September 11, 2015

Sent Via Electronic Delivery: **comments@fdic.gov**

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

RE: FDIC Proposal Related to Small Bank Assessments
RIN 3064-AE37, 12 CFR Part 327

Dear Mr. Feldman:

On behalf of the Oregon Bankers Association (OBA) and its membership of Oregon's state and national banks, we appreciate the opportunity to comment on the above-referenced proposed rules ("Rules"). The Rules would change the deposit insurance assessment system for small insured depository institutions. The OBA raises the following concerns with respect to the proposed Rules.

1. Greater Emphasis Should be Placed on a Bank's CAMELS Rating in the Assessment Formula

CAMELS ratings should be the truest measure of the potential for an individual bank to fail and should therefore be given the highest weight in the FDIC's small bank assessments formula. A mathematical formula based on a few items from a call report cannot gauge the performance and condition of an individual bank, and its potential for failure, better than the findings of bank supervisors conducting regular, on-site examinations. Proper supervision thoroughly considers the business model, history, and unique qualities of each bank individually, and assigns CAMELS ratings corresponding to the degree of risk the bank undertakes. Thus, CAMELS component ratings should be given the highest weight in the FDIC's small bank assessment formula – much higher than as proposed.

2. "Well Capitalized" Banks Should Not be Penalized in the Proposed Assessment Formula

The increased weighting for the tier 1 leverage ratio in the proposed assessment formula, as compared to the current formula, would unfairly penalize many banks that meet the regulatory standards of being "well-capitalized." FDIC assessments should not punish banks for putting their capital to work in making loans if they meet the standard of being "well capitalized." The proposed weighting appears to disproportionately impact certain banks that are "well capitalized" but don't hold significant capital above that standard. An elevated weighting for tier 1 leverage may be fitting for banks that are less than "well-capitalized." However, for banks that obtain "well-capitalized" status, the weighting should be more in line with the current formula.

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3. A Loan Portfolio Distribