July 21, 2023

James P. Sheesley
Assistant Executive Secretary
Attention: Comments-RIN 3064–AF93
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Special Assessments Pursuant to Systemic Risk Determination, RIN 3064–AF93, 88 Fed. Reg. 32694 (May 22, 2023)

Dear Mr. Sheesley:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposal") issued by the Federal Deposit Insurance Corporation ("FDIC").[2]

The Proposal, if adopted, would establish a special assessment to recover the losses to the FDIC Deposit Insurance Fund ("DIF") resulting from the protection of uninsured depositors at two failed banks – Silicon Valley Bank ("SVB")[3] and Signature Bank ("Signature")[4] – as required by the Federal Deposit Insurance Act ("FDI Act").[5] Because the failure of these two institutions was determined by financial regulators to threaten financial stability, the Secretary of the U.S. Department of Treasury, in consultation with the President, made a systemic risk determination with concurrence from the FDIC Board of Directors and the Federal Reserve System ("Fed") Board of Governors.[6]

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies – including many in finance – to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[2] Special Assessments Pursuant to Systemic Risk Determination, RIN 3064–AF93, 88 Fed. Reg. 32694 (May 22, 2023).

[3] *See* Press Release, FDIC, *FDIC Creates a Deposit Insurance National Bank of Santa Clara to Protect Insured Depositors of Silicon Valley Bank, Santa Clara, California* (Mar. 10, 2023), https://www.fdic.gov/news/press-releases/2023/pr23016.html.

[4] *See* Press Release, FDIC, *FDIC Establishes Signature Bridge Bank, N.A., as Successor to Signature Bank, New York, NY* (Mar. 12, 2023), https://www.fdic.gov/news/press-releases/2023/pr23018.html.

[5] *See* Federal Deposit Insurance Act, https://www.fdic.gov/regulations/laws/rules/1000-100.html (last updated Feb. 9, 2023).

[6] *See* Press Release, U.S. Department of the Treasury, *Joint Statement by the Department of Treasury, Federal Reserve, and FDIC* (Mar. 12, 2023), https://home.treasury.gov/news/press-releases/jy1337.

The FDI Act provides the FDIC with discretion to respond to a systemic risk determination by designing a special assessment to recover losses to the DIF, to be imposed on a specific subset of banks, rather than recover losses to the DIF through the normal process that could increase assessments for the entire banking industry. A special assessment considers the types of entities that benefit from the government's actions and assistance as well as economic conditions, the effects on the industry, and other factors that the FDIC deems appropriate and relevant.[7]

To be clear, the Proposal **is not** addressing the question of whether uninsured depositors at these two institutions should have been protected or whether a systemic risk determination was justified. All depositors at the two failed banks, with both insured and uninsured funds, were fully protected at an estimated loss of $18.5 billion to the DIF. *This Proposal is focused on determining* ***how*** *these losses should be recovered to restore the DIF balance*.

We recommend approval of the Proposal with the following key changes:

- Calculation of the size and repayment period of the special assessment: We recommend that the entire cost of the failures be repaid with the special assessment and that the repayment occur much quicker than the Proposal states, specifically over the course of one year (four quarters).
- Determination of banks that are subject to the special assessment: We recommend simplifying the Proposal by eliminating the safe harbor framework that excludes banking associations' first $5 billion in uninsured deposits from the special assessment. Instead, the FDIC should determine an asset size threshold to appropriately allocate payment of the special assessment to large banks,[8] which benefited significantly from the government actions in March 2023.

BACKGROUND

In March 2023, the U.S. banking system experienced a dangerous crisis and lack of confidence, resulting primarily from the failure of the management and Boards of Directors of SVB and Signature. While many of those failures were identified, they were not adequately mitigated or eliminated due to grossly deficient regulation and supervision of those large banks. Leading up to the failures, SVB and Signature were not held accountable for poor management decisions, weak risk management practices, and the usual outcome of such a toxic combination – excessive risk-taking. As a result of SVB's and Signature's failures, the DIF experienced losses which must now by law be replenished to maintain full coverage for bank depositors who are protected by FDIC insurance.

On March 10, 2023, SVB failed.[9] At the time, SVB was the largest bank failure since the 2008 Crash and the second largest failure in U.S. history. SVB's condition deteriorated so quickly

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7 12 U.S.C. § 1823(c)(4)(G)(ii)(III).

8 "Large banks" in this letter are institutions with more than $100 billion in total assets.

