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CLIENT MEMORANDUM

November 30, 2023

FDIC Adopts Final Rule on Special Assessment Following March 2023 Bank Failures

Executive Summary

On November 16, 2023, the Federal Deposit Insurance Corporation ("FDIC") adopted a final rule ("Final Rule") to impose a special assessment for the recovery of losses to the Deposit Insurance Fund ("DIF") stemming from the protection of uninsured depositors after the closures of Silicon Valley Bank ("SVB") and Signature Bank. The Final Rule, which is expected to become effective on April 1, 2024,[1] will guide the special assessment process and outlines the method for calculating and collecting payments from insured depository institutions ("IDIs").[2]

FDIC Chairman Martin J. Gruenberg described the special assessment as applying to the types of banking organizations that benefitted most from the protection of uninsured depositors, and using the amounts of uninsured deposits to ensure "equitable, transparent, and consistent treatment" of IDIs.[3] The FDIC estimates that the special assessment will result in total revenue of $16.3 billion, equal to the losses stemming from the FDIC's protection of the uninsured deposits of SVB and Signature Bank.[4]

The FDIC estimates that 114 U.S. banking organizations will be subject to the special assessment, based on uninsured deposits as of December 31, 2022.[5] Under the Final Rule, the FDIC will collect the special assessment from IDIs at an annual rate of 13.44 basis points beginning with the first quarterly assessment period of 2024 (January 1 through March 31, 2024), with payment for the first assessment due on June 28, 2024.[6] The FDIC will adjust the assessment base for the special assessment by excluding the first $5 billion of uninsured deposits.[7]

1 *See* Final Rule at page 2.

2 Section 13 (4)(G) of the Federal Deposit Insurance Act (FDI Act) provides that any loss to the DIF arising from the use of a systemic risk exception must be recovered from one or more special assessments on IDIs, depository institution holding companies (with the concurrence of the Secretary of the Treasury with respect to holding companies), or both, as the FDIC determines to be appropriate. *See* 13(4)G)(I) FDI Act.

3 *See* joint press release (March 12, 2023), available at https://www.fdic.gov/news/press-releases/2023/pr23017.html.

4 *See* Final Rule at pages 1-2.

5 This is broken down into 48 banking organizations with more than $50 billion in total assets and 66 banking organizations with between $5 billion and $50 billion in total assets. *See* Final Rule pages 10 and 26.

6 *See* Final Rule at page 1.

7 *See* Final Rule at page 1.

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Notably, the FDIC received 312 comment letters from various stakeholders responding to its May 11, 2023 notice of proposed rulemaking for the special assessment ("Proposed Rule").[8] The comments included proposals to change the accounting treatment of the special assessment and to exclude certain IDIs from the special assessment. These proposals ultimately were rejected by the FDIC in the Final Rule.

Background

On March 10, 2023, the California Department of Financial Protection and Innovation closed SVB and appointed the FDIC as receiver.[9] On March 12, the New York State Department of Financial Services closed Signature Bank, also appointing the FDIC as receiver.[10] SVB's and Signature Bank's failures were the third and fourth largest bank failures in United States' history.[11] At the time of its closure, SVB was the 16th largest U.S. bank, with 17 branches across California and Massachusetts and around $209 billion in assets as of year-end 2022.[12] Signature Bank was the 29th largest U.S. bank, with total assets of $110.4 billion as of December 31, 2022 and with 40 branches across New York, California, Connecticut, North Carolina, and Nevada.[13] SVB had $151.6 billion in uninsured deposits as of its last call report, while Signature Bank had $79.5 billion in estimated uninsured deposits.[14]

Given the risks posed to the financial system by the closures of SVB and Signature Bank, Secretary of the Treasury Janet L. Yellen, acting on the recommendation of the FDIC and the Federal Reserve Board of Governors, and after consultation with President Biden, invoked the systemic risk exception to the rule prescribing least-cost resolution.[15][16] While the FDIC is required to adopt the least-cost resolution in the event of a bank failure, the exception to this rule is permitted following a systemic risk determination when necessary to avoid "serious adverse effects on economic conditions or financial stability."[17] The exception

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8 *See* 88 FR 32694 (May 22, 2023).

9 *See* FDIC PR-16-2023, "FDIC Creates a Deposit Insurance National Bank of Santa Clara to Protect Insured Depositors of Silicon Valley Bank, Santa Clara, California." March 10, 2023, available at https://www.fdic.gov/news/press-releases/2023/pr23016.html.

