.9	$10,500.2	$10,586.3
Q-O-Q Growth in Est. Insured Deposits	1.0%	2.2%	0.8%
Ending Reserve Ratio	1.25%	1.11%	1.10%

*Absolute value less than $50 million
[a]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.
[b]Components of fund balance changes may not sum to totals due to rounding.

As of June 30, 2023, the DIF balance totaled $117.0 billion, down $7.5 billion from one year earlier. Other than in the first quarter of 2023, the only other quarterly decline since 2009 was a $0.1 billion decline in first quarter 2022, primarily due to unrealized losses on available-for-sale securities. The large decline in the DIF balance in the first quarter of 2023, coupled with insured deposit growth, resulted in the reserve ratio declining from 1.25 percent as of December 31, 2022, to 1.11 percent as of March 31, 2023. The reserve ratio further

[5] *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).
[6] *See* 87 FR 39388 (July 1, 2022) and 87 FR 64314 (Oct. 24, 2022). The reserve ratio is based on total estimated insured deposits at the end of a given quarter. 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.

declined 1 basis point from March 31, 2023, to 1.10 percent as of June 30, 2023, as insured deposits increased at a slightly higher rate than the DIF balance.

Despite outflows for total deposits for five straight quarters, insured deposit growth has been strong and balances remain significantly elevated, as explained further below. Following a 1.0 percent increase in the quarter ending December 31, 2022, insured deposits increased by 2.2 percent in the quarter ending March 31, 2023, and by 0.8 percent in the quarter ending June 30, 2023. Quarterly growth this year has been due to increases in insured brokered deposits and reciprocal deposits. As of June 30, 2023, annual insured deposit growth was 4.7 percent, slightly higher than the long-term historical average of 4.5 percent experienced from 2000 to 2019.

Increased loss provisions were the primary contributor to the decline in the DIF during 2023. The increase in loss provisions in the first half of 2023, which reduced the DIF balance by $18.4 billion, was primarily driven by the March 2023 failures of Silicon Valley Bank and Signature Bank and the May 2023 failure of First Republic Bank. The failure of First Republic Bank is estimated to cost the DIF $15.6 billion.[7] The decline in the DIF balance does not include the cost of protecting uninsured deposits pursuant to the systemic risk determination announced following the two bank failures in March 2023, as the FDIC is required by statute to recover those losses through special assessments.[8] Of the combined $18.7 billion in updated estimated losses at Silicon Valley Bank and Signature Bank, the estimated loss attributable to the protection of uninsured depositors is $16.3 billion.[9] Only the remaining estimated loss from these two failures of $2.4 billion, combined with provisions for other actual or anticipated failures, including First Republic Bank, directly impact the DIF balance.

Assessment revenue slightly offset the decline in the DIF in the first half of 2023. Assessments earned in the quarters ending March 31, 2023 and June 30, 2023, reflect the 2 basis point increase in initial base deposit insurance assessment rate schedules, which took effect beginning on January 1, 2023. The weighted average assessment rate was approximately 4.0 basis points for the assessment period ending December 31, 2022, and increased to 6.0 basis points for the assessment period ending March 31, 2023, and 6.1 basis points for the assessment period ending June 30, 2023.

Net investment contributions and other income added $1.8 billion to the DIF balance in the first half of 2023. Interest earned on investments totaled $1.3 billion, as increased yields offset a reduction in the book value of the portfolio. Realized and unrealized gains and losses on available-for-sale securities further increased the DIF balance by $0.4 billion.

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. In recent years, the DIF has experienced low losses from bank failures, until 2023. On average, three banks per year failed between 2016 and 2022, at an average annual cost to the fund of

[7] For estimated cost of the failure of First Republic Bank, see page 31 of the FDIC Quarterly Banking Profile for Second Quarter 2023, available at https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2023jun/qbp.pdf#page=1.
[8] *See* 12 U.S.C. § 1823(c)(4)(G)(ii)(III).
[9] As with all failed bank receiverships, loss estimates will be periodically adjusted as assets are sold, liabilities are satisfied, and receivership expenses are incurred. The amount of the special assessment to be collected will be adjusted as the loss estimate changes.

about $178 million.[10] Five banks failed thus far in 2023, following more than two years without a bank failure and eight years in a row with few or no failures. The total cost to the DIF from failures in 2023, excluding losses that will be recovered through the special assessment described below, is estimated to be $18.1 billion.