9 *See* Press Release, FDIC, *FDIC Creates a Deposit Insurance National Bank of Santa Clara to Protect Insured Depositors of Silicon Valley Bank, Santa Clara, California* (Mar. 10, 2023), https://www.fdic.gov/news/press-releases/2023/pr23016.html.

that it couldn't even last until the end of the business day on a Friday so the FDIC could carry out an orderly resolution over the weekend. That was because SVB's depositors were withdrawing money so quickly that the bank became insolvent as it sold large amounts of assets that had declined in value to provide the liquidity needed to fund withdrawals. An intraday closure of SVB was unavoidable due to the severity of the bank run and the losses taken on the "fire sale" of assets.[10]

SVB did not have a traditional business plan; instead, it concentrated on serving high net worth clients and their businesses in the tech-centric, venture capital-funded Silicon Valley. Total assets at the bank grew very rapidly, more than tripling from about $60 billion at the end of 2019 to over $200 billion by the end of 2022.[11] SVB invested the influx of cash in longer-term maturity securities, in an attempt to increase profits during a period of low interest rates.[12] As the Fed raised interest rates, SVB experienced a deadly combination of deposit outflows and an increase in unrealized losses on its (now much larger) securities portfolio (which occurred after SVB sold its hedges). In early March 2023, reportedly after at least one rating agency notified the bank it was facing a downgrade, SVB's management was ostensibly attempting to implement a complex, multipart plan to restructure its balance sheet, including selling securities, recognizing losses, increasing borrowings, and raising capital. However, the plan was dramatically unsuccessful. Simply put, management's attempts to remedy the bank's problems were far too little and far too late.

On March 12, 2023, Signature failed.[13] Like SVB, Signature had grown rapidly, increasing from $43 billion in total assets at year-end 2017 to $110 billion at year-end 2022.[14] Signature's management also made numerous poor if not reckless decisions, including a heavy reliance on uninsured deposits for funding and a business model that was concentrated in the volatile digital asset industry.[15] Signature reported substantial deposit outflows on March 9 and 10. On March 10 alone, Signature lost 20 percent of its total deposits in a matter of hours, significantly depleting its cash, and endangering its liquidity position.[16] Ultimately, regulators determined that Signature was no longer viable and closed it on Sunday, March 12, just days after SVB failed.[17]

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[10] *See* Press Release, Better Markets, *Growing Banking Crisis Caused By Contagion From Silicon Valley Bank Failure Going To Get Worse, Inevitable Due To Federal Reserve Policies* (Mar. 10, 2023), https://bettermarkets.org/newsroom/growing-banking-crisis-caused-by-contagion-from-silicon-valley-bank-failure-going-to-get-worse-inevitable-due-to-federal-reserve-policies/.

[11] *See* FDIC, *Remarks by Chairman Martin J. Gruenberg on Recent Bank Failures and the Federal Regulatory Response before the Committee on Banking, Housing, and Urban Affairs, United States Senate* (Mar. 27, 2023), https://www.fdic.gov/news/speeches/2023/spmar2723.html.

[12] *See* FEDERAL RESERVE BOARD OF GOVERNORS, REVIEW OF THE FEDERAL RESERVE'S SUPERVISION AND REGULATION OF SILICON VALLEY BANK (Apr. 28, 2023), https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf.

[13] *See* Press Release, FDIC, *FDIC Establishes Signature Bridge Bank, N.A., as Successor to Signature Bank, New York, NY* (Mar. 12, 2023), https://www.fdic.gov/news/press-releases/2023/pr23018.html.

[14] *See* FDIC, *Remarks by Chairman Martin J. Gruenberg on Recent Bank Failures and the Federal Regulatory Response before the Committee on Banking, Housing, and Urban Affairs, United States Senate* (Mar. 27, 2023), https://www.fdic.gov/news/speeches/2023/spmar2723.html.

[15] *Id*.

[16] *Id*.

[17] *Id*.

In response to the failures of two large banks in rapid succession and evidence of a burgeoning banking crisis, growing depositor panic, and a potential credit crunch, the Secretary of the Treasury, in consultation with the President, and the Boards of the FDIC and Federal Reserve made a systemic risk determination for both SVB and Signature.[18] This action meant that uninsured depositors at both failed banks could be protected along with insured depositors. The purpose of the systemic risk determination was to instill confidence in the flagging banking sector, but a dangerous side effect was the implication that too-big-to-fail was alive and well, thanks to the wave of deregulatory actions that occurred during the Trump administration.[19]

The primary purpose of FDIC deposit insurance is to protect bank depositors. The standard deposit insurance coverage limit is currently $250,000 per depositor, per FDIC-insured bank, per ownership category.[20] At most banks, especially most community banks that conduct traditional banking services in support of their local cities and towns, most deposit accounts are insured. In fact, as of December 2022, more than 99 percent of deposit accounts were below the $250,000 deposit insurance limit.[21] As stated in the FDIC's May 2023 Deposit Insurance Study mandated by Congress, "Uninsured deposits are held in a small share of accounts but can be a large proportion of banks' funding, particularly among the largest 10 percent and largest 1 percent of banks by asset size. Large concentrations of uninsured deposits, or other short-term demandable liabilities, increase the potential for bank runs and can threaten financial stability."[22]