10 *See* FDIC PR-18-2023, "FDIC Establishes Signature Bridge Bank, N.A., as Successor to Signature Bank, New York, NY." March 12, 2023, available at https://www.fdic.gov/news/press-releases/2023/pr23018.html.

11 *See* New York Times *"Banking Turmoil: What we Know."* March 15, 2023, available at https://www.nytimes.com/article/svb-silicon-valley-bank-explainer.html.

12 *See* analysis of the bank closures here: https://crsreports.congress.gov/product/pdf/IN/IN12125.

13 *Id.*

14 *Id.*

15 Under the FDIC Act, the systemic risk exception is invoked when the following five statutory requirements have been met: (1) the Treasury Secretary, in consultation with the President and upon a written recommendation of at least two-thirds of the boards of the FDIC and Board of Governors of the Federal Reserve System, determines that (a) the least cost resolution "would have serious adverse effects on economic conditions or financial stability" and (b) the FDIC's actions would avoid or mitigate those effects; (2) the Treasury Secretary determines that loss to the FDIC must be repaid through one or more special assessments on insured depository institutions by the FDIC; (3) the Treasury Secretary documents the decision; (4) the Comptroller General of the United States shall review and report to the Congress on any determination under clause (i), including— (I) the basis for the determination; (II) the purpose for which any action was taken pursuant to such clause; and (III) the likely effect of the determination and such action on the incentives and conduct of insured depository institutions and uninsured depositors; and (5) the Treasury Secretary notifies the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Representatives of the determination, and the basis for the determination, within three days. *See* 12 U.S.C. §1823(c)(4)(G).

16 Deposits are insured up to a legal limit of $250,000, pursuant to section 11(1)(e) of the FDI Act. Uninsured deposits, on the other hand, are typically not guaranteed, although they may ultimately be made whole as is the case when a systemic risk exception to "least-cost resolution" is invoked.

17 *See* an analysis of the systemic risk exception by the Congressional Research Service, here: https://crsreports.congress.gov/product/pdf/IF/IF12378#:~:text=The%20systemic%20risk%20exception%20is%20a%20recognition%20by%20Congress%20that,resolution%20costs%20to%20the%20FDIC.

was invoked by the government in this case for fear that unprecedented withdrawals by uninsured depositors would trigger runs on other banks, ultimately resulting in a loss of confidence in our own banks and in a broader financial crisis.[18]

The systemic risk determination empowered the FDIC to fully protect depositors and protect the stability of the financial system at a time of uncertainty.[19] However, invoking the systemic risk exception and guaranteeing uninsured deposits was not without consequences as it resulted in a $16.3 billion loss to the DIF. Consequently, the FDIC is turning to IDIs to recoup the losses, as required by the Federal Deposit Insurance Act ("FDI Act").[20]

The Final Rule

Differences Between the Final Rule and the Proposed Rule

The Final Rule is substantially similar to the Proposed Rule, but for a few noteworthy changes.

1. **Annual Rate Increase**. In the Final Rule, the FDIC's estimated loss is $16.3 billion, $500 million higher than it estimated in the Proposed Rule (i.e. $15.8 billion). This increase in estimated loss results in an increase in the annual rate to 13.44 basis points, as compared to 12.5 basis points in the Proposed Rule, and the quarterly rate increases from 3.13 basis points to 3.36 basis points.[21]

2. **Adjustment Removal**. Under the Proposed Rule, if the FDIC extended the collection period or imposed a one-time final shortfall assessment, each banking organization's assessment base would be adjusted to account for mergers and failures that occurred during the eight-quarter assessment period. Under the Final Rule, such an adjustment is not necessary.[22]

3. **Considerations of Amendments**. Under the Proposed Rule, in determining estimated uninsured deposits, the FDIC would not take into account any amendments made by IDIs to correct the reporting of uninsured deposits on their call reports that arise from, or are confirmed through, the FDIC's review of the IDI's reporting methodology. Under the Final Rule, such amendments are taken into consideration when determining estimated uninsured deposits.[23]

Key Provisions in the Final Rule

1. Estimated Special Assessment Amount

The FDIC determined that the total estimated loss to the DIF attributable to the protection of the SVB's and Signature Bank's uninsured depositors to be $16.3 billion.[24] In order to ascertain the cost of the FDIC's protection of uninsured deposits at SVB and Signature Bank, the FDIC determined the percentage of deposits that were uninsured at the time of failure and applied that percentage to the total cost of the failure at SVB and Signature Bank.[25] With respect to SVB, for which 88 percent of deposits were uninsured at the time of failure, $15.7 billion of the total estimated loss of $17.8 billion is attributable to the protection of

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[18] *See* "Remarks by Chairman Martin J. Gruenberg on "Oversight of Financial Regulators: Financial Stability, Supervision, and Consumer Protection in the Wake of Recent Bank Failures" before the Committee on Banking, Housing, and Urban Affairs, United States Senate", available at https://www.fdic.gov/news/speeches/2023/spmay1723.html.

