July 10, 2023

James P. Sheesley

Assistant Executive Secretary, Federal Deposit Insurance Corporation

Attn: Comments – RIN 3064-AF93

550 17th Street NW

Washington, DC 20429

comments@fdic.gov

Dear Secretary Sheesley:

This is a comment on the proposed regulation "Special Assessments Pursuant to Systemic Risk Determination" RIN 3064-AF93.

The Federal Deposit Insurance Corporation (FDIC) covers depositors up to $250,000 at Insured Depository Institutions (IDIs). Claims are paid by the FDIC through its Deposit Insurance Fund (DIF) which is financed by assessments on IDIs and interest income on the DIF's Treasury bills and notes.

After the collapse of Silicon Valley Bank (SVB) and Signature Bank, the FDIC covered depositors' losses in excess of the $250,000 limit. This resulted in losses to the DIF of $18.5 billion, with $15.8 billion of those losses being from uninsured depositors. At Signature Bank, 67 percent of deposits were uninsured, accounting for $1.6 billion in losses to the DIF. At SVB, 88 percent of deposits were uninsured, accounting for $14.2 billion in losses to the DIF. The proposed rule would levy a special assessment of 12.5 basis points annually on IDIs' uninsured deposits over $5 billion until the losses to the DIF are recouped.

The proposed rule alleges that protections given to uninsured depositors at SVB and Signature Bank in turn gave protection to uninsured depositors at other banks, calming markets and preventing the mass withdrawal of uninsured deposits, thus preventing additional bank runs. But this view runs counter to statements by officials in the Federal government, including the Treasury Secretary. In testimony before Congress, while under oath, the Treasury Secretary was specifically asked if all uninsured depositors at all banks were now covered by the FDIC and she responded by saying, "A bank only gets that treatment if a majority of the FDIC board, a supermajority of the Fed board, and I in consultation with the president, determine that the failure to protect uninsured depositors would create systemic risk and significant economic and financial consequences."

The Treasury Secretary disclaimed any policy of plenary coverage of uninsured depositors, with the result that the action to cover uninsured depositors at the two failed banks did not calm markets nor reassure uninsured depositors. Declines in equities of regional banks on the New York Stock Exchange after the Treasury Secretary's comments are evidence that financial markets did not believe the FDIC's limited actions provided the blanket protections alleged in the proposed regulation.

Conversely, systemically Important Banks (SIBs) already had sweeping protections before the collapses of SVB and Signature Bank, according to the Treasury Secretary. Therefore, SIBs did not receive any additional benefit from the alleged protection generated by the action taken to cover uninsured depositors at SVB and Signature Bank.

The proposed rule merely asserts the FDIC's coverage of uninsured depositors at SVB and Signature Bank protected other banks, specifically small commercial banks, but does not present empirical evidence to support this claim. The proposed rule incorrectly implies that deposits have fallen more at smaller commercial banks than large ones by only mentioning deposit outflows at smaller commercial banks after the collapses of SVB and Signature Bank. In fact, deposits had been flowing out of large commercial banks for an entire year as the Federal Reserve reduced the securities held outright on its balance sheet, but deposits had not been flowing out of the small commercial banks. Even after the withdrawals during early and mid-March, the year-over-year percentage decline in deposits at small commercial banks was less than for large commercial banks. In the year from Wednesday, March 30, 2022 to Wednesday, March 29, 2023, deposits at small commercial banks fell 3.3% while deposits at large commercial banks fell 5.8% over that same time. While the deposit outflows at small commercial banks happened faster, on average, than at large commercial banks, the change was smaller over the course of the Federal Reserve's interest rate increase cycle and reduction of securities held outright, which took place over the course of the year before the collapses of SVB and Signature Bank. Indeed, the deposit outflows were greater in absolute and percentage terms at large commercial banks.

Furthermore, the reversal from deposit outflows to inflows was more likely the result of action taken by the Federal Reserve. Indeed, it was the central bank that created the money needed by the FDIC to pay uninsured depositors at SVB and Signature Bank. By Wednesday, May 3, 2023, the Federal Reserve had created $228 billion and lent it to the FDIC and banks in FDIC receivership. Additionally, the Federal Reserve created the Bank Term Funding Program (BTFP) that allowed banks with mark-to-market losses to raise large amounts of capital, without realizing those paper losses, by accepting as collateral depreciated securities at par. As of Wednesday, June 28, 2023, over $103 billion of liquidity had been created by the Federal Reserve via this facility and lent out to banks with devalued securities valued at par serving as collateral.

