CALIFORNIA BANKERS ASSOCIATION
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March 7, 2016

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Attention: Comments

Re: Proposed Rule on Assessments (12 CFR §327); RIN 3064–AE37

Dear Mr. Feldman:

The California Bankers Association is a non-profit organization that represents most of the FDIC-insured financial institutions doing business in California. Last September CBA submitted comments on the FDIC's original proposal to improve the risk-based assessment of smaller banks for deposit insurance. We appreciate that the FDIC had responded to our comments and others', and believe that this revised proposal ("Proposal") represents an improvement. As with our previous letter, CBA will focus on four of the proposed changes to the existing system.

Introduction

From data obtained before and during the recent financial crisis, the FDIC developed statistical models that it believes allow it to estimate better the probability of individual bank failures within three years. The FDIC proposes to use these estimates to modify the assessment system in order "to better capture risk when the risk is assumed, rather than when the risk has already resulted in losses." If the system better aligns premiums with the risks that banks pose to the insurance fund, then healthier banks would not subsidize riskier and unsafe banks. Banks that engage in activities that do not pose risks to the fund would not be suppressed by being overtaxed. And on the other end, moral hazard is avoided because banks that engage in risky activities would not be under-taxed.

CBA reiterates its support of the FDIC's effort to avoid what it calls "cross-subsidization." In large part this means matching insurance premiums with actual risks. However, despite some improvements from the original proposal (which we note further below), we believe that the revised Proposal in important respects still undermines the FDIC's own goals.

Loan Mix

CBA and its members continue to have concerns about giving undue risk weighting to a bank's "loan mix." This factor is based on a comparison between the average charge-off rates of specified loan types and the number of historical bank failures. But this analysis points to correlations, not causation, and moreover fails to account adequately for individual bank differences. Why should any bank pay insurance premiums based on a historical statistical profile, when the FDIC already has access to CAMELS ratings that are derived from close regulatory scrutiny of individual banks? A bank's rating offers insights to its condition and the way that it manages risks better than any statistic profile ever can. More specifically, a bank's asset quality rating (the "A" in CAMELS) reflects how a bank actually underwrites loans and mitigates related risks.

As a consequence of loan profiling, the Proposal penalizes some banks for making certain kinds of loans even if the loans are properly underwritten and benefit the banks and their customers. It also leads to under-assessment of banks that have a "proper" loan mix but uses poor underwriting. In other words, loan profiling results in precisely the kind of cross-subsidization that the FDIC wishes to avoid. The statistical approach may also be insufficiently sensitive to account for emerging risks associated with lending that is not incorporated in the historical data. We acknowledge that the FDIC may periodically revise the loan mix, but the process is still backward-looking and not as sensitive as simply staying focused on the risk profiles of individual banks.

One Year Asset Growth

Applying a factor for small banks that grow significantly over a year is another instance of inappropriately elevating generalities over specifics. Once again, the consequence is to penalize banks that grow in healthy ways that do not pose risks to the insurance fund. For example, a bank might safely exceed the 10% threshold for a number of salutary reasons, including loan growth driven by market fluctuations in core deposits. What the growth factor misses are nuances reflected in an individual bank's liquidity rating (the "L" in CAMELS)—for example, did the bank deploy additional liquidity in a prudent manner?—as well as the quality of the bank's management (or "M").

As an illustration, a certain California community bank is currently presented with an opportunity to expand into a market that is underserved by local banks. To enter the market would entail undergoing relatively quick growth—growth that would help the bank defray increased expenses. Done prudently, such expansion can be positive for the bank and the local market in many ways. But the fixed growth factor disregards such details and indeed, in this instance, acts as a potential cost or penalty if the bank chooses to serve this additional market. Applying this blanket assumption is not helpful and it should be dropped.

Core Deposits/Total Assets

CBA appreciates that the FDIC responded to the expressed concerns about the treatment of reciprocal deposits and Federal Home Loan Bank advances. In this way the Proposal acknowledges the benefits of maintaining a diversified deposit base. CBA and others have articulated the view that local, FDIC-insured deposits are not the only funds that are stable and less sensitive to rate (attributes usually attributed to core deposits). Also contributing to a bank's ability to attract and hold stable deposits are its reputation, breadth of services provided to the same customer, and other factors. The Proposal still treats reciprocal deposits held by lower rated banks as brokered deposits. We do not believe this is justified since any concerns about a bank's deposits are adequately accounted for under the Liquidity factor in a bank's CAMELS rating.

Tier 1 Capital

CBA believes that substantially elevating the weighting for Tier 1 leverage ratio could penalize well-capitalized banks for choosing to deploy excess capital by making loans in their communities. Applying a substantial capital charge across the board is to wield a blunt instrument intended to incentivize banks to boost capital for capital's sake without giving sufficient thought to the consequences. Strong capital is important for many reasons, but that doesn't mean more capital is always better. There are costs to holding too much capital both to the bank and the communities that they serve. Here again, a bank's capital is already a major component of any bank's CAMELS rating. CBA urges the FDIC to reconsider this part of the Proposal.

Conclusion

We have argued in this and in our original letter that the four proposed changes to the assessment system each relies on the unnecessary and faulty notion that industry-wide profiles accurately predict individual bank risks. They do not. Each bank is unique and operates in its own market. The prudential banking agencies and banks have invested a tremendous amount of resources into the examination process. The universally understood CAMELS rating is a forward looking assessment of banks' risks and, as such, is a useful basis upon which to assess deposit insurance. We simply ask the FDIC to trust the examination and rating systems it helped create. By more closely aligning assessments with individual banks' risk profile, the FDIC would go far to achieve its stated goals.

Thank you once again for the thoughtful effort in this important endeavor, and for considering our comments.

Sincerely,

Leland Chan
General Counsel