[19] *See* Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC. March 12, 2023. May be accessed here: https://www.fdic.gov/news/press-releases/2023/pr23017.html.

[20] Section 13(c)(4)(G) of the FDI Act. Under this provision, losses to the DIF arising from the use of a systemic risk exception must be recovered from one or more special assessments on IDIs and depository institution holding companies as the FDIC determines to be appropriate.

[21] *See* Final Rule at page 11.

[22] *See* Final Rule at page 37.

[23] *See* Final Rule at page 27.

[24] This is approximately $500 million higher than the amount originally projected in the Proposed Rule.

[25] *See* Final Rule at page 9.

uninsured depositors. In relation to Signature Bank, for which 67 percent of deposits were uninsured at the time of failure, $0.6 billion of the total estimated loss of $0.9 billion is attributable to the protection of uninsured depositors.[26]

However, the FDIC will periodically adjust these loss estimates as SVB and Signature Bank's assets are sold, liabilities are satisfied, and receivership expenses incurred, and the exact amount of losses incurred will ultimately be determined when the FDIC terminates its receiverships for both banks.[27]

2. Assessment Base and Scope of Application for the Special Assessment

Under the Final Rule, each IDI's assessment base will be equal to its estimated uninsured deposits as reported on its Call Report[28] for the quarter that ended on December 31, 2022, after deducting the first $5 billion of uninsured deposits.[29] In determining estimated uninsured deposits, the FDIC will take into consideration amendments made by IDIs to correct the reporting of uninsured deposits on Call Reports , provided that such amendments arise from the FDIC's review of the relevant IDI's reporting methodology.[30]

The Final Rule exempts most IDIs that are part of a small banking organization[31] from making payments under the special assessment. The special assessment will not apply to any banking organizations with total assets under $5 billion. However, some commenters on the Proposed Rule suggested that certain groups of banks should be exempt from or pay less of the special assessment, while one commenter recommended that all banks be subject to the special assessment.[32] The FDIC rejected all of these proposals. While the FDIC is legally required by the FDI Act to consider the types of entities that benefit from any action taken or assistance provided pursuant to the determination of systemic risk,[33] the FDIC claims that its method ensures that the banks that benefited most from the assistance provided under the systemic risk determination will bear their fair share of the burden, with banks of larger asset sizes and that hold greater amounts of uninsured deposits paying a higher amount.[34]

The FDIC also rejected comments recommending that an updated date should be used to calculate the assessment base. The FDIC concluded that the December 31, 2022 date for calculating the assessment base "most closely approximates an institution's

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[26] *Id.*

[27] *See* Final Rule at page 10.

[28] The Final Rule notes that estimated uninsured deposits are reported in Memoranda Item 2 on Schedule RC-O, Other Data for Deposit Insurance Assessments of the Call Report. IDIs with less than $1 billion in total assets as of June 30, 2021, were not required to report the estimated amount of uninsured deposits on the Call Report for December 31, 2022. Therefore, for IDIs that had less than $1 billion in total assets as of June 30, 2021, the amount and share of estimated uninsured deposits as of December 31, 2022, would be zero. *See* Final Rule at page 12.

[29] *See* Final Rule at pages 11-12.

[30] *See* Final Rule at page 35.

[31] While not defined under the FDI Act and the Final Rule, the FDIC adopts a definition by the Small Business Administration ("SBA") (*See* Final Rule at page 62.) The SBA, created pursuant to section 4(a) of the Small Business Act, defines "small entities" to include "banking organizations with total assets of less than or equal to $850 million in assets, where an organization's assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year." *See* 13 CFR 121.201 (as amended by 87 FR 69118, effective December 19, 2022). In its determination, the SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates. *See* 13 CFR 121.103. Following these regulations, the FDIC uses an insured depository institution's affiliated and acquired assets, averaged over the preceding four quarters, to determine whether the insured depository institution is a "small" banking organization.

[32] Among the groups of banks commenters stated should be exempt from the special assessment were: banks under a range of other asset or uninsured deposit thresholds, banks not considered systemically important financial institutions, community development financial institutions, minority depository institutions, rural banks, and mutual banks.

[33] 12 U.S.C. 1823(c)(4)(G)(ii)(III).

