DECISION
OF THE
ASSESSMENT APPEALS COMMITTEE

CASE NO. 2015-01

*** (the "Bank") filed an appeal with the Assessment Appeals Committee ("AAC" or "Committee") of the Federal Deposit Insurance Corporation ("FDIC") by letter dated April 24, 2015. The Bank is appealing a determination issued by the FDIC's Division of Insurance and Research ("DIR") on March 26, 2015. In that decision, DIR denied the Bank's request to change the assessment rate applied to *** (the "Acquired Bank"), a bank with which it had merged on ***, for the quarterly assessment period ending ***. Specifically, the Bank, as successor to [the Acquired Bank], requested that DIR exclude a goodwill impairment loss from the calculation of one of the financial ratios used to determine the assessment rate for the Acquired Bank. With DIR's denial, the Acquired Bank's *** quarter *** assessment was approximately $*** higher than it would have been if the Bank's request had been granted. This appeal followed.

After carefully considering the oral presentations made on July 22, 2015, the written submissions, and the facts of the case, the Committee has determined that the Bank's appeal is denied.

BACKGROUND

On ***, shareholders approved a merger plan involving the Bank, [the Acquired Bank], and their respective holding companies. On ***, the Bank's holding company merged with the holding company of [the Acquired Bank]. This merger resulted in [the Bank's holding company] becoming the surviving bank holding company of two bank subsidiaries, the Bank and [the Acquired Bank]. On ***, [the Acquired Bank] and the Bank merged, which resulted in the Bank becoming the sole bank subsidiary of [the Bank's holding company].

Once shareholders approved the merger plan on ***, [the Acquired Bank] conducted a test for goodwill impairment under U.S. generally accepted accounting principles ("GAAP"). As a result, [the Acquired Bank] recorded a goodwill impairment loss of $*** in its *** Consolidated Reports of Condition and Income ("Call Report"), which contributed to a *** quarter pre-tax loss before extraordinary items and other adjustments. The quarterly loss, in turn, resulted in a negative *** quarter *** value for the net income before taxes to risk-weighted assets ratio ("Income Ratio"), thereby increasing [the Acquired Bank's] assessment for the *** quarter *** by approximately $***. Because the Income Ratio uses the most recent twelve-month period of pre-tax income before extraordinary items and other adjustments, the goodwill impairment loss also affected [the Acquired Bank's] assessment rate for the [following quarter].

The Bank requested review of the assessment rate applied to the Acquired Bank for the *** quarter of *** in a letter dated March 9, 2015, under procedures set forth at 12 C.F.R. § 327.4(c). The Bank contended that a goodwill impairment loss, triggered by shareholder approval of a merger plan, should be considered an extraordinary item and therefore should not be included in the calculation of the Income Ratio, one of the financial ratios used to calculate a small bank's assessment rate. It asserted that the Acquired Bank did not pose additional risk to the deposit insurance fund ("DIF") because the goodwill impairment did not affect its capital or core earnings. On March 26, 2015, DIR denied the Bank's request for review.

By letter dated April 24, 2015, the Bank timely appealed DIR's denial. In the Bank's appeal and oral presentation, the Bank reiterated the arguments set forth in its request for review. In addition, the Bank contended that the Acquired Bank's increase in assessments was the result of technical requirements and accounting practice related to the merger timing and trigger event for testing for goodwill impairment, not a true reflection of risk under the risk-based assessment system.[1]

ANALYSIS

The Bank appeals for relief from application of the calculation of the Income Ratio under the FDIC's assessment regulations. With $*** in assets as of ***, [the Acquired Bank] was classified as a small bank for assessment purposes and, therefore, subject to the small bank pricing method. The small bank pricing method for IDIs with less than $10 billion in total assets in Risk Category I, including [the Acquired Bank], is based on a combination of financial ratios and CAMELS ratings. 12 C.F.R. § 327.9(a)(4). The Income Ratio is one of the financial ratios used to determine assessments for such institutions. The Income Ratio is defined as "income before taxes and extraordinary items and other adjustments for the most recent twelve months divided by risk-weighted assets." 12 C.F.R. Part 327, Subpt. A, App. A. Under FDIC regulations, the FDIC uses data reported on a bank's Call Report to calculate an IDI's assessment rate, including financial ratios like the Income Ratio.

