

July 18, 2023

**Via Electronic Mail:** [comments@fdic.gov](mailto:comments@fdic.gov)

Mr. James P. Sheesley  
Assistant Executive Secretary  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street NW  
Washington, DC 20429

**Re: Special Assessments Pursuant to Systemic Risk Determination, RIN 3064-AF93**

Dear Mr. Sheesley:

The Puerto Rico Bankers Association<sup>1</sup> (the "Association") appreciates the opportunity to provide comments on the Federal Deposit Insurance Corporation's Notice of Proposed Rulemaking regarding special assessments pursuant to the recent systemic risk determination. The purpose of the proposal is to recover the losses to the Deposit Insurance Fund incurred as a result of actions taken by the FDIC to protect the uninsured depositors of Silicon Valley Bank and Signature Bank by means of a special assessment levied against insured depository institutions' ("IDIs") estimated uninsured deposits reported as of December 31, 2022, adjusted to exclude an IDI's first \$5 billion of uninsured deposits.

The Association appreciates the FDIC's efforts to protect uninsured depositors of Silicon Valley Bank and Signature Bank and support the U.S. financial system's stability following those banks' closures, and we recognize the FDIC's statutory mandate to recover the losses stemming from the systemic risk determination.<sup>2</sup> We also recognize the FDIC's effort to develop a "methodology [that] ensures that the banks that benefited most from the assistance provided under the systemic risk determination would be charged special assessments to recover losses to the DIF resulting from the protection of uninsured depositors".<sup>3</sup>

We are concerned, however, that the proposed assessment methodology includes an IDI's preferred deposits in calculation of the assessment base, which

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<sup>1</sup> The PRBA represents commercial banks doing business in Puerto Rico.

<sup>2</sup> 12 USC § 1823(c)(4)(G).

<sup>3</sup> *Special Assessments Pursuant to Systemic Risk Determination*, 88 Fed. Reg. 32694, 32688 (May 22, 2023).

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undermines the FDIC's stated goal of tying together the amount of the assessment borne by an IDI and benefit that the IDI derived from the systemic risk determination. Preferred deposits—that is, the uninsured deposits of, *inter alia*, U.S. states and political subdivisions and of the Commonwealth of Puerto Rico and its political subdivisions<sup>4</sup>—are fundamentally different from other uninsured deposits in that they must be collateralized by the depository bank in accordance with applicable law. Preferred deposits are a significantly more stable funding source for IDIs because, among other reasons, the collateralization requirement substantially mitigates any incentives from preferred depositors to withdraw deposits due to concerns about a bank's solvency. Importantly, "[i]n the event of the failure of the bank, the FDIC will honor the collateralization agreement [associated with preferred deposits] if the agreement is valid and enforceable under applicable law."<sup>5</sup> Furthermore, preferred deposits may not be used to fund a bank's loan growth to the same extent as other uninsured deposits because they must be collateralized by high-quality assets, mostly government and highly-rated agency securities.

For these reasons, we believe that including preferred deposits in the calculation of the assessment base for IDIs would be inconsistent with the stated rationale of allocating the burden of the special assessment to institutions that benefited most from the assistance provided under the systemic risk determination. Moreover, public sector entities could face unintended adverse consequences if preferred deposits are included in IDIs' assessment bases with respect to future assessments.

In order to avoid these outcomes, we recommend that the Proposal's special assessment methodology be revised so as to exclude an IDI's preferred deposits. Our letter therefore responds to Question 7 of the notice of proposed rulemaking ("*Should the FDIC consider an exemption for specific types of deposits from the base for special assessments? On what basis?*"). As explained in more detail below, we believe that excluding preferred deposits would bring the assessment methodology in line with the stated goals of the special assessment and would avoid unfairly penalizing IDIs that focus on providing banking services to public sector entities. Such an exclusion would also reflect the fact that preferred deposits, by their very nature, present a substantially lower risk profile than other uninsured deposits in terms of funding stability and resilience to short-term

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<sup>4</sup> See 12 U.S.C. §§ 1813(a)(3), 1813(m)(4).

<sup>5</sup> Federal Deposit Insurance Corporation, "Deposit Insurance for Accounts Held by Government Depositors", <https://www.fdic.gov/deposit/deposits/factsheet.html>, last accessed June 12, 2023.