[34] *See* Final Rule at page 18.

vulnerability to significant deposit withdrawals in the absence of the systemic risk determination and therefore reflects the institutions that most benefited from such determination."[35]

A number of other commenters advocated a revision of the FDIC's methodology for calculating the assessment base. Specifically, one commenter[36] argued that the FDIC's undifferentiated use of all uninsured deposits as the assessment base overlooks significant variations in the risks posed by different types of uninsured deposits, such as collateralized deposits, deposits held by custody banks, and intercompany deposits, which are generally more stable and should be treated accordingly.[37] However, the FDIC declined to adopt these proposals, noting that the presence of collateral "does not fully mitigate run risk," and that there is no "clear evidence that intercompany deposits are more stable relative to other deposits."[38]

3. Special Assessment Rate

The FDIC will apply a special assessment rate equal to an annual rate of 13.44 basis points for an anticipated total of eight quarterly assessment periods, which is slightly different from the initial 12.5 basis point annual rate stated in the Proposed Rule.[39] The Final Rule notes that some incremental amendments to reported estimated uninsured deposits since the adoption of the Proposed Rule resulted in a lower total assessment base, and this decline, combined with the increase in the overall cost estimate, has resulted in a higher annual rate relative to the projections in the Proposed Rule.[40]

It is also worth noting that the special assessment rate will not change from the date of adoption of the Final Rule through the duration of the initial eight quarter collection period. Over the initial eight-quarter collection period, the FDIC projects that it will collect an amount sufficient to recover estimated losses attributable to the protection of the uninsured depositors in SVB and Signature Bank.[41]

4. Collection Period for the Special Assessment

Per the Final Rule, the special assessment will be collected over an eight-quarter period beginning with an initial quarterly assessment in the first quarter of 2024, and with the first invoice payment due on June 28, 2024.[42] During this collection period, the FDIC will continue to review the loss estimate on a quarterly basis. If, prior to the end of the first eight quarters, the FDIC expects the loss to be lower than the anticipated special assessment collection, the FDIC will cease collection of the special

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35 *See* Final Rule at page 19.

36 *See* https://bpi.com/bpi-responds-to-fdic-special-assessment-rulemaking/.

37 *Id*.; *See* Final Rule at pages 20-24.

38 *See* Final Rule at page 21; *see also* Section 13(4)(G)(ii)(I) of the FDI Act.

39 The Proposed Rule noted that the special assessment rate was subject to change prior to any final rule depending on any adjustments to the loss estimate, mergers or failures, or amendments to reported estimates of uninsured deposits. Estimates of the special assessment rate and expected effects in the Proposed Rule generally reflected any amendments to data reported through February 21, 2023, for the reporting period that ended December 31, 2022, while estimates for this final rule reflect any amendments as of November 2, 2023. Given the closure of First Republic Bank, San Francisco, CA, announced on May 1, 2023, estimates in the proposed rule and this final rule exclude First Republic Bank in addition to Silicon Valley Bank and Signature Bank. *See* FDIC: PR-34-2023. Also *see* "JPMorgan Chase Bank, National Association, Columbus, Ohio Assumes All the Deposits of First Republic Bank, San Francisco, California." May 1, 2023. May be accessed here: https://www.fdic.gov/news/press-releases/2023/pr23034.html.

40 The special assessment rate, base, and expected effects in this final rule reflect any amendments to data as of November 2, 2023, for the reporting period that ended December 31, 2022.

41 *Id.*

42 *See* Final Rule at page 31.

assessment and provide notice of such cessation at least 30 days before the next payment is due.[43] On the other hand, if there is a deficit and the FDIC has yet to recover the estimated or actual loss amount after the first eight quarters, the FDIC will extend the collection period for one or more quarters, as necessary, to recover any deficit.[44] Additionally, if a final loss amount is not determined until after the initial collection period plus any extension, the FDIC will impose a "one-time final shortfall special assessment" to collect the final shortfall amount, to be collected at the same time and in the same manner as an IDI's regular quarterly deposit insurance assessment.[45]

5. Mergers, Consolidations and Terminations of Deposit Insurance

Under the Final Rule, if an IDI acquires another IDI, whether by way of a merger or a consolidation, the acquired IDI's payment responsibility will effectively be transferred to the acquiring IDI, which will be responsible for the acquired IDI's remaining special assessment amount in addition to its own from the quarter of the acquisition through the remainder of the special assessment collection periods.[46] If the FDIC extends the collection period or imposes a one-time final shortfall assessment, the assessment base for each IDI will not be adjusted to account for mergers and failures that occurred during the eight-quarter assessment period.[47]