SVB and Signature were extreme outliers with their holdings of uninsured deposits. At failure, 88 percent of SVB's deposits were uninsured and 67 percent of Signature's deposits were uninsured. FDIC documents show that some of SVB's largest (likely uninsured) depositors included Sequoia, a large firm that backs tech giants such as Apple, Google, and WhatsApp; Kanzhun, a company backed by Chinese tech giants; Altos Labs, a life sciences company supported by tech billionaires such as Jeff Bezos; Circle Internet Financial Ltd., a crypto company; and Roku, an internet entertainment company.[23] In short, the decision to support uninsured deposits shielded many large corporations (and their owners) that irresponsibly if not culpably held

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18 *See* Press Release, U.S. Department of the Treasury, *Joint Statement by the Department of Treasury, Federal Reserve, and FDIC* (Mar. 12, 2023), https://home.treasury.gov/news/press-releases/jy1337.

19 *See* BETTER MARKETS, BANKING FACT SHEET: POWELL-LED FEDERAL RESERVE DEREGULATION CAUSED THE FAILURE OF SILICON VALLEY BANK AND THE 2023 BANKING CRISIS (Mar. 27, 2023), https://bettermarkets.org/wp-content/uploads/2023/03/BetterMarkets_FactSheet_Powell-Led_Fed_Eregulation_Caused_SVB_Failure_March-2023.pdf.

20 FDIC deposit insurance protects bank customers in the event that an FDIC-insured depository institution fails. Deposits are insured up to $250,000 per depositor, per FDIC-insured bank, per ownership category. Some examples of FDIC ownership categories, include single accounts, certain retirement accounts, employee benefit plan accounts, joint accounts, trust accounts, business accounts as well as government accounts. FDIC, *Deposit Insurance FAQs*, https://www.fdic.gov/resources/deposit-insurance/faq/index.html (last updated Mar. 20, 2023).

21 *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM § 1 (May 1, 2023), https://www.fdic.gov/analysis/options-deposit-insurance-reforms/report/options-deposit-insurance-reform-full.pdf.

22 *Id*.

23 Lizette Chapman, Jason Leopold, & Bloomberg, *The FDIC Has Accidentally Released a List of Companies It Bailed Out For Billions In The Silicon Valley Bank Collapse,* FORTUNE (Jun. 23, 2023), https://fortune.com/2023/06/23/fdic-accidentally-released-list-of-companies-it-bailed-out-silicon-valley-bank-collapse/.

those deposits at the failed banks from losses that they should have known were possible if not likely. Rather than suffering losses as a direct consequence of those decisions, those large corporations de facto transferred their losses to the DIF, other healthy banks, and of course, taxpayers. The combined loss resulting from the failures of SVB and Signature is estimated by the FDIC to be $18.5 billion, with $16.1 billion attributed to SVB and $2.4 billion attributed to Signature.

The FDI Act specifies that the loss to the DIF resulting from the use of a systemic risk determination must be recovered by a special assessment,[24] not the typical assessment process that shares the burden of loss among all FDIC-insured institutions. The Act directs the FDIC to consider a range of factors[25] when designing the special assessment, including:

- the types of entities that benefited from the action taken or assistance provided by the systemic risk determination:
- economic conditions:
- the effects on the industry: and
- other factors the FDIC deems appropriate and relevant.

SUMMARY OF THE PROPOSAL

The Proposal outlines the FDIC's plan for implementing the special assessment:

(1) **Amount of the special assessment** will be calculated by multiplying the total loss of each failure by the failed bank's share of uninsured deposits at failure. To illustrate:

- SVB: ($16.1 billion total loss) x (88 percent uninsured deposits to total deposits at failure) = **$14.2 billion**

- Signature: ($2.4 billion total loss) x (67 percent uninsured deposits to total deposits at failure) = **$1.6 billion**

- Total amount of the special assessment: $14.2 billion + $1.6 billion = **$15.8 billion**

- The remaining amount of the loss ($18.5 billion - $15.8 billion = **$2.7 billion**) would be borne by the DIF, in other words by the banking industry as a whole.

(2) **Assessment base** (the measure by which a banking organization's individual share of the total special assessment will be calculated) is the amount of estimated uninsured deposits as of December 31, 2022, adjusted to exclude the first $5 billion in estimated uninsured deposits. For institutions that are part of a holding company or with one or more subsidiaries, this calculation is done at the banking organization level. Using this

[24] 12 U.S.C. § 1823(c)(4)(G)(ii)(I).
[25] 12 U.S.C. § 1823(c)(4)(G)(ii)(III).

framework, 113 banking organizations will be subject to the special assessment, with an appropriate skew toward large institutions:

- **48 banking organizations** with **more than $50 billion in total assets** each will together pay **95.2 percent of the total** assessment
- **65 banking organizations** with **between $5 billion and $50 billion in total assets** each will together pay **4.8 percent of the total** assessment
- **No banking organizations with less than $5 billion in total assets will pay** any portion of the special assessment

(3) **Collection time period** will be 8 quarters, beginning the first quarter of 2024 (January 1 through March 31, 2024, with an invoice date of June 28, 2024).

