James F. Getz
Chairman & Chief Executive Officer

VIA E-MAIL

March 2, 2016

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
comments@FDIC.gov

Re: RIN 3064–AE37

Ladies and Gentlemen:

TriState Capital Bank ("TSCB") appreciates the opportunity to comment on the FDIC's proposed revisions to the deposit insurance assessment system for established small banks ("revised NPR"). TSCB is an FDIC-insured commercial and private bank headquartered in Pittsburgh, Pennsylvania with approximately $3 billion in assets. TSCB is among the banks subject to the revised NPR.

TSCB appreciates the changes made in response to public comments on the earlier (2015) NPR, including the limited exclusion of reciprocal deposits from the Brokered Deposit Ratio, as well as the minimum 10 percent threshold for the One-Year Asset Growth measure.

However, the revised methodology still has material shortcomings that cause inconsistencies with the FDIC's stated goals and that could be remediated by the FDIC with reasonable additional steps. We note that the FDIC press release related to the publication of the Initial NPR on June 16, 2015 discussed the FDIC's goals for the revised methodology. "...These contemplated improvements would allow assessments to better differentiate riskier banks from safer banks, and allocate the costs of maintaining a strong Deposit Insurance Fund accordingly." This updated focus has caused a change in the risk assessment's focus from predicting a downgrade in CAMELS rating within one year that is used in the current methodology to a focus on better predicting the risk characteristics that are more likely to contribute to a bank's total failure within three years.

The revised methodology continues to generate material inaccuracies in its risk assessments that result from the over-reliance on broad statistical analysis of historic data, particularly in the loan mix index. The broad analytical tools and categories used by the risk assessment result in under-assessing the risk of a number of activities and over-assessing the risk in many others. These results are not necessarily more predictive of bank failures in the future.

Additionally, these inaccuracies result in inconsistent negative financial impacts to profitable and highly rated banks. The revised methodology would cause some low risk, highly-rated banks' assessments to

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spike solely due to changes in the assessment methodology, which we believe is an inappropriate result. Under the revised NPR, some 1- and 2-rated banks with low risk profiles could experience an increase in deposit assessment rates exceeding 20%. Moreover, tables 17 and 2.3 of the revised NPR indicate that 96% of unprofitable institutions will experience an assessment decrease, compared to only 55% of profitable institutions. These counter-intuitive results further indicate that the approach outlined in the revised NPR warrants reconsideration.

Accordingly, TSCB urges the FDIC to consider further changes in four key areas, described below, that we believe would significantly improve measurement accuracy; reduce unwarranted results; promote safe and sound lending practices; and provide the agency with a better analytical tool for assessing risk to the Deposit Insurance Fund.

1. **The Loan Mix Index does not adequately capture risk mitigation or underwriting quality.**

    - Recommendation: Modify the Loan Mix to prevent anomalous outcomes for banks with "1" ratings for Asset Quality.

The Loan Mix Index attempts to measure the riskiness of a bank's lending activities based on the types and amounts of loans. For each category of loans, the index assigns a risk factor based on historical, industry-wide charge-off rates. The loan categories originate from Schedule RC-C of the Call Report.

The Schedule RC-C loan categories are too broadly defined to accurately differentiate risk. For example, the loan categories on which the revised NPR relies do not recognize the amount or quality of available risk mitigation, such as collateral or guarantees. The very broad loan categories, including "Commercial & Industrial" ("C&I") loan and "Other Consumer" loan categories , do not consider risk mitigation at the loan or bank level in their definitions at all. As a result, significantly safer loans, such as those that are fully secured by cash on deposit or government securities, would receive the same risk factor as unsecured loans. Correspondingly, those same more risky unsecured loans receive the benefit of being pooled together with significantly safer collateralized loans.

The Schedule RC-C loan categories that the revised methodology relies on simply were not designed to measure risk. The Schedule RC-C loan category definitions include loans with wide differences in underwriting quality. For example, a portfolio of subprime auto loans would receive the same risk factor as a portfolio of prime auto loans. In many cases, differences in loan risk levels within a loan category will exceed differences between loan categories.

As a result, the charge-off rates associated with these broad categories are overstated for higher quality loan portfolios and understated for lower quality portfolios, resulting in an over-allocation or under-allocation of assessments based on this measure in most instances. Moreover, by treating all loans in certain categories – such as C&I loans – as relatively risky, the revised NPR can serve to discourage banks from lending to deserving C&I borrowers.

