

EnerBankUSA

SALT LAKE CITY, UTAH ▪ MOORESVILLE, NORTH CAROLINA

Mr. Robert E. Feldman
Executive Secretary
Comments
Federal Deposit Insurance Corporation
550 17th St.
Washington, DC 20429

VIA EMAIL TO: comments@FDIC.gov

Re: RIN 3064-AE37 Request for comments regarding proposed rulemaking to amend 12CFR part 327 to refine the deposit insurance assessment system.

Dear Mr. Feldman,

We appreciate the opportunity to respond to the Request for Comments published in the Federal Register on February 4, 2016 and are submitting the following comments on behalf of EnerBank USA.

EnerBank USA is an industrial bank that specializes in providing unsecured home improvement loan programs for homeowners through nationwide dealer networks of leading home improvement manufacturers, distributors, and franchisors as well as through home improvement contractors and retailers. Headquartered in Salt Lake City, Utah, EnerBank USA has approximately \$1.2 billion in assets. Our parent company, CMS Energy Corporation (NYSE: CMS), is a Michigan-based company that owns an electric and natural gas utility, Consumers Energy Company, as its primary business and also owns and operates independent power generation businesses. EnerBank USA represents 3% of CMS Energy's net assets.

We applaud the goals of the FDIC in the proposed rule-making to "improve the risk-based deposit insurance assessment system applicable to small banks to more accurately reflect risk." However, we are concerned that instead of out-performing the existing methodology, the proposed methodology could actually incentivize banks to add riskier assets to their balance sheet and could, like in the case of EnerBank USA, significantly increase the degree to which a lower-risk bank subsidizes the deposit insurance of higher-risk banks.

Quality of the Analysis

The analysis appears to contain material flaws. Table 17 in the Notice of Proposed Rulemaking (NPR) shows the impact of the proposed change to unprofitable small institutions. It indicates that the proposed methodology would **reduce** the assessment of 96% of unprofitable institutions. While profitability is not the only factor to consider in the likelihood of failure, it is not reasonable to think that 96% of unprofitable institutions would receive lower assessments using a more accurate, risk-based methodology. Indeed, Table 2.3 in the NPR shows that 21% of profitable institutions will be charged a higher assessment. Despite the fact that FDIC's studies show that there is a statistically significant correlation with unprofitability and failure, unprofitable institutions are more likely to experience a reduction in assessments under the proposed methodology.

In all three regression series, the Brokered Deposit Ratio, Asset Growth and Loan Mix Index (“Weaker Variables”) are relatively inconsequential compared to Tier-1 Leverage Ratio, Net Income, Non-Performing Assets, OREO and CAMELS ratings. The incremental value of the Weaker Variables is far less predictive of insolvency compared to the other five more obvious variables. Depending on how the modeler scales these variables, all three of these weaker variables combined will be less meaningful in the prediction of failure than any one of the remaining five variables.

Logically, if the Weaker Variables have little impact in the model’s prediction of failure, they should also have little impact on FDIC assessments. It turns out that is not the case (See Table 1). Despite having a weak correlation and little or no causation, the Brokered Deposit Ratio and Loan Mix Index have the second and third most impact on deposit insurance assessments in the proposed methodology. It is interesting to note that CAMELS ratings have the strongest correlation, kudos to the FDIC, but surprisingly only have the fourth highest impact to the assessment in the proposed methodology.

Table 1 -- Comparison of Rank Order of Correlation to Actual Impact

	Strength of Correlation	Impact to Assessment
Tier 1 Leverage Ratio	2	1
Net Income before Taxes/Assets	4	5
Loan Mix Index	7	3
Brokered Deposit Ratio	6	2
Nonperforming Assets/Gross Assets	3	7
Other Real Estate Owned/Gross Assets	5	8
Asset Growth	8	6
CAMELS Rating	1	4

Due to these concerns, we request that the FDIC amend the proposed deposit insurance assessment methodology to be based on the five variables with the strongest correlation to probability of failure; Tier-1 Leverage Ratio, Net Income, Non-Performing Assets, OREO and CAMELS ratings.

Reasons Banks Fail.

The vast majority of bank failures can be tied to poor asset quality or to a liquidity crisis. The proposed methodology could actually incent banks to become more risky in these two areas and increase their likelihood of failure while reducing their deposit insurance assessment.

When contemplating asset quality, we believe that the proposed “Loan Mix Index” provides incentives for banks to originate risky loans. By applying the category of loan’s historical weighted average industry-wide charge-off rate to a bank’s loan portfolio, it reduces the incentive to originate high quality loans. EnerBank USA originates high quality unsecured installment loans to consumers for the purpose of home improvement. The average FICO score at origination is 760. Our 12 month net charge-off rate is 0.63%. Under the proposed methodology, a charge-off rate of 1.46%, more than double our existing rate, would be applied to our high quality loan portfolio. On the other hand, a bank desperate to increase yield could originate sub-prime pay day loans with double digit charge-off rates and their far riskier portfolio



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would be treated the same as ours in the Loan Mix Index, creating the exact subsidy situation the FDIC is seeking to avoid, since the lower-risk bank would be paying an assessment based on assets riskier than its own, and the higher-risk bank would be paying based on assets less risky than its own.