(4) **Assessment rate** will be approximately 12.5 basis points, which when fully collected will yield $15.8 billion.

(5) **Adjustments for shortfall or overpayment** are permitted. The FDIC may:

- Cease collection early if it is determined that actual losses from the SVB and Signature failures are less than the current estimate,
- Extend the collection period one or more quarters beyond the initial eight-quarter collection period if the actual loss amount is more than the current loss estimate, and
- Impose a final shortfall special assessment on a one-time basis after the receiverships for SVB and Signature terminate.

SUMMARY OF COMMENTS

The FDIC's Proposal for a special assessment is crucial to recover the losses that resulted from the failures of SVB and Signature. Importantly, the DIF is already under a Restoration Plan, which was put in place in September 2020 because the size of the DIF fell below the statutory minimum required to protect the banking system and the American people during the COVID-19 pandemic.[26] Therefore, it is imperative to fully replenish the DIF as quickly as possible.

The Proposal contains valuable components that we support:

- Using estimated uninsured deposits as the assessment base is appropriate because the failures of SVB and Signature were driven by elevated uninsured deposits levels, which are known to be risky and volatile. This assessment base will allocate the losses among banking organizations proportionate to their share of the overall amount of uninsured

[26] *See* FDIC, *Financial Institution Letter: Restoration Plan for the FDIC Deposit Insurance Fund* (Sept. 15, 2020), https://www.fdic.gov/news/financial-institution-letters/2020/fil20090.html.

deposits. We do, however, propose a change to eliminate the $5 billion uninsured deposits safe harbor in tandem with a change to the methodology used to identify banks that are subject to the special assessment, as described further below.

- <u>The assessment base date of December 31, 2022, is appropriate</u> because it is the last reported amount of estimated uninsured deposits before the SVB and Signature failures. Using a later date would allow banks to adjust their deposit structure and therefore change (and potentially reduce) the amount of the special assessment that they would pay.

We also recommend several important changes to the Proposal, including:

- <u>The overall size of the special assessment should be $18.5 billion, not $15.8 billion.</u> The FDI Act states that the special assessment should be structured with "rates sufficient to cover the losses incurred." The statute itself thus provides for full, not partial, recovery of losses through the special assessment. The FDI Act also provides that the special assessment should be set by considering the types of entities that benefitted from government actions (the systemic risk determination, in this case), economic conditions, effects on the industry, and other relevant factors. As a direct result of the government actions and systemic risk determination, large banks benefitted while smaller banks did not. Data from the FDIC Quarterly Banking Profile[27] shows that the banking industry as a whole gained $255 billion in insured deposits in the first quarter of 2023. However, nearly half of all community banks **lost** deposits during the quarter. Community banks also increased wholesale funds (brokered deposits, reciprocal deposits, and other borrowings) in the first quarter of 2023. Large banks clearly benefitted during the quarter, gaining new deposits from community banks that were believed to be less safe. To make up for the insured deposit outflow, community banks took on additional wholesale funds, which are typically more expensive than traditional deposits. Community banks may also have to reduce lending as a result of reduced deposit inflows. In summary, large banks should be required to replenish the entire amount of the loss, and smaller banks should not be responsible for any amount of the loss.

- <u>Whether or not a bank is subject to the special assessment should be based on asset size, not the proposed calculation of an uninsured deposit safe harbor</u>. The proposed safe harbor calculation is unnecessarily complex, and it is unclear why $5 billion is the appropriate level for the safe harbor. It appears that the safe harbor was implemented to place the burden for the special assessment on large banks, which is appropriate because large banks benefitted from the systemic risk determination. Better Markets recommends this is done explicitly, by basing inclusion in the group required to repay DIF losses on bank asset size.

- <u>The collection period should be reduced to one year (4 quarters)</u>. Large banks ***can*** and ***should*** repay the DIF for the special assessment as quickly as possible. A collection period of 4 quarters is reasonable and appropriate for several reasons. The banking industry is

[27] *See* FDIC, *Quarterly Banking Profile*, 17 FDIC QUARTERLY (2) (First Quarter 2023), https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2023mar/qbp.pdf#page=1.

reporting near-record profits. There is no evidence of a liquidity problem or credit crunch, and the largest banks continue to fund enormous dividends and stock buybacks. Furthermore, 11 of the nation's largest banks conditionally deposited a combined $30 billion (far more than the proposed amount of the special assessment) on March 16, 2023, to try to save the already failing First Republic Bank.[28] These same institutions should be even more willing and able to replenish the DIF, which supports the entire banking industry. Furthermore, the fact that the DIF is already in a Restoration Plan and the fact that the longer the DIF is without the lost funds, the less interest income it earns, unquestionably supports the faster repayment period.

- The shortfall special assessment should be calculated at the end of the one-year payment period, not the two-year payment period in the Proposal. While it is true that more information may be known about the exact actual cost of the SVB and Signature failures after a two-year period compared to a one-year period, it is not sensible to postpone a final adjustment if the entire special assessment is repaid in one year.

