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March 3, 2016

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Re: RIN 3064-AE37

Dear Mr. Feldman:

We appreciate the opportunity to respond to the revised Notice of Proposed Rulemaking (NPR) and Request for Comments published in the Federal Register on February 4, 2016 by the Federal Deposit Insurance Corporation (FDIC). The NPR was published to refine the deposit insurance assessment systems for established small banks, and revises the original NPR published on July 13, 2015 (the "2015 NPR").

Introduction

We appreciate the FDIC's continual effort to refine the risk based deposit insurance assessment system for established small banks. However, while contrasting the revised NPR with both the current assessment system and the 2015 NPR, we note the assessment rate's increased sensitivity to brokered deposit funding concentrations for institutions **without** recent rapid asset growth (measured by either one year or four year cumulative growth rates). We would argue that evidence, much of which has previously been presented by the FDIC, would point towards greater risk in institutions with **both** brokered deposit funding concentrations and high asset growth rates.

In the following commentary, we will provide an illustration of one of these institutions and the increased sensitivity that is exhibited within the revised proposal.

Example

The following illustration contrasts the current insurance assessment calculation for a sample institution against the revised NPR calculation. Again, we highlight the increased sensitivity to brokered deposit funding concentration despite this institution exhibiting neither a rapid one year nor four year growth rate.

Current Calculation

Utilizing the calculator provided on the FDIC website, we assumed the following institution carried a CAMELS rating of 2 for each component and the composite rating[1]. This sample

[1] We do not have knowledge of any institution's respective CAMELS rating; therefore, we are using the stated assumption.

institution has a higher than average concentration in brokered deposit funding, well in excess of both 10 percent of total domestic deposits and 10 percent of total assets. Additionally, this institution has not exhibited rapid growth either over a one year or four year period. Given this information, the current calculation and the "adjusted brokered deposit ratio" provides a zero contribution within the financial ratios method of the assessment rate calculation (boxed in red below).

Section 2 - Financial Ratios				
Which quarter of financial data do you wish to use?			December 31, 2015	
(Place cursor over underlined text for definition)	Risk Measure Value		Pricing Multipliers	Contribution to Assessment Rate
Tier 1 Leverage Ratio	8.863	x	(0.056) =	(0.496)
Loans Past Due 30-89 Days/Gross Assets	0.582	x	0.575 =	0.335
Nonperforming Assets/Gross Assets	0.089	x	1.074 =	0.096
Net Loan Charge-Offs/Gross Assets	0.098	x	1.210 =	0.119
Net Income before Taxes/Risk-Weighted Assets	2.176	x	(0.764) =	(1.662)
Adjusted Brokered Deposit Ratio	0.000	x	0.065 =	0.000
Sum of Contributions				(1.610)

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Restore Initial Values

3) **Based on the information provided and the current assessment rate schedule, the rate your institution would pay is shown below.**

Part A - Financial Ratios Method				
(Place cursor over underlined text for definition)	Risk Measure Value		Pricing Multipliers	Contribution to Initial Base Assessment Rate
Uniform Amount				4.861
Sum of Financial Ratios Contributions				(1.610)
Weighted Average CAMELS Component Rating	2.000	x	1.095	2.190
Sum of Contributions				5.441
Initial Base Assessment Rate from Financial Ratio Method				5.44

Part B - Assessment Rate Calculation	
Assessment Methodology Used	Financial Ratio Method
Initial Base Assessment Rate	5.44
Unsecured Debt Adjustment	0.00
Depository Institution Debt Adjustment	0.00
Brokered Deposit Adjustment (Risk Category II, III, IV only)	N/A
Assessment Rate (basis points)	5.44

Established

The formula for the Adjusted Brokered Deposit Ratio as defined in the 2009 final ruling of assessments is as follows:

"The adjusted brokered deposit ratio will affect only those established Risk Category I institutions whose total gross assets are more than 40 percent greater than they were four years previously, after adjusting for mergers and acquisitions, rather than 20 percent greater as proposed in the NPR, and whose brokered deposits (less reciprocal deposits) make up more than 10 percent of domestic deposits."[2]

[2] https://www.fdic.gov/news/board/27Feb09_Final_Rule.pdf pg 18

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This institution's four year cumulative growth rate falls beneath 40% and therefore, they have no adjustment to its overall assessment rate due to the adjusted brokered deposit ratio.

Revised Proposal Calculation

In contrast, the revised proposal's calculation would adversely affect the same institution's calculation due to the new "brokered deposit ratio". This ratio would increase the assessment rate if the institution has brokered deposits in excess of 10 percent of its total assets (allowing institutions with a CAMELS composite rating of 1 or 2 to deduct reciprocal deposits from the brokered deposit sum). <u>However, the corresponding required rapid growth rate of 40 percent over a four year period is omitted</u>.

The proposed removal of the joint growth rate requirement has significant consequences. As shown below, the same sample institution would have a very large increase in their assessment rate under the revised proposal, primarily due to the new brokered deposit ratio contribution.