[1] This argument was not presented to DIR in its request for review, and under AAC Guidelines, may be submitted to the Committee if authorized by the AAC Chairperson. In this particular case, based on the facts and circumstances, the AAC Chairperson permitted the Bank's argument.

In considering past requests for relief, the Committee has looked to whether unique circumstances, generally circumstances beyond the bank's control, prevented the bank from complying with the regulations or whether application of the regulations to the facts of the case would be inequitable. *See, e.g.*, Case Nos. 2009-01; 2008-02; 2004-06. In this case, for the reasons set forth below, the Committee does not believe that the Acquired Bank's circumstances warrant the relief sought.

<u>Extraordinary Item</u>

First, the Acquired Bank's goodwill impairment loss is not an "extraordinary item" under FDIC regulations or GAAP, and therefore may not be excluded from the calculation of the Income Ratio. The Bank argues that the goodwill impairment loss is an "extraordinary item," that is, an unusual and infrequent occurrence, because it was the result of a one-time merger between the Acquired Bank's holding company and the Bank's holding company. However, under FDIC regulations, which were subject to notice and comment, and under GAAP, goodwill impairment losses are not considered extraordinary items.

As discussed above, the FDIC uses Call Report data for the financial ratios, including the Income Ratio, that are used to calculate an IDI's assessment rate. In the past, the Committee has previously denied requests in which the institution contests an assessment premium based on accurate Call Report data. *See* AAC Case No. 2010-01 (rejecting bank's argument that its capital evaluation for assessments purposes should be based on Call Report data that initially contained goodwill reporting errors, rather than the amended Call Reports in which the bank reported goodwill correctly; the Committee reasoned that the bank is responsible for accurate reporting); AAC Case No. 2009-01 (denying bank's appeal to upgrade its capital evaluation, which was based on data reported on its Call Report).

In this case, the Acquired Bank's *** Call Report indicated negative income because of the goodwill impairment loss triggered by shareholder approval of the merger plan. The Acquired Bank did not report the goodwill impairment adjustment as an extraordinary item on its Call Report, but rather as part of its pretax income before extraordinary items and other adjustments. This aspect of the small bank pricing method largely follows GAAP, under which goodwill impairment losses are included in the calculation of income before taxes and extraordinary items. Under GAAP, as stated above, goodwill impairment losses are not considered extraordinary.

Further, as compared with other banks, the Acquired Bank's circumstances are not unique in that accounting practice required it to reflect its goodwill impairment loss in its pretax income before extraordinary items. According to DIR, an average of 54 banks per quarter report goodwill impairment losses on their Call Reports and these losses have been included in the calculation of each institution's Income Ratio, respectively. Thus, allowing the Bank to exclude goodwill impairment from the income component of the Income Ratio would provide an adjustment that has not been provided to other IDIs in the same or similar circumstances.

<u>Risk to the Deposit Insurance Fund</u>

Second, under assessment regulations, which were subject to notice and comment rulemaking, supervisory ratings, regulatory capital measures, and certain financial ratios are used together to determine a bank's assessment rate, which is a reflection of risk to the DIF. For banks in Risk

Category I, like the Acquired Bank, financial ratios, which measure several aspects of an institution's financial condition using data from the institution's Call Report, provide specific information on an institution's risk profile. In particular, the Income Ratio measures an institution's earnings for a trailing 12-month period. Goodwill impairment losses are included in the calculation of the Income Ratio because such losses reduce earnings, even though they may not necessarily affect other aspects of the small bank pricing method.

Although the Bank argues that the goodwill impairment did not create additional risk to the DIF because the Acquired Bank was "profitable in quarters before and after the impairment charge" and because "impairment had no impact on [the Acquired Bank's] capital levels," these are not the only relevant factors that may affect a bank's risk to the DIF, as discussed above. In this case, the goodwill impairment ultimately affected the Acquired Bank's assessment rate because it reduced the Acquired Bank's earnings. Thus, even assuming that the Acquired Bank remained profitable or that the goodwill impairment losses did not affect the Acquired Bank's capital, such losses reduced the income component of the Income Ratio, and therefore the Income Ratio itself. The Income Ratio, in conjunction with other financial ratios, supervisory ratings, and regulatory capital measures, were used to calculate the Acquired Bank's assessment rate, which ultimately reflects the Acquired Bank's relative risk to the DIF.