Beyond these comments, we recommend that the FDIC promptly consider a separate rulemaking to adjust deposit insurance pricing to recognize and manage the risk inherent in uninsured deposits. The recent bank failures have clearly shown the risk that results from reliance on uninsured deposits. Furthermore, academic studies have clearly demonstrated the risk and volatility associated with this type of funding.

COMMENTS

I. USING ESTIMATED UNINSURED DEPOSITS AS THE ASSESSMENT BASE IS APPROPRIATE.

The failures of SVB and Signature resulted from recklessly high levels of uninsured deposits. Therefore, it is sensible and fair to scale the relative contributions for banks subject to the special assessment to replenish the DIF to uninsured deposit reliance.

As shown in Table 2 of the Proposal (included below), reliance on uninsured deposits generally increases with bank size. However, even after accounting for bank size, SVB (with 88 percent of deposits being uninsured at the time of failure) and Signature (with 67 percent of deposits being uninsured at failure) were clear outliers.

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[28] *See* Press Release, First Republic Bank, *Reinforcing Confidence in First Republic Bank* (Mar. 16, 2023), https://news.firstrepublic.com/news-releases/news-release-details/reinforcing-confidence-first-republic-bank.

Uninsured Deposits as a Percentage of Total Domestic Deposits, by Banking Organization Asset Size	
Asset Size of banking organization	**Ratio of uninsured deposits to total domestic deposits (percent)**
$1 to $5 Billion	33.2
$5 to $10 Billion	35.0
$10 to $50 Billion	39.9
$50 to $250 Billion	44.2
Greater than $250 Billion	51.8

On a related note, we disagree with the safe harbor amount (as discussed in more detail in Comment IV) because it is not substantiated and introduces unnecessary complexity into the special assessment calculations. Instead, we propose using bank asset size to determine which institutions are subject to the special assessment and then using uninsured deposits as the assessment base. This will achieve the goal of having institutions contribute to the special assessment in an amount that is proportionate to their overall share of risk stemming from uninsured deposit reliance, and also simplify and streamline the program and calculations.

II. THE ASSESSMENT BASE DATE OF DECEMBER 31, 2022, IS APPROPRIATE BECAUSE IT IS THE LAST REPORTED AMOUNT OF ESTIMATED UNINSURED DEPOSITS BEFORE THE SVB AND SIGNATURE FAILURES.

Banks report financial information each quarter through Reports of Condition and Income ("Call Reports"). The last reported amounts of estimated uninsured deposits prior to the SVB and Signature failures are contained in the Call Report data as of December 31, 2022. Using any other later date would allow banks to adjust their funding structure and therefore adjust (and potentially reduce) the amount of the special assessment that they would pay. Since the special assessment is intended to be based upon the amount of benefit that banks received from the government support in March 2023, the measure of banks' reliance on uninsured deposits should be prior to that period of banking stress.

III. THE OVERALL SIZE OF THE SPECIAL ASSESSMENT SHOULD BE THE ENTIRE AMOUNT OF THE LOSS RESULTING FROM THE SVB AND SIGNATURE FAILURES, $18.5 BILLION, NOT $15.8 BILLION.

The FDI Act provides the basis for the terms of a special assessment, specifically:

> In prescribing such regulations, defining terms, and setting the appropriate assessment rate or rates, ***the Corporation shall establish rates sufficient to cover the losses incurred*** as a result of the actions of the Corporation under clause (i) [Emergency Determination by Secretary of the Treasury] and shall consider: the types of entities that benefit from any action taken or

> assistance provided under this subparagraph; economic conditions, the effects on the industry, and such other factors as the Corporation deems appropriate and relevant to the action taken or the assistance provided.

The FDIC's Quarterly Banking Profile,[29] which contains aggregate data about the banking industry and community banks, and the Federal Reserve's "H.8" release,[30] which contains weekly statistics on deposit flows within the banking system, provide clear information to support the fact that large banks benefitted from the government's actions while smaller banks did not. The FDI Act states that the institutions that benefitted from the government's action are those that should pay for the special assessment.

Data from the FDIC Quarterly Banking Profile show that in the first quarter of 2023, the banking industry as a whole **gained $255 billion in insured deposits** and **lost $663 billion in uninsured deposits**. At the same time, nearly half of the country's 4,230 community banks reported **deposit outflows**. Community banks also reported increases in wholesale funds (brokered deposits, reciprocal deposits, and other borrowings). In aggregate, community banks reported the share of wholesale funds to total assets at 21.1 percent in the first quarter of 2023, up from 19.2 percent in the fourth quarter of 2022 and up from the pre-pandemic (first quarter 2015 through the fourth quarter of 2019) average of 17.5 percent. These data illustrate two key points: deposits were flowing from community banks to larger banks in the first quarter of 2023 and community banks had to turn to alternative (typically more expensive) sources of funding to maintain operations.