Even as systemic interest rate risk temporarily paralyzed the federal funds market, additional action by the Federal Reserve beyond the BTFP also provided liquidity in a timely manner to offset deposit drains and prevent the need to realize paper losses of assets. For the week ending Wednesday, March 15, 2023, the week average of discount window lending increased more than $80 billion, the largest weekly increase ever. For context, during the global financial crisis, the largest weekly increase in primary credit was $31 billion. The largest weekly increase during the 2020 pandemic was $33 billion, a new record at the time but less than half the increase in mid-March 2023. The increase in primary credit is indicative of the speed with which the Federal Reserve responded to the sudden demand for liquidity.

The volume of lending at the discount window, like the volume of lending through the BTFP or other credit extensions to the FDIC, demonstrates how the Federal Reserve created the money to arrest any panic among depositors. By Wednesday, March 15, 2023, when lending in the federal funds market was declining, borrowing at the discount window set a new record high of $153 billion. For context, that is three times the peak reached during the liquidity decline of March 2020 during the pandemic, and it is

about 40% more than the peak reached during the liquidity decline of October 2008 during the global financial crisis.

By virtue of fractional reserve banking, all depository institutions have deposits in excess of cash assets, which is the basic justification for federal deposit insurance. It is not, therefore, the belief that a bank has cash on hand which calms depositors, but the belief that the bank has access to ample liquidity when needed. This is true for both insured and uninsured depositors. By acting as the lender of last resort and providing the needed liquidity for the banking system, the Federal Reserve removed the incentive for depositors to withdraw funds in a panic, thus shifting the equilibrium as described by Diamond-Dybvig from a bank collapse to continued operation.

Aside from the false causation that the FDIC's extension of coverage to uninsured depositors prevented bank runs, the structure of the proposed special assessment is also problematic for two reasons. First, the $5 billion threshold for uninsured deposits is arbitrary and capricious.

No justification is provided for this threshold. While the proposed rule does note that the ratio of uninsured deposits to total domestic deposits tends to increase with a bank's size, as does the average share of assets funded by uninsured deposits, there is almost no difference across the $5 billion threshold. Comparing banks having assets from $1 billion to $5 billion with banks having assets from $5 billion to $10 billion, the average share of assets funded by uninsured deposits rises from 28.1% to just 28.9%, while the ratio of uninsured deposits to total domestic deposits rises from 33.2% to just 35.0%. Conversely, SVB and Signature Bank had uninsured deposit ratios at about twice these rates, 88% and 67%, respectively.

The proposed rule states that "generally speaking, larger banks benefited the most from the stability provided to the banking industry under the systemic risk determination." Thus, the $5 billion threshold for uninsured deposits is a progressive assessment which is disproportionately paid by larger IDIs. Such an assessment structure is only justified if larger IDIs actually benefited from more than their smaller counterparts as alleged by the proposed rule.

As already explained, The Treasury Secretary was among those who publicly and explicitly stated, including while testifying before Congress under oath, that extending FDIC coverage to uninsured depositors at one IDI did not guarantee coverage to uninsured depositors at other IDIs. Even if the systemic risk determination regarding SVB and Signature Bank had provided stability to the banking industry, the proposed rule provides no justification for the claim that larger banks benefited the most from this assumed increase in stability.

The deposit inflow and outflow data from the Board of Governors of the Federal Reserve System indicate the exact opposite of the claim from this proposed rule. Both before and after the systemic risk determination by the FDIC, uninsured deposits were being withdrawn mostly from small commercial banks and then deposited at large commercial banks, since the latter were perceived by the public as safer than smaller banks. Yet the proposed rule says "large banks … were the banks most exposed to and likely would have been the most affected by uninsured deposit runs." In reality, small commercial banks were experiencing uninsured deposit runs while large commercial banks, mostly SIBs, were receiving those same deposits.

Furthermore, the withdrawal of deposits from banks, regardless of a bank's size, was primarily problematic when paired with interest rate risk on banks' balance sheets because raising liquidity meant selling devalued assets at a loss. The size of a bank's uninsured deposits alone is not a sufficient determination of its residual, its overall financial health, its ability to raise liquidity, or the degree to which it was impacted by the FDIC's coverage of uninsured depositors at SVB and Signature Bank.

The proposed rule assumes that larger IDIs' balance sheets were in the same precarious position as SVB and Signature Bank regarding interest rate risk yet provides no evidence to support this vital assumption. Absent such risk, larger IDIs could have raised liquidity by selling securities at par, and not a loss. Withdrawals of deposits would not, therefore, have caused the losses seen at SVB or Signature Bank to occur at larger IDIs.

In conclusion, the proposed rule does not provide sufficient justification for levying this special assessment and the structure of the assessment is inadequately supported, arbitrary, and capricious. I look forward to your response in addressing these concerns.

Sincerely,

E. J. Antoni, Ph.D.

Public Finance Economist