From: Doug Krause <Doug.Krause@eastwestbank.com>
Sent: Saturday, June 03, 2023 8:27 PM
To: Comments
Subject: [EXTERNAL MESSAGE] May 22, 2023 - Special Assessments Pursuant to Systemic Risk Determination - Notice of Proposed Rulemaking; Comment Request (RIN 3064-AF93)

Chairman Martin J. Gruenberg
Federal Deposit Insurance Corporation
Via e-mail: comments@fdic.gov

Subject: Comments – RIN 3064-AF93; Proposed Special Assessments Pursuant to Systemic Risk Determination

Thank you for the opportunity to comment on the proposed special assessments to cover insurance fund losses related to the closures of Silicon Valley Bank and Signature Bank.

We recommend that the framework of the proposed special assessments be re-considered and that the special assessments apply only to the banks that have been designated as "systemically important" (i.e., too big to fail). In addition, we recommend that the special assessment be based on asset size, as is currently being done for general assessments, and not on uninsured deposits. In addition, we recommend that a post-SVB failure date is more appropriate than December 31, 2022 as the "as of date" on which the special assessments are calculated.

Systemically Important Banks. The rationale proposed for the allocation of the special assessments is that the costs should be borne by the banks that most benefited from the use of the FDIC insurance deposit fund to pay the uninsured depositors of Silicon Valley Bank and Signature Bank. I disagree with the conclusion as to which banks benefited from the handling of these two closures. As they teach in detective school, Follow the Money. Money flowed out of most community and regional banks after the seizure of Silicon Valley Bank and into the banks designated as systemically important by the banking regulators and where the FDIC implicitly guarantees their deposits. There was no assurance that uninsured deposits of banks not designated as systemically important would be protected. To the contrary, it was expressly stated by leading regulators and government officials that other banks should not assume that their uninsured deposits would also be protected. These remarks of course led nervous depositors to move even more money to banks designated as systemically important and away from banks where there was no assurance the FDIC insurance fund would be used to cover uninsured deposits[1]. If the FDIC and other regulators and government officials had announced that all deposits at all banks would be covered for some period of time, then a special assessment levied on all banks would be fair. But that is not what happened. The handling of the Silicon Valley and Signature Bank seizures did not strengthen public confidence that depositors of banks not designated as systemically important would be protected by the FDIC, especially banks under $100 billion, several of which saw material outflows. Accordingly, the banks that benefited from

how the bank seizures were managed were the systemically important banks and so in fairness they are the ones who should pay the special assessment[2].

Community and regional banks exist for a purpose. As a general matter most lend out the large majority of their deposits and do so at reasonable interest rates to businesses and consumers. They generally have stronger capital ratios and engage in lower risk activities than do the mega banks that are designated systemically important. The mega banks have a different business model. They are good vehicles for the creation of assets that can be securitized (such as homogenized commercial loans and the use of algorithms to make high interest loans to small businesses and consumers). But they are not so good at returning phone calls or providing customized solutions or personalized service. Making the entire banking system pay to cover the use of the FDIC insurance fund in a way that benefits the systemically important banks will only further the gradual consolidation of the banking industry into a few large banks. It is the community and regional banks that fund the small to medium sized businesses that create jobs and economic growth.

<u>Uninsured Deposits vs. Total Assets</u>. We also recommend that the special assessment be based on the total assets of a bank, as is currently being done for general assessments to fund the FDIC deposit insurance fund.

First of all, the amount of uninsured deposits a bank has is not a good proxy to measure how much it benefits from the existence of the FDIC deposit insurance fund because there is no assurance that the fund will be used to pay uninsured depositors (unless of course they are at a bank designated as systemically important). Regulators and government officials have repeated this numerous times and it has been widely reported on in the press.

Secondly, the use of uninsured deposits as pulled from CALL reports is also not a good proxy for how many deposits are at risk of not being paid in the event of a seizure of a bank. The CALL report asks a bank to provide an “estimate” of uninsured deposits but in Schedule RC-O, Memorandum 2 does so by asking a bank to provide the amount of all deposits in excess of $250,000 per deposit customer as an estimate by a bank of uninsured deposits. The instructions are well known to be unclear, and it is my understanding that banks fill in this line item of the CALL report differently; the reported “uninsured deposits” numbers of identical banks might be very different depending on how they interpret the CALL report instructions. For example, an account with a balance over $250,000 can be fully insured depending on the vesting of an account such as an account owned jointly by a couple which would be insured up to $500,000. And yet a bank that strictly followed the CALL report definitions would report $250,000 of insured deposits and $250,000 of uninsured deposits. This has been a problem with the CALL report for years and it is well known by the examiners in the field that how banks report their “uninsured deposits” varies bank to bank because the instructions are not clear. In addition, there are other deposits such as government deposit and bankruptcy court deposits where the deposits are secured by a pledge of securities (usually U.S. treasuries) or by letters of credit and so these deposits are also in effect covered from loss even though their deposits may be over $250,000. Depositors with loans have a right of offset of uninsured deposits against their loan obligations and so these depositors also do not have a risk of loss to the deposits even though considered “uninsured” under the CALL report instructions. The CALL report is not well designed to provide information on either uninsured deposits or the amount of deposits that are at risk if a bank is seized.