The failures of Silicon Valley Bank on March 10, 2023, and Signature Bank on March 12, 2023, were due to sudden and unexpected liquidity needs as a result of large withdrawals of uninsured deposits. The FDIC's most recent updated loss estimates for these failures are $17.8 billion and $0.9 billion, respectively; however, of that estimated total cost of $18.7 billion, the FDIC estimates that approximately $16.3 billion was attributable to the cost of covering uninsured deposits pursuant to systemic risk determinations made on March 12, 2023.[11] By statute, the FDIC is required to recover through one or more special assessments the estimated losses to the DIF incurred as a result of the actions of the FDIC pursuant to determinations of systemic risk.[12] Staff are separately and concurrently recommending the Board authorize publication of a final rule to implement a special assessment to recover the loss to the DIF associated with protecting uninsured depositors following the closures of Silicon Valley Bank and Signature Bank. Therefore, only the estimated loss of $2.4 billion not attributable to covering uninsured deposits for these two failures directly impacted the DIF balance.

First Republic Bank was closed on May 1, 2023.[13] As mentioned above, the FDIC estimates the cost to the DIF from the failure of First Republic Bank to be $15.6 billion. As with all failed bank receiverships, this estimate will be periodically adjusted and the final cost will be determined when the FDIC terminates the receivership.

The two other bank failures in 2023 were Heartland Tri-State Bank on July 28, 2023, and Citizens Bank on November 3, 2023. Heartland Tri-State Bank had approximately $139 million in total assets and $130 million in total deposits, as of March 31, 2023.[14] Citizens Bank had approximately $66 million in total assets and $59 million in total deposits, as of September 30, 2023.[15] The FDIC estimates the cost to the DIF from these two failures to be $69.0 million.

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 2027 would cost the DIF approximately $4.4 billion. The total number of institutions on the FDIC's Problem Bank List was 43 at the end of the second quarter of 2023, which is unchanged from the first quarter of 2023 and significantly below the peak of 888 institutions in March 2011.[16]

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[10] FDIC, Annual Report 2022, Assets and Deposits of Failed or Assisted Insured Institutions and Losses to the Deposit Insurance Fund, 1934-2022, page 178, available at: https://www.fdic.gov/about/financial-reports/reports/2022annualreport/2022-arfinal.pdf.

[11] The exact cost will be determined when the FDIC terminates the receiverships.

[12] 12 U.S.C. § 1823(c)(4)(G).

[13] FDIC PR-34-2023. "JPMorgan Chase Bank, National Association, Columbus, Ohio Assumes All the Deposits of First Republic Bank, San Francisco, California," May 1, 2023, available at: https://www.fdic.gov/news/press-releases/2023/pr23034.html.

[14] 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.

[15] 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.

[16] "Problem" institutions are institutions with a CAMELS composite rating of "4" or "5" due to financial, operational, or managerial weaknesses, or a combination of such issues. It is common for banks to move on or off this list each quarter.

Economic growth slowed after 2021 but has remained resilient despite elevated inflation and interest rates, driven by business and consumer spending. U.S. GDP grew 2.1 percent at a real seasonally adjusted annualized rate in second quarter 2023, after 2.2 percent growth in first quarter 2023.[17] The September Blue Chip Economic Indicators consensus forecast for GDP growth is 2.1 percent for full year 2023.[18] Risks to the economic outlook include the effects of high inflation, higher interest rates, geopolitical uncertainty, bank credit tightening, and global economic slowdown. A weaker economy may reduce bank profitability, weaken credit quality and capital, and limit loan growth.

Despite the period of stress earlier this year, the banking industry continues to be resilient. In the first and second quarters of 2023, net income remained high by historical measures, asset quality metrics remained favorable, and the industry remained well capitalized. However, banks reported tightening net interest margins and funding pressures for both quarters. The banking industry continues to face significant downside risks from the effects of inflation, rising market interest rates, and geopolitical uncertainty.