The H.8 data support the aggregate trends reported in the Quarterly Banking Profile. In the initial weeks following SVB and Signature's failures, H.8 data show that deposits flowed out of smaller banks and into large banks. Uninsured depositors were reportedly spreading deposits among institutions to gain multiples of the $250,000 insurance coverage that is available from a single institution. In addition, and perhaps more damaging, the data supports the assertion that depositors believed that the largest banks were immune from failure and uninsured deposits would be protected.

At its core, the business of banking consists of banks taking in deposits and making loans. The deposit flows during March 2023 benefitted the institutions that gained deposits (large banks) and harmed the institutions that lost deposits (smaller banks). Large banks that gained new deposits will not have to incur additional interest expense to acquire funding. These banks will be able to make new loans and earn additional profit from the new deposits gained during March. Smaller banks that lost deposits have lost a source of (low-cost) funding and a source of potential profit. Smaller banks may have to consider a combination of remedies, including raising interest rates to attract new deposits (increasing interest expense), obtaining funding from other (typically more costly) sources such as deposit brokers or the Federal Home Loan Banks, or reducing lending (which in turn reduces profits and harms local communities and economic growth).

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[29] *See* FDIC, *Quarterly Banking Profile*, 17 FDIC QUARTERLY (2) (First Quarter 2023), https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2023mar/qbp.pdf#page=1.

[30] *See* Federal Reserve, *Assets and Liabilities of Commercial Banks in the United States - H.8*, https://www.federalreserve.gov/releases/h8/.

The current Proposal says that the amount of the special assessment will be calculated by multiplying the total loss of each failure by each failed bank's share of uninsured deposits to the total deposits at the time of failure. More specifically, 88 percent of SVB's total loss of $16.1 billion plus 67 percent of Signature's total loss of $2.4 billion equals the total special assessment of $15.8 billion. While this methodology allocates the majority of the loss to the largest banks, it also places the burden of $2.7 billion of loss on the DIF as a whole. The entire banking industry, including small institutions and community banks that did not benefit from the government's actions in March, will be responsible for replenishing the $2.7 billion in loss. **Placing any amount of this loss on small institutions and community banks is not only unfair but also inconsistent with the FDI Act, which expressly provides that assessment rates shall "be sufficient to cover the losses incurred."** The amount of the special assessment, therefore, must be the total loss amount of $18.5 billion, which should be paid in full by large banks.

An additional and final reason that the biggest banks should pay for the entire cost of the SVB and Signature special assessment is because community banks were put on the hook to subsidize JPMorgan Chase's acquisition of First Republic Bank. That deal was structured to avoid yet another systemic risk determination and special assessment. Regardless of why it was structured that way, the fact is that the entire banking system is going to pay for the $13 billion cost of First Republic's failure.[31] Put differently, 99% of banks are going to pay for a failure that wasn't their fault and resulted from reckless, if not worse, management of First Republic Bank. The FDIC shouldn't add insult to injury by making small banks pay for any part of the failures of SVB and Signature on top of the costs they are going to be forced to pay to subsidize JPMorgan Chase's acquisition of First Republic Bank.

IV. <u>ASSET SIZE SHOULD DETERMINE WHICH BANKS ARE SUBJECT TO THE SPECIAL ASSESSMENT, NOT A COMPLEX AND UNFOUNDED CALCULATION OF AN UNINSURED DEPOSIT SAFE HARBOR.</u>

There are two key problems with the proposed uninsured deposit safe harbor. First, the safe harbor calculation is unnecessarily complex. Second, it is unclear why $5 billion is the appropriate level for the safe harbor.

It appears that the safe harbor was implemented to place the burden for the special assessment on large banks. We support this goal and think it can be done more directly and transparently by simply setting an asset size threshold instead. The Proposal rejects this option because it would create a "cliff effect." In other words, banks that are only slightly larger than the determined asset size threshold would bear the burden of a special assessment payment while banks that are just below the determined asset size threshold are excluded from payment and avoid an expense. However, we think that the mere existence of a defined safe harbor creates a cliff effect. Using an existing subset of banks, large banks with total assets of more than $100 billion in this case, results in a simplified and transparent system for which the benefits outweigh the risk.

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[31] *See* FDIC, Press Release, *JPMorgan Chase Bank, National Association, Columbus, Ohio Assumes All the Deposits of First Republic Bank, San Francisco, California* (May 1, 2023), https://www.fdic.gov/news/press-releases/2023/pr23034.html.

Furthermore, the so-called burden of the special assessment ***should*** fall on the largest banks, even the "smallest" large bank.

V. THE COLLECTION PERIOD SHOULD BE REDUCED TO ONE YEAR (4 QUARTERS).

Large banks can and should repay the DIF for the special assessment as quickly as possible. A collection period of 4 quarters is both reasonable and appropriate.