Because of the different ways of calculation by different banks and the poorly drafted CALL report instruction, the CALL report information on uninsured deposits is not useful data for any purpose and certainly not as a basis on which to make deposit insurance assessments.

It is better to base the FDIC deposit fund assessment on total assets as is currently done. The logic for doing so applies here also.

If, however, the FDIC desires to impose the special assessments based on what creates risk of failure and a bank run, the banks that failed did so because of low tangible common equity ratios and this is what made customers nervous. Both *insured and uninsured* depositors pulled money from both banks. If the assessment is to be based on something other than the usual criteria, it would be more appropriate to do so in a way that banks with a lower tangible common equity ratio pay relatively more assessments.

"As of Date" for the Assessment. The use of the date "December 31, 2022" to calculate an assessment based on deposits does not match the reality of the banking system post-SVB. It is well known that after the SVB collapse the community and regional banks have in general lost deposits and that these deposits have gone to the banks designated as systemically important. Accordingly, the use of this date means that the designated systemically important banks who gained deposits after the seizures pay relatively less based on their current deposits while the rest of the banks in the country that lost deposits post SVB pay relatively more compared to their post-SVB deposits.
The use of uninsured deposits on December 31, 2022 has the effect of being yet one more banking rule that makes operating a bank more expensive for the non-systemically important banks and so furthers the creation of a banking system more consolidated and less competitive than it would be absent regulatory practices such as a special assessment that favors the so-called too-big-to fail banks.

Thank you for your consideration.

Very truly yours,

Douglas P. Krause
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FN 1: First Republic Bank was an extreme example of a bank that did not benefit from the use of the FDIC deposit insurance fund to pay uninsured deposits of Silicon Valley Bank. FDIC officials and other government spokespersons said there were no assurances that similar treatment would be given to other banks that were not designated as systemically important. Officers of the FDIC-run Silicon Valley Bridge Bank (which had a large overlap in customer base with Silicon Valley Bank) in fact told depositors of First Republic and other banks that there were only three kinds of banks: SVB and Signature where the FDIC guaranteed 100% of deposits; too big to fail banks that had an implicit FDIC guaranty; and the rest of the banking industry, none of which had assurances of FDIC protection. First Republic may have failed anyway but it was certainly nudged in that direction by statements from regulators and the FDIC- run SVB that other banks should not expect their uninsured deposits to benefit from the FDIC deposit insurance fund. The point of this footnote is to illustrate that contrary to the conclusions stated in the FDIC background material for the proposed special assessment, the banking industry (other than the designated systemically important banks) did not benefit from any implicit promises or comfort that the FDIC deposit fund would be used to cover uninsured deposits.

FN 2: The commentary on the proposed assessment states that the flow of nervous deposits to the systemically important banks has slowed because of the comfort of depositors at the non-systemically

important banks that uninsured deposits would certainly be paid because that is what happened at Silicon Valley Bank and Signature Bank. However as noted, regulators and government officials did not provide any such comfort. Instead, the flow of deposits to the mega banks slowed and sometimes reversed because depositors realized why they were not at mega banks to begin with. It was also because there was more focus on that fact that many of the regional and community banks have stronger ratios of tangible equity to assets than do the systemically important banks.

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[2] The commentary on the proposed assessment states that the flow of nervous deposits to the systemically important banks has slowed because of the comfort of depositors at the non-systemically important banks that uninsured deposits would certainly be paid because that is what happened at Silicon Valley Bank and Signature Bank. However as noted, regulators and government officials did not provide any such comfort. Instead, the flow of deposits to the mega banks slowed and sometimes reversed because depositors realized why they were not at mega banks to begin with. It was also because there was more focus on that fact that many of the regional and community banks have stronger ratios of tangible equity to assets than do the systemically important banks.