Section 1 - Financial Ratios						
Which quarter of financial data do you wish to use?				September 30, 2015		
(Place cursor over underlined text for definition)	Risk Measure Value		Pricing Multipliers		Contribution to Assessment Rate	
Tier 1 Leverage Ratio	8.517	x	(1.201)	=	(10.253)	
Net Income before Taxes/Total Assets	1.325	x	(0.684)	=	(0.906)	
Nonperforming Loans and Leases/Gross Assets	0.086	x	0.895	=	0.077	Well Capitalized
Other Real Estate Owned/Gross Assets	0.000	x	0.506	=	0.000	
Brokered Deposit Ratio	29.129	x	0.251	=	7.311	
Loan Mix Index	33.267	x	0.077	=	2.562	Restore Initial Values
One-year Asset Growth		x	0.058	=	0.000	
Sum of Contributions					(1.209)	

See important message below

3) Based on the information provided and the current assessment rate schedule, the rate your institution would pay is shown below.

Part A - Initial Base Assessment Rate				
(Place cursor over underlined text for definition)	Risk Measure Value		Pricing Multipliers	Contribution to Initial Base Assessment Rate
Uniform Amount				7.398
Sum of Financial Ratios Contributions				(1.209)
Weighted Average CAMELS Component Rating	2.000	x	1.443	2.886
Sum of Contributions				9.075
Initial Base Assessment Rate from Financial Ratio Method				9.07

Part B - Pricing Adjustments		
Assessment Methodology Used	Financial Ratio Method	
Initial Base Assessment Rate	9.07	
Unsecured Debt Adjustment	0.00	
Depository Institution Debt Adjustment	0.00	
Brokered Deposit Adjustment (Not well-rated or not well-capitalized new institutions only)	N/A	
Assessment Rate (basis points)	9.07	Established

This begs the question: why has the revised proposal removed the mutual requirement of rapid growth and high brokered funding concentration, instead penalizing institutions with solely a high brokered funding concentration (regardless of growth rate)?

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Evidence for Mutual Requirement, as Opposed to Independent Evaluation

There have been several references put forward by the FDIC over the preceding years which support the higher risk profile of institutions that exhibit both rapid growth rates and higher concentrations of brokered deposit funding concentrations.

From the "Study on Core Deposits and Brokered Deposits" issued July 8, 2011

"Benston (1986) finds no relationship between brokered deposits, as a percent of earning assets, and failure within one year. Benston does find some evidence that very substantial one-year increases in brokered deposits are associated with failure. However, he states that "because great increases in brokered deposits and total liabilities (growth) tend to be coincident, it is not possible to say which is causally related to failure." However, his findings are based on the experience of savings and loan associations from 1981-1985 only, and the data may be less than ideal due to issues related to FSLIC resolutions."[3]

From the current ruling, there is a clear relationship established between rapid growth **and** brokered deposits funding concentration.

"However, in the FDIC's view, a ratio of brokered deposits to domestic deposits greater than 10 percent is a significant amount of brokered deposits. Still, for institutions in Risk Category I, brokered deposits alone will not trigger higher rates, but must be combined with significant asset growth."[4]

Concluding Thought

In conclusion, we are suggesting a minor amendment to the revised proposal. The separation of rapid growth rates from brokered deposit concentration in the financial ratios method seemingly contradicts prior evidence and stances taken by the FDIC. As a result of evaluating each factor independently, a significant count of institutions would be penalized when they were previously unaffected. We would encourage a recoupling of the two items in the calculation to be consistent with prior approaches and the evidence pointing towards a higher risk when **both** factors are present.

Once again, we are grateful for the opportunity to comment on the revised proposal as presented and look forward to working with the agency and industry to find a palatable solution. Below, please find the institutions that have co-signed this comment letter. If there are any questions or requests for more information, please contact us at the numbers below.

Respectfully,

Stifel Financial - Financial Institutions Strategies Team

Co-signers: Farmers & Merchants Bank (Milford, NE)
Community Financial Services Bank (Benton, KY)

[3] https://www.fdic.gov/regulations/reform/coredeposit-study.pdf pg 45
[4] https://www.fdic.gov/news/board/27Feb09_Final_Rule.pdf pg 23

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Submitted signatures

Ryan Henley, CFA
Managing Director
Head of Financial Institutions Strategies
Stifel Financial Corp.
henleyr@stifel.com
(205) 949-3509

Ryan Smith
Managing Director
Head of Financial Institutions Analytics
Stifel Financial Corp.
smithry@stifel.com
(212) 887-4724

Michael Benedict, CFA
Director
Financial Institutions Strategies
Stifel Financial Corp.
benedictm@stifel.com
(212) 887-8797

David Kantor
Analyst
Financial Institutions Strategies
Stifel Financial Corp.
kantord@stifel.com
(212) 887-8795

Gerry A. Dunlap
Chairman/President
Farmers & Merchants Bank
Milford, NE
gdunlap@bankfmb.com
(402) 761-4601

Kamal Hosein, CFA
Managing Director
Head of Fixed Income Strategies
Stifel Financial Corp.
hoseink@stifel.com
(205) 271-6269

Will Lankford
Director
Financial Institutions Strategies
Stifel Financial Corp.
lankfordw@stifel.com
(205) 949-3523

David Shadix, CFA
Vice President
Financial Institutions Strategies
Stifel Financial Corp.
shadixd@stifel.com
(205) 271-6218

Jake Samuels
Analyst
Financial Institutions Strategies
Stifel Financial Corp.
samuelsj@stifel.com
(212) 887-8926

Linda Blanchard
EVP and Chief Financial Officer
Community Financial Services Bank
Benton, KY
lindab@cfsvcs.com
(270) 527-6042

Kathy Jones
AVP and Financial Team Leader
Community Financial Services Bank
Benton, KY
kathyj@cfsvcs.com
(270) 527-6040