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shocks, as evidenced by the stability that preferred deposits exhibited during the recent crisis. Moreover, the exclusion of preferred deposits could be readily implemented, since IDIs are already required to calculate and report preferred deposits on a single line item in their annual (YE) call reports. We respectfully submit that the exclusion would better reflect the FDIC's consideration of the statutorily mandated factors the FDIC must take into account in imposing a special assessment pursuant to a systemic risk determination.<sup>6</sup>

## **I. Background on Preferred Deposits**

### **A. Legal Requirements to Collateralized Preferred Deposits**

Preferred deposits are uninsured "deposits of any public unit... at any insured depository institution which are secured or collateralized as required under State law".<sup>7</sup> These deposits can generally be collateralized either through the pledge of securities or other readily marketable assets of a certain rating<sup>8</sup>, with certain jurisdictions limiting eligible securities to highly liquid government issued or sponsored securities. Because 12 U.S.C. § 1813's definition of "preferred deposits" requires compliance with the collateralization requirements under State law, we have summarized below the requirements in Puerto Rico, the jurisdiction in which our member institutions maintain the majority of their preferred deposits.<sup>9</sup>

Puerto Rico law requires that "[a]ll government entities' funds . . . be deposited in financial institutions that can answer with sufficient

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<sup>6</sup> 12 U.S.C. § 1823(c)(4)(G)(ii)(III) (stating the FDIC must consider, *inter alia*, the types of entities that benefited from any action taken or assistance provided under a determination of systemic risk, economic conditions, and the effects of an assessment on industry).

<sup>7</sup> 12 U.S.C. § 1813(m)(4). Pursuant to 12 U.S.C. § 1813(a)(3), when used in § 1813, "[t]he term 'State' means any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, the Virgin Islands, and the Northern Mariana Islands." Where "State" is capitalized in this comment letter, we intend it to have the same meaning.

<sup>8</sup> See FFIEC 031 and 041, RC-E10a, Section 1.e, "Preferred deposits", available at: <https://www.fdic.gov/resources/bankers/call-reports/crinst-031-041/2020/2020-09-rc-e.pdf>.

<sup>9</sup> While our comment letter focuses on the mechanisms related to preferred deposits at Puerto Rico law, it is the Association's understanding, based on our member institutions' experience with preferred deposits in other jurisdictions, including their current footprint in the Virgin Islands and certain mainland states, that Puerto Rico's laws regarding preferred deposits are representative of the laws in place in those other jurisdictions.

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collateral, consisting of previously-selected securities or instruments (including irrevocable letters of credit)".<sup>10</sup> Furthermore, prior to accepting such funds, an institution must be designated by the Secretary of the Treasury of the Commonwealth of Puerto Rico (the "Secretary") as a depository of public funds, which designation must take the form of a contract entered into between the Secretary and the financial institution.<sup>11</sup> In addition, the institution must execute a deposit and rendering of collateral contract with the Secretary.<sup>12</sup> Eligible financial institution must actually do business in Puerto Rico, which reduces the number of potential depositories for all public funds.<sup>13</sup>

With respect to the form of collateral, depositories in Puerto Rico may pledge certain short-term securities<sup>14</sup> or irrevocable letters of credit issued by U.S. or Puerto Rico-based entities rated AAA or AA or their equivalent by Moody's, Standard & Poor's, Fitch, or any other internationally recognized credit rating agency.<sup>15</sup> Puerto Rico law requires that an institution enter into an effective and valid pledge against third parties and in favor of the Secretary with respect to an amount of securities or irrevocable letters of credit with a market value sufficient to secure 100% of the public deposits held by the institution.<sup>16</sup> The law imposes an obligation on the Secretary to mark the value of the collateral to market from time to time, requiring that an institution supplement pledged collateral in the event the value of pledged securities falls below the value of public deposits at the institution.<sup>17</sup>

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<sup>10</sup> 7 LPR § 251a.

<sup>11</sup> 7 LPR § 251e.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> See 7 LPR § 252a and Regulation 5327 of November 7, 1995, which specifies the categories of authorized collateral.

<sup>15</sup> 7 LPR § 252a.