<u>Timing of Merger</u>

Finally, the merger timing and the trigger event for a test for goodwill impairment do not appear to be unique to the Acquired Bank or outside of its control. In its appeal, the Bank argued that the timing of the mergers and test for goodwill impairment were the result of technical accounting practice. The Bank explained that the trigger event for the impairment to goodwill was shareholder approval of the merger plan in the *** quarter of ***. According to the Bank, if the merger of the two banks had taken place in the [same quarter], there would not have been an opportunity for [the Acquired Bank] to report a goodwill impairment loss. This outcome would have occurred because [the Acquired Bank] would not have been required to file a Call Report for [that] quarter *** if it had been merged out of existence on or before [the end of the quarter].

The Bank also argued in its oral presentation that the goodwill impairment loss should be excluded from income for assessment purposes because if the test for impairment occurred on ***, the date of the holding company merger, the goodwill would not have been an impairment to income, but would have been accounted for as a difference between the fair value of [the Acquired Bank] and its carrying amount. Thus, the Bank contended that carrying a goodwill impairment loss for the *** days between ***, the date of shareholder approval of the merger plan, which triggered the test for impairment, and ***, the holding company merger date, is not reflective of the Acquired Bank's riskiness and should not be considered in the calculation of its assessment rate.

Based on regulatory filings and the Bank's statements during oral presentation, however, the timing of the holding company merger and subsequent corporate reorganization of the subsidiary banks was a business decision. The Bank postponed the corporate reorganization of the banks until the *** quarter of *** for operational reasons, relating particularly to human resources and employee benefit issues. While the Acquired Bank may have been obligated under accounting principles to test for goodwill impairment on the date of shareholder approval of the merger plan, the decision to merge at the agreed upon transaction value, the timing of the merger and corporate reorganization, and the date on which shareholders approved the merger plan, were within the control of the transacting institutions.

In past cases, the Committee has not granted relief where a bank's increased assessment rate stems from a decision within the bank's control. For example, in AAC Case No. 2008-02, the Committee denied the bank's appeal to upgrade its capital evaluation, reasoning that timing circumstances related to the bank's public stock offering process, which the bank argued caused its capital ratio to fall, was in the full discretion of the bank and not based on any regulatory constraint. *See also* AAC Case No. 2009-01 (denying bank's appeal to upgrade its capital evaluation, reasoning that there was no unusual delay in approval of the bank's capital plan by the primary federal regulator and that it was the bank's decision to continue to hold government-sponsored enterprise (GSE) securities that were declining in value).

In any event, the Committee notes that given the facts and circumstances before it, an argument may exist that the test for goodwill impairment could have occurred even earlier than the *** shareholder approval date. Under GAAP, goodwill of a reporting unit shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. One of these events is a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit.

According to the *** joint merger announcement, [each company's board of directors negotiated and approved the merger agreement and determined the value of the transaction]. It is possible that this may be evidence of a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit, that is, [the Acquired Bank]. This arguably should have triggered the test for goodwill impairment by [the Acquired Bank] in the [prior] quarter ***, which would have affected [the Acquired Bank's] income, and as a result, its assessments, for an additional quarter prior to the bank holding company merger on ***.

CONCLUSION

In sum, after considering the facts and arguments the Bank presented in its appeal, the Committee finds that the circumstances in this case are neither unique nor inequitable so as to warrant the exclusion of goodwill impairment from the calculation of the Acquired Bank's assessment rate. The Acquired Bank's assessment rate was correctly calculated pursuant to FDIC assessment regulations, using data reported in its Call Report and consistent with GAAP. In particular, the goodwill impairment loss was accurately included in the calculation of the Income Ratio. No basis for granting relief from application of the FDIC's regulations is presented here. Accordingly, for the reasons set forth in this decision, the Bank's appeal is denied.

By direction of the Assessment Appeals Committee, dated September 21, 2015.

Valerie J. Best
Assistant Executive Secretary