If you choose to retain the Loan Mix Index in the calculation and the goal is to reduce the impact of cyclical in the new methodology, the methodology could include a bank's 10 year weighted average net-charge-off rate or 1 year net-charge-off rate, whichever is higher, in the Loan Mix Index. Using a 10 year weighted average net-charge-off rate would generally include at least one recession and thus avoid solely using low charge-off rates experienced in good economic conditions. For banks with less than 10 years of history in a particular loan category, an industry loss rate or their actual 1 year net-charge-off rate, whichever is higher, could be used.

Brokered CDs reduce the likelihood of a liquidity crisis. These deposits can only be withdrawn before maturity if the depositor dies or is declared incompetent by a court of law. Material levels of unexpected deposit outflows are impossible. The case could be made that banks with brokered CDs should have a lower assessment rate due to the reduced likelihood of a liquidity crisis associated with this form of deposits.

Proposed Assessment Methodology is Inconsistent with Well-Established Ratings.

The IDC Financial Publishing, Inc. (IDC) uses its unique CAMEL rankings of financial ratios to determine the safety ratings of banks, bank holding companies, savings institutions, and credit unions. IDC's methodology for ranking financial institutions for safety is an open platform, allowing banks, savings institutions, credit unions, and any client to understand financial ratios and rank for a specific institution. IDC produces a score from 1 to 300, with a 1 being assigned to banks on the verge of failure and 300 being a perfect score. EnerBank USA has an IDC score of 300, yet the proposed assessment methodology would increase our deposit insurance assessment by 110%. This is inconsistent with such ratings from this well-respected entity.

Proposed Assessment Methodology Would Penalize Highly Successful Institutions.

EnerBank USA is a highly rated bank by the FDIC, with a long history of strong earnings, high asset quality and excess capital. Currently it has a Tier 1 Leverage Ratio of 11.1%, a Net Income before Taxes ratio to Total Assets of 3.6%, a ratio of Non-Performing Loans and Leases to Total Assets of 0.1% and a ratio of Other Real Estate Owned to Gross Assets of 0.0%, yet the proposed assessment methodology would increase EnerBank's deposit insurance assessment by a staggering 110%. We think that EnerBank USA has one of the lowest risks of failure in the next three years, and reiterate our concern that the proposed methodology would create substantial inequities between lower and higher risk banks.

The type of deposits utilized or growth experienced by banks do not cause banks to fail. Rather, poor loan quality, insufficient capital and insufficient liquidity cause banks to fail. In the cases of the 472 FDIC insured banks that failed between 2004 and 2013, publicly available financial data published by the FDIC shows a clear and dramatic progression from lower troubled asset ratios to higher troubled asset ratios (on average from 20.6% to 241.5%) from three years prior to an institution's failure date to the quarter ended immediately prior to that date. The same group of banks experienced an equally clear and dramatic progression from higher reserve ratios to lower reserve ratios (on average from 958.6% to 25.0%) from three years prior to an institution's failure date to the quarter ended immediately prior to that date.

The FDIC's Study on Core Deposits and Brokered Deposits states, "there should be no particular stigma attached to the acceptance by well-capitalized banks of brokered deposits per se and that the proper use of such deposits should not be discouraged." We believe the NPR is inconsistent with this worthy objective.

Conclusion

We commend the FDIC's goals to reduce "the subsidy that lower-risk banks provide higher-risk banks and provide incentives for banks to monitor and reduce risks that could increase potential losses to the DIF." However, in order to achieve this goal, the new methodology should be based on the variables with the strongest correlation to bank failures. We propose that the FDIC amend the proposed deposit insurance assessment methodology to be based on the five variables with the strongest correlation to probability of failure; Tier-1 Leverage Ratio, Net Income, Non-Performing Assets, OREO and CAMELS ratings and exclude the Weaker Variables from the methodology.

Utilizing weighted average industry-wide charge-off rates in the Loan Mix Index would provide incentive for banks to lower their underwriting standards. We propose that methodology should not include the Loan Mix Index or that the calculation use each bank's 10 year weighted average net charge-off rate or 1 year net-charge-off rate, whichever is higher, instead of the industry rate in order to capture loss rates during different economic conditions while rewarding banks that maintain prudent underwriting standards and penalizing banks with lower standards.

We are confident that the FDIC has no intention of increasing the deposit insurance assessment on highly rated, highly profitable, well-capitalized banks with high quality loan portfolios, such as EnerBank, and we hope that you will thoughtfully consider our proposed changes.

Thank you for your consideration of these comments.

Sincerely,



Charles E. Knadler
EnerBank USA
President & CEO