<sup>16</sup> 7 LPR §§ 252a, 252b.

<sup>17</sup> *Id.* In practice, our member institutions report that they mark collateral securities to market on a daily basis, providing a report to the Secretary and pledging additional collateral, if necessary, each week.

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B. Concentration of Preferred Deposits in Puerto Rico

Preferred deposits make up a small percentage of total uninsured deposits within the U.S. deposit insurance system. As of December 31, 2022, there was an estimated total of \$6.58 trillion in uninsured deposits held at all IDIs in the United States that would be subject to the special assessment. Of this total, we estimate that approximately \$390 billion were preferred deposits—*i.e.*, approximately 5.9% of total uninsured deposits across the IDIs that would be subject to the special assessment.<sup>18</sup>

The Association's member firms include the leading banks in Puerto Rico, which are relied upon by public sector entities in Puerto Rico to provide a wide array of banking services, including depository services. These banks have a much higher ratio of preferred deposits to uninsured deposits as compared with other IDIs and, as a result, would be disproportionately penalized by the inclusion of preferred deposits in the special assessment base. As of [December 31, 2022], preferred deposits account for approximately 58% of the total uninsured deposits of Popular, Inc. ("Popular") and approximately 33% of total uninsured deposits of First Bancorp ("FirstBank").<sup>19</sup> Popular and FirstBank are the two largest financial institutions on Puerto Rico and, collectively, have approximately 85% of the deposits maintained by Puerto Rico public sector entities.<sup>20</sup>

The concentration of high levels of preferred deposits among a small number of Puerto Rico IDIs traces back to several factors. As mentioned previously, Puerto Rico law requires that a financial institution "actually do business in Puerto Rico" before it may be designated a depository for preferred deposits.<sup>21</sup> Furthermore, in our member institutions' experience, public sector entities often choose

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<sup>18</sup> Figures are estimated based on data provided by S&P Capital IQ.

<sup>19</sup> Figures are inclusive of Popular's and FirstBank's respective IDI subsidiaries and are estimated based on data provided by S&P Capital IQ. Popular, Inc. has the sixth largest amount of preferred deposits across all institutions, despite being the 42<sup>nd</sup> largest in terms of deposits. FirstBank, which is the 100<sup>th</sup> largest institution in terms of deposits, is the 31<sup>st</sup> largest institution in terms of preferred deposits.

<sup>20</sup> This figure is estimated based on data contained within the Office of the Commissioner of Financial Institutions report on Commercial Banks' Deposits as of December 31, 2022 (available [here](#)) combined with data provided by S&P Capital IQ.

<sup>21</sup> 7 LPR § 251e.

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to work with depository institutions in the same locale when deciding where to hold their preferred deposits, which increases trust between depositor and depository and tends to make the banking relationship more resilient and enhance the stability of preferred deposits. In addition, public sector entities often require highly customized banking services that only a handful of IDIs in Puerto Rico are able to provide, which further concentrates preferred deposits among a limited group of IDIs. Notably, Puerto Rico IDIs experienced a surge in public sector deposits between 2017 and 2023. Specifically, the amount of public sector deposits increased from approximately \$6.9 billion at December 31, 2017 to \$20.3 billion at May 31, 2023 as a result of Puerto Rico public sector entities receiving significant inflows of funds associated with natural disaster aid, public finance renegotiations and the COVID-19 pandemic assistance payments.<sup>22</sup> These preferences on the part of public sector entities, together with the limited number of IDIs that operate in Puerto Rico and the relatively high level of liquid reserves held by Puerto Rico public sector entities, means that preferred deposits account for a significantly higher portion of uninsured deposits at our member firms than at IDIs more generally.

C. Stability of Preferred Deposits and Other Risk Mitigants Unique to Preferred Deposits

By their nature, preferred deposits are more stable than other uninsured deposits. Because they are fully collateralized and, given the FDIC's commitment to honor collateralization agreements entered into between public sector entities and depository institutions accepting the deposits, preferred deposit holders need not fear sustaining a loss even in the unlikely event that the depository were to fail. For this reason, public sector entity depositors lack the same incentive to withdraw preferred deposits even if a depository's outlook is uncertain.