The Final Rule also provides that if an IDI's insured status is terminated and its liabilities are not assumed by another IDI, the terminating IDI must, among other things, continue to pay assessments for the remaining assessment periods that its deposits are insured.[48] For an IDI that voluntarily terminates its insured status after the adoption of the Final Rule or during any special assessment collection period, the Final Rule requires that it pay the entire remaining amount of its special assessment at the same time that its obligation to pay regular deposit insurance assessments is projected to end.[49] The rationale for this inclusion is "to avoid incentivizing banks to voluntarily terminate their insured status to avoid paying the special assessment."[50]

6. Accounting Treatment of the Special Assessment

Banking organizations must account for the special assessment in accordance with U.S. generally accepted accounting principles ("GAAP") under the Final Rule.[51] Therefore, IDIs are expected to recognize in their call reports and other financial statements the accrual of a liability and estimated loss (i.e., expense) from a loss contingency[52] for the special assessment when the IDI determines that the conditions for accrual under GAAP have been met.[53]

Some comments suggested alternative accounting methods, such as restructuring the special assessment as a prepaid expense amortizable over a multi-year period. The FDIC rejected such proposals, noting that such treatment would lessen the one-time

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43 *See* Final Rule at page 32.

44 *See* Final Rule at pages 33-34.

45 *See* Final Rule at page 36.

46 *See* Final Rule at page 37.

47 *See* Final Rule at pages 37-38.

48 *See* Final Rule at page 38.

49 *See* Final Rule at page 40. Also *see* 12 C.F.R. § 327.6(C).

50 *Id.* at page 40.

51 *Id.*

52 In accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 450, Contingencies (FASB ASC Topic 450), an estimated loss from a loss contingency shall be accrued by a charge to income if information indicates that it is probable that a liability has been incurred and the amount of loss is reasonably estimable. *See* FASB ASC paragraph 450-20-25-2.

53 *See* Final Rule at page 40.

effect on income but also reduce liquidity by the full amount of the special assessment at payment, thereby inhibiting the institution's ability to absorb unexpected setbacks while also supplying credit to the economy.

Likely Effect of the Special Assessment

In the Final Rule, the FDIC evaluates the likely effects of the special assessment on banking organizations and the industry as a whole. First, the FDIC estimates that the after-tax impact of the special assessment will reduce the dollar amount of Tier 1 capital of affected banking organizations by 62 basis points, but that no banking organizations will fall below the minimum 4 percent Tier 1 leverage capital requirement as a result of the assessment.[54] In addition, the FDIC estimates that the special assessment will result in an average one-quarter reduction in the income of IDIs subject to the special assessment by 20.4 percent.[55] In addition to this projected reduction, available FDIC data also suggests that some banks will experience substantially higher reductions, and that the average reduction in income would be higher if calculated based on assets rather than number of banks.[56]

Conclusion

In its memorandum adopting the Final Rule, the FDIC noted that the banking industry is at risk of facing significant downturns from the effects of inflation, rising market interest rates, and geopolitical instability.[57] The FDIC believes that these risks may lead to "credit quality deterioration weakness in profitability, which may result in more stringent underwriting standards, a slowdown in loan growth, higher provision expenses, and liquidity constraints."[58] Chairman Gruenberg has reiterated concerns about banks' continued reliance on uninsured deposits and has argued that risk-based deposit insurance pricing are a legitimate tool for deterring overreliance on uninsured deposits in light of the liquidity risks such deposits pose to the financial system.[59] For now, the debate over the proper implementation of the special assessment following the March bank failures is over, but the coming months will shed light on whether the FDIC's preferred approach will achieve its stated policy goals.

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54 *See* Final Rule at pages 47-48.

55 *See* Final Rule at page 49.

56 The FDIC estimates that its special assessment will result in a one-quarter reduction in income of more than 30 percent for 15 banking organizations with approximately $5.8 trillion in total assets and a one-quarter reduction in income of between 20 percent and 30 percent for 23 banking organizations with approximately $6.3 trillion in total assets. Conversely, the FDIC estimates that the special assessment would result in a one-quarter reduction in income of 20 percent or less for 73 banking organizations with approximately $7.3 trillion in total assets.

57 Access memorandum here: https://www.fdic.gov/news/board-matters/2023/2023-11-16-notice-dis-a-mem.pdf.

58 *See* Final Rule at page 52.

59 *See* "Remarks by Martin J. Gruenberg, Chairman, FDIC, on the Resolution of Large Regional Banks – Lessons Learned," available at https://www.fdic.gov/news/speeches/2023/spaug1423.html.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content.
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