There are several reasons that large banks ***can*** fully repay the special assessment in four quarterly payments without any adverse impact on their operations:

- First, the banking industry is reporting record profits. Net income for the banking industry was nearly **$80 billion** in the first quarter of 2023.[32] In the May 2023 Quarterly Banking Profile press release, FDIC Chairman Gruenberg stated, "The banking industry has proven to be quite resilient during this period of stress."[33] Early earnings reports for the second quarter of 2023 clearly indicate that the largest banks continue to thrive, in part directly because of government assistance. JPMorgan Chase, for instance, just reported $41.3 billion in revenue and $14.4 billion in net income in just three months, a 67% increase from a year ago and beating expectations of $11.9 billion. JP Morgan Chase greatly benefited from the deposit inflows, as evidenced by its net income increase which "was driven by higher net interest margin."[34] The bank also reported a gain of $2.7 billion from the takeover of failed First Republic Bank.[35]

- Second, there is no evidence of a liquidity or credit crunch. In the May 2023 Quarterly Banking Profile, Chairman Gruenberg referenced the ratio of liquid assets to total deposits.[36] While this ratio has declined recently, it is similar to the pre-pandemic level and suggests that banks still have ample cash and other sources of liquidity. Chairman Gruenberg also stated that "Loan growth has been robust during the last year, driven by pent-up demand from both consumers and businesses as well as higher inflation."[37]

- Third, banks remain able to fund enormous dividends. U.S. banks paid more than **$152 billion** in cash dividends in 2022, and another **$44.3 billion** in the first quarter of 2023

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[32] *See* FDIC, Press Release, *FDIC-Insured Institutions Reported Net Income of $79.8 Billion in First Quarter 2023* (May 31, 2023), https://www.fdic.gov/news/press-releases/2023/pr23043.html.

[33] *Id*.

[34] Joshua Franklin, *JPMorgan Reaps Profit Boost from Higher Interest Rates*, FINANCIAL TIMES (July 14, 2023), https://www.ft.com/content/a0597653-d129-4287-ae42-442767eecb6e.

[35] *See* JPMorgan Chase & Co., *Second Quarter 2023 Earnings Results* (2023), https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/investor-relations/documents/quarterly-earnings/2023/2nd-quarter/fc5019d6-4433-4a61-a340-a9cb89c4c7e1.pdf.

[36] *See* FDIC, *Remarks by FDIC Chairman Martin Gruenberg on the First Quarter 2023 Quarterly Banking Profile*, Chart 7 (May 31, 2023), https://www.fdic.gov/news/speeches/2023/spmay3123.html.

[37] *See id*. at Chart 8.

according to the FDIC's Quarterly Banking Profile.[38] These totals suggest that the largest banks could certainly fund the special assessment over the course of one year.

- Fourth, the largest banks remain able to fund stock buybacks. After dropping sharply in 2020 because of uncertainty about the economy and effects of the pandemic, stock buybacks have, for the largest banks, resumed in 2021. Between the first quarter of 2021 and third quarter of 2022, aggregate stock buybacks for 21 large bank holding companies averaged more than **$22 billion** per quarter and reached a high of nearly **$40 billion** in the third quarter of 2021 alone.[39] Several large bank CEOs indicated that plans for buybacks in 2023 will exceed 2022 levels, citing the fact that capital is "well above" regulatory minimums, allowing for buyback flexibility.[40]

- Fifth, a consortium of 11 of the nation's largest banks conditionally deposited a combined **$30 billion** (well above the proposed amount of the special assessment) on March 16, 2023, to try to save the already failing First Republic Bank. These same institutions should be equally willing and able to replenish the DIF.[41]

In addition to being able to pay the special assessment in one year, the large banks **should** repay the special assessment in full in one year.

- First, the DIF is already in a Restoration Plan because it is below the minimum amount required by law to protect depositors. The Restoration Plan began in September 2020, after a record dollar amount of new deposits flowed into the banking system from various fiscal programs that were put in place to support consumers and businesses during the COVID-19 pandemic. Statutorily, the DIF must be restored to a minimum reserve ratio level of 1.35 percent by 2028. In October 2022, the FDIC Board recognized the urgency of the situation and voted to increase assessment rates on all banks because the DIF was at risk of not meeting the 1.35 minimum level within the statutory deadline.[42] In summary, the DIF level is too low already and it should be replenished as quickly as possible.

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[38] *See* FDIC, *Quarterly Banking Profile*, 17 FDIC QUARTERLY (2), Table II-A (First Quarter 2023), https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2023mar/qbp.pdf#page=1.

[39] Beverly Hirtle & Sarah Zebar, *Bank Profits and Shareholder Payouts: The Repurchases Cycle,* FEDERAL RESERVE BANK OF NEW YORK: LIBERTY STREET ECONOMICS (Jan. 9, 2023), https://libertystreeteconomics.newyorkfed.org/2023/01/bank-profits-and-shareholder-payouts-the-repurchases-cycle/.