Risk of deposit flight is further reduced by the fact that the governmental units with large amounts of preferred deposits often

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<sup>22</sup> Compare Government of Puerto Rico, Department of Treasury, Summary of Bank Account Balances for the Government of Puerto Rico and its Instrumentalities, December 31, 2017 with Government of Puerto Rico, Department of Treasury, Summary of Bank Account Balances for the Government of Puerto Rico and its Instrumentalities, May 31, 2023.

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require, and receive, highly customized banking services from their IDI. Rather than an “off the shelf” deposit agreement that would be used with a typical retail or commercial depositor, public sector entities often have customized and complex agreements that are negotiated with the IDI and tailored to the particular needs of the relevant governmental functions. Establishing a relationship between a public sector entity and a depository institution (as well as moving preferred deposits to a different institution) may require a “request for proposal” process and other customary, government-contracting procedures—including, at a minimum, entering into collateralization agreement with the IDI as required under local law. Notably, public sector entities require tailored cash management solutions, tied to their deposit accounts, as well as accounting and collection systems that often require careful and lengthy design and implementation processes. These solutions and systems are not easily replicated at other financial institutions. Moving these deposits, negotiating new agreements and recreating a customized banking relationship with a different IDI can be challenging and time-consuming from a logistical and procedural perspective, which further reduces depositors’ incentives to withdraw preferred deposits, which in turn enhances the stability of those deposits.

In our member institutions’ experience, barring significant infrastructure or similar projects, public sector entities tend to make and withdraw preferred deposits in a regular and predictable manner. Deposit patterns demonstrate a degree of seasonality due to the annual cycle of income and property tax collections, the payment of tax refunds to early filers and the receipt of tax payments made by those filing closer to the yearly deadline (rather than being driven by, for example, short-term “herding” effects that can lead to deposit runs and/or concerns regarding a bank’s solvency).<sup>23</sup> Similarly, expenditures and encumbrances occur at regular intervals based on programmatic and policy commitments.

Furthermore, even when preferred deposits are withdrawn, the liquidity impact of the withdrawal is offset by the fact that the IDI

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<sup>23</sup> Our member institutions report that their experiences with preferred deposit outflows in early 2023 were in line with expectations held prior to the events relating to the failures of Silicon Valley Bank and Signature Bank.

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now has unencumbered access to the assets that were formerly pledged as collateral for the deposits. As discussed, these assets are largely comprised of highly liquid securities that are marked to market on a daily basis. For these reasons, the withdrawal of preferred deposits does not stress our member institutions in the way that the outflow of ordinary uninsured deposits may affect other institutions.

Because preferred deposits must be 100% collateralized under Puerto Rico law, they cannot be used to fund loan growth in the same manner as other uninsured deposits. In order to accept a preferred deposit, the depository must pledge eligible collateral—namely, high-quality assets that are equal in value to the amount of the deposit. Furthermore, such pledged collateral must be assessed on a daily basis based on changes in collateral values and preferred deposit levels to ensure that these deposits are at all times fully collateralized. Unlike other uninsured deposits, funding obtained through preferred deposits is inherently constrained by the collateralization requirement and does not contribute to a bank's ability to leverage its funding in pursuit of higher-yielding and potentially riskier assets. This is another fundamental difference between preferred deposits and other uninsured deposits, and it highlights another reason why preferred deposits present a significantly different—and much lower—risk profile than uninsured deposits.

## **II. Preferred Deposits Should Not Be Included Within IDIs' Special Assessment Base**

### **A. Including preferred deposits within a covered IDI's assessment base would be inconsistent with the FDIC's rationale for imposing the assessment.**

The FDIC's proposal identifies two primary justifications for basing an IDI's special assessment amount on its amount of uninsured deposits. First, the proposal explains that banks with large amounts of uninsured deposits reported that depositors had begun to withdraw their funds shortly after Silicon Valley Bank was closed. The announcement of the systemic risk determination, with the result



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that uninsured depositors at Silicon Valley Bank and Signature Bank would be made whole, stemmed the tide of these outflows, and the FDIC concluded that banks with larger amounts of uninsured deposits benefitted the most from the stability provided by the systemic risk determination.<sup>24</sup> Second, the proposal states that certain banking organizations fund a larger share of their assets with uninsured deposits<sup>25</sup>, which exposes them to more significant consequences in the event that they experience large outflows of uninsured deposit.