We urge the FDIC to consider a simple modification to the Loan Mix Index that would mitigate the most extreme unintended consequences. Specifically, we recommend adding a provision to the Loan Mix

Index that would prevent banks with the highest supervisory rating for Asset Quality (i.e., a "1" rating) from receiving inappropriately high charges under the new methodology relative to their actual loan quality. For such banks, this could be accomplished through either of the following ways:

- An exemption from additional assessment amounts related to the Loan Mix Index. The exemption would operate similarly to the revised NPR's current exemption from additional assessment amounts related to the One-Year Asset Growth measure for banks with one-year asset growth of 10% or less.
- A scaling factor applied to the Loan Mix Index. For example, the Loan Mix Index value could be multiplied by 50%.

These solutions would apply only to banks with the highest asset quality rating – i.e., banks that are typically less likely to fail due to loan mix issues. Any of these simple measures (or other variations that the FDIC might develop, such as low charge off rates) would significantly reduce the potential for anomalous results arising from the Loan Mix Index without materially increasing its operational complexity.

2. **The One Year Asset Growth measure does not adequately distinguish growth fueled by aggressive underwriting from other types of growth.**

   ➢ Recommendation: Modify the One Year Asset Growth measure to prevent anomalous outcomes for banks with "1" ratings for Asset Quality.

The One Year Asset Growth measure is designed to increase a bank's insurance assessment in proportion to its rate of growth, if greater than 10 percent, during the preceding year. This measure is premised on the idea that, in general, rapid growth equates to higher risk.

TSCB believes this measure overestimates the tie between growth and risk. It is true that, heading into the recent financial crisis, some banks which grew rapidly also evidenced lax underwriting practices. However, many banks that maintained conservative underwriting standards through the pre-crisis era emerged from the crisis with both the capacity and opportunity for strong growth. Their growth does not necessarily reflect increased risk but is instead the end result of patience during a prior period of exuberance that ultimately forced less careful competitors to retrench.

Furthermore, as a general matter, growth will often coincide with innovation in the design or delivery of banking products and services. Successful innovation has no fixed relationship to risk. Further, it should be encouraged, since it benefits both bank customers and the banking industry. Yet the One Year Asset Growth measure effectively penalizes it, without regard to asset quality.

To mitigate the most extreme problems associated with this measure, TSCB recommends a tailored adjustment for banks with a "1" supervisory rating for Asset Quality. Specifically, similar to our recommendation regarding the Loan Mix Index, we suggest that the FDIC incorporate a scaling factor, cap, or exemption from the One Year Asset Growth measure for banks with the highest asset quality rating – i.e., banks that are typically less likely to fail due to imprudent growth. Any of these simple

measures (or other variations that the FDIC might develop, such as low charge off rates) would significantly reduce the potential for anomalous results arising from the asset growth without materially increasing its operational complexity. Fundamentally, the One Year Asset Growth measure should target growth in lower quality assets, not all growth in general.

3. **The overall assessment formula over-weights broad statistical data relative to bank-specific judgments.**

   - Recommendation: Increase the weight given to the Weighted Average CAMELS Component Rating in the overall assessment calculation.

The specific areas for improvement discussed above illustrate the general difficulty of quantifying risk using primarily broad statistical data. First, the right combination of data elements must be identified. Even then, the Call Report simply does not capture certain key aspects of risk. Moreover, those risks that are captured may have less predictive power today than in the past. Due to subsequent changes in bank products, technology, business models, interest rates, and the market environment, certain statistical bank characteristics may influence the likelihood of failure less today than in prior years. For all these reasons, statistical data simply cannot substitute for informed, current, and bank-specific judgments – particularly the examiner judgments underlying supervisory ratings.

Each of the refinements suggested earlier in this comment letter will help address this larger problem. But TSCB urges the FDIC to go further. In particular, we encourage the FDIC to increase the weight given to the Weighted Average CAMELS Component Rating in the overall assessment calculation. We would also support other steps to ensure that insurance assessments reflect the more current, bank-specific judgments of bank examiners at least as much as broad statistical findings.

4. **The revised NPR would cause some highly-rated banks to experience a severe year-over-year assessment increase.**

   - Recommendation: For 1- and 2-rated banks that would experience a severe increase (e.g., exceeding 20%), provide for a more gradual phase-in over several years.

The overall distribution of projected assessment rates under the revised NPR may indicate that most banks would either benefit or experience modest increases. However, the revised methodology would also have the perverse effect of causing some low risk, highly-rated banks' assessments to spike solely due to changes in the assessment methodology, which we believe is an inappropriate result that the FDIC should seek to avoid.

TSCB suggests that the FDIC impose a temporary cap on year-over-year assessment increases caused by the new methodology for 1- and 2-rated banks. Any increases above a certain threshold –we would propose 20% – that are attributed to a change in methodology should be phased in gradually over a period of several years.

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TSCB thanks the FDIC for the opportunity to comment on this matter.

Sincerely,

James F. Getz