Furthermore, unrealized losses in the banking industry's securities portfolios remain elevated. Declines in medium- and long-term rates reduced the volume of these unrealized losses in fourth quarter 2022 and first quarter 2023, before unrealized losses increased again in second quarter 2023. Additional short-term interest rate increases combined with longer asset maturities may also affect bank balance sheets in coming quarters. As evidenced in the recent bank failures, 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. Higher market interest rates may also erode real estate and other asset values, as well as hamper the loan repayment ability of borrowers with adjustable rate loans or in need of refinancing.

The downside risks described above could present challenges and could 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. The estimated losses to the DIF from the three large bank failures earlier this year, especially from the failure of First Republic Bank, have had a significant impact. However, the increase in assessment rate schedules that became effective on January 1, 2023, will 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

Total deposits declined by 2.5 percent in the first quarter and by 0.5 percent in the second quarter. Since the first quarter of 2022, deposit balances have declined for five consecutive quarters, driven by customers actively seeking higher yields often at nonbank financial institutions, particularly money market mutual funds. Deposit outflows likely accelerated in the first quarter as a result of the significant stress faced by the industry following the two large bank failures in March 2023. Outflows related to industry stress appear to have dissipated in the second quarter.

In contrast, insured deposit balances increased by 2.2 percent in the first quarter and 0.8 percent in the second quarter. Year-over-year insured deposit growth was 4.7 percent, as of June 30, 2023, slightly above the long-term historical average annual rate of 4.5 percent.[19] Industry insured deposits remain elevated, with total balances equal to $1.5 trillion above the level that would have resulted if deposits had grown at the long-term historical average since 2019. Compared to 2020 and 2021, when insured deposit growth was driven by non-

[17] Bureau of Economic Analysis.

[18] September 2023 Blue Chip Economic Forecast.

[19] Long-term historical average is based on data from 2000 through 2019.

brokered insured deposits, the recent increase in insured deposit balances has been primarily driven by growth in insured brokered deposits and additionally by non-brokered reciprocal deposits.

The outlook for insured deposit growth remains uncertain and depends on several factors, including the outlook for the economy, inflation, interest rates, and consumer behavior. For example, an economic slowdown or a weaker labor market would reduce consumer incomes, which could reduce consumer savings and deposit balances. On the other hand, concerns about slower economic growth or employment may cause businesses and consumers to increase precautionary savings to maintain the ability to cover expenses in the event of decreased income. Higher interest rates may also inhibit growth of insured deposits in the banking system if depositors continue to shift to higher-yielding alternatives, particularly money market mutual funds. However, to the extent that banks replace insured deposit outflows with other insured deposit funding sources, such as brokered CDs, the net effect on insured deposit growth would be mitigated.

Over two years have passed since the period of extraordinary growth in insured deposits prompted by the last round of fiscal stimulus, and aggregate balances remain significantly elevated, as noted above. 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 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 June 30, 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 last semiannual update 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.

Net investment contributions and other income totaled $1.5 billion in first quarter 2023, before decreasing to $0.3 billion in the second quarter. In the first quarter of 2023, the DIF experienced a $2.5 billion unrealized gain which was partially offset by a $1.7 billion realized loss from the sale of securities to meet liquidity needs for the two bank failures. Interest income increased from $0.5 billion as of fourth quarter 2022, to $0.7 billion as of first quarter 2023. During the second quarter, unrealized losses of $0.5 billion were partially offset by realized gains of $0.1 billion from the sale of securities. Interest income remained flat at about $0.7 billion. While subject to changing market expectations of interest rates and partially contingent on any additional sales of DIF investments, staff expect that the yield on the DIF portfolio will remain elevated over the next year.

Projections for fund balance and reserve ratio

Despite a decline in the DIF balance in the first half of 2023, including increased loss provisions for actual and anticipated bank failures, 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, the reserve ratio would likely reach 1.35 percent as early as 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, these projections are subject to uncertainty around many assumptions that affect the reserve ratio. In particular, 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 Fund 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 2023. 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. Despite the period of stress earlier this year, the banking industry has proven to be resilient. 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 or if those deposits resulting from extraordinary growth begin to recede. 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 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 related to recent developments in the financial system and the banking sector and because loss and reserve ratio projections made far into the future are subject to considerable uncertainty. Staff will provide the next semiannual update in 2024, and may be able to provide additional clarity on the amount of losses associated with past bank failures as the FDIC completes sales of assets in receivership.

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