[40] Polo Rocha, *Several Big Banks Will Resume Buybacks After 2022 Breather*, AMERICAN BANKER (Jan. 13, 2023), https://www.americanbanker.com/news/several-big-banks-will-resume-buybacks-after-2022-breather.

[41] *See* Press Release, First Republic Bank, *Reinforcing Confidence in First Republic Bank* (Mar. 16, 2023), https://news.firstrepublic.com/news-releases/news-release-details/reinforcing-confidence-first-republic-bank.

[42] *See* Press Release, FDIC, *FDIC Board of Directors Adopts Final Rule on Assessments, Revised Deposit Insurance Assessment Rates; Maintains the Designated Reserve Ratio for 2023* (Oct. 18, 2022), https://www.fdic.gov/news/press-releases/2022/pr22073.html.

- Second, DIF is generally invested in Treasury securities. These securities earn interest income, which contributes to building the overall size of the DIF. The longer that the DIF is without the funds that will eventually be replenished by the special assessment the more interest income is lost. With interest rates at relatively high levels, the interest income that the DIF could be earning – but isn't – is even larger. Lower amounts of interest income also mean that the rest of the industry will have to pay even more in regular assessments to rebuild the DIF.

VI. THE SHORTFALL SPECIAL ASSESSMENT SHOULD BE CALCULATED AT THE END OF THE ONE-YEAR PAYMENT PERIOD, NOT THE TWO-YEAR PAYMENT PERIOD IN THE PROPOSAL.

Consistent with Comment V above, which calls for the special assessment to be fully paid in one year, we recommend that any shortfall be calculated at the end of this one year-period, following the fourth quarter 2024 collection. While it is true that more precise information may be known about the actual cost of the SVB and Signature failures after a longer period, it is not sensible to postpone the final adjustment. As the Proposal states, if subsequent information indicates that the loss from the SVB and Signature failures exceeds the initial special assessment, an additional assessment on the institutions responsible for the special assessment should be made.

VII. THE FDIC SHOULD PROMPTLY CONSIDER A SEPARATE RULEMAKING TO ADJUST DEPOSIT INSURANCE PRICING FOR THE ENTIRE INDUSTRY TO RECOGNIZE AND MANAGE THE RISK OF ELEVATED UNINSURED DEPOSIT LEVELS.

The recent bank failures have clearly shown the risk that results from an excessive reliance on uninsured deposits. Studies from the FDIC's own Center for Financial Research and other academics demonstrate the risk and volatility associated with this type of funding. For example, the FDIC published a study of depositor behavior that analyzed data from 2007 to 2009 to assess liquidity and funding stability as a bank experiences stress and approaches failure.[43] The authors summarize their findings as follows:

> There were many bank failures during and after the financial crisis of 2007-2009. In this period, many systemically important institutions, as well as numerous smaller firms, faced severe liquidity stress. The inability of financial institutions to maintain stable funding sources was central to the crisis, which resulted in the high-profile failure or near failure of many financial institutions and unprecedented emergency liquidity support by governments around the world. Large quantities of deposits exited from failing banks, prompting a host of academic studies and regulatory responses attempting to find ways to reduce illiquidity and funding

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[43] Christopher Martin, Manju Puri, & Alexander Ufier, *Deposit Inflows and Outflows in Failing Banks: The Role of Deposit Insurance*, (FDIC: Center for Financial Research, Working Paper No. 2018-02), https://www.fdic.gov/analysis/cfr/2018/wp2018/cfr-wp2018-02.pdf.

stress.

The authors specifically point to uninsured deposits exiting banks during periods of stress and the more concerning trend that the uninsured depositors typically also pull large amounts of insured deposits from the failing bank. The study mentions that new insured deposits also flowed into banks that faced regulatory action, but this fact does not negate the volatility of this funding source and the need to appropriately price the risk inherent in using it.

Another study, based on the experience in March 2023 illustrates the fragility of the banking system in relation to reliance on uninsured deposits.[44] The study authors summarize their findings as follows:

> Even if **only half of uninsured depositors** decide to withdraw, almost **190 banks with assets of $300 billion are at a potential risk of impairment, meaning that the mark-to-market value of their remaining assets after these withdrawals will be insufficient to repay all insured deposits.** If uninsured deposit withdrawals cause even small fire sales, substantially more banks are at risk.

The results of these studies and the experience with SVB and Signature support the need to augment regulatory processes to hold banks accountable for the risk they incur and present to the banking system if they choose to hold elevated levels of uninsured funding.

CONCLUSION

We hope these comments are helpful as the FDIC finalizes the Proposal.

Sincerely,

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[44] Erica Xuewei Jiang, Gregor Matvos, Tomasz Piskorski, & Amit Seru, *Monetary Tightening and U.S. Bank Fragility in 2023: Mark-to-Market Losses and Uninsured Depositor Runs?* (Mar. 13, 2023), http://dx.doi.org/10.2139/ssrn.4387676 (emphasis added).