For these reasons, the notice concludes that, by determining an IDI's assessment base based on its uninsured deposits, the banks that benefitted the most from the assistance provided by the systemic risk determination would be responsible for funding the special assessment.

Although we take no position on whether this reasoning supports a decision to base an IDI's assessment base on its uninsured deposits in general, we believe that this reasoning clearly does not support a decision to include preferred deposits in an IDI's assessment base. Thanks to the unique features of preferred deposits that make them more stable than other uninsured deposits during times of stress and more resilient in the face of concerns about bank solvency, as discussed above, we believe that the determination of systemic risk provided less benefit to IDIs with comparatively higher ratios of preferred deposits to ordinary uninsured deposits, as compared with the benefit derived by IDIs with smaller ratios of preferred deposits to ordinary uninsured deposits.

For these reasons, our member institutions and similarly situated IDIs did not in fact benefit from the March 12, 2023 systemic risk determination in the same manner or to the same degree as IDIs with smaller preferred deposit to uninsured deposit ratios. Including preferred deposits in their assessment base would therefore be inconsistent with the FDIC's articulated reasoning for structuring the assessment as proposed.

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<sup>24</sup> See, e.g., *Special Assessments Pursuant to Systemic Risk Determination*, 88 Fed. Reg. 32694, 32698 (May 22, 2023).

<sup>25</sup> *Id.* at 32697.

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**B. Including preferred deposits within IDIs' assessment base going forward could have unintended consequences for State and local entities.**

In addition to imposing an unfair penalty on IDIs whose deposit base consists of a comparatively higher level of preferred deposits, we are concerned about the unintended and adverse effects on public sector entities that could result from including preferred deposits in IDIs' assessment bases going forward. Charging IDIs a special assessment based on their preferred deposits increases the costs of deposits from banking State and local governments and other public sector entities. Doing so could therefore disincentivize IDIs from accepting such deposits and/or lead to reductions in the interest rates offered on preferred deposits, which would reduce income to State and local governments. In addition, this would increase the costs borne by State and local governments, which rely on earning credits generated by deposits to pay for banking services, and could harm the fiscal well-being of State and local governments and undermine their ability to pursue public policy goals. Finally, increasing the cost that IDIs must bear in order to accept preferred deposits could reduce IDIs' demand for State and municipal securities, which are a common form of collateral for preferred deposits. This could, in turn, create additional funding difficulties for State and local governments.

**C. The FDIC can recover its losses and more equitably allocate costs due to the recent systemic risk determination by excluding preferred deposits from IDIs' assessment base.**

As noted above, including preferred deposits in an IDI's assessment base would not be consistent with the FDIC's rationale for structuring the assessment as proposed. It would, however have a significant and disproportionate cost to our member institutions and, in effect, penalize them for their provision of banking services to Puerto Rico public sector entities and their willingness to serve as the Puerto Rico government's banker during its response to natural disasters, bankruptcy actions and the COVID-19 pandemic.

We recognize that the FDIC may be concerned that any deviation from the proposed assessment methodology based on gross insured

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deposits could “open the door” to other deviations. We submit, however, that our proposed revision represents a discrete and very limited deviation that is based on the Federal Deposit Insurance Act, avoids undue and unfair harm to a concentrated group of IDIs that serve States and municipalities and is consistent with the FDIC's stated objectives. In addition, the revision to the assessment base is objective, and the relevant data is readily available and simple to calculate based on the subtraction of the separate preferred deposit line item from the overall uninsured deposit line item on an IDI's December 31, 2022 call report.

In order to align better the proposed special assessment methodology with the stated goals of the assessment, we respectfully submit that the proposed special assessment methodology should be modified such that preferred deposits are disregarded in determining an IDI's special assessment base.

### **Conclusion**

We appreciate your consideration of our recommendation regarding the proposed special assessment. We would be happy to provide any additional information or to discuss any of our comments with the FDIC in more detail.

Sincerely,

A large black rectangular redaction box covering the signature area.

Zoimé Álvarez Rubio, Esq.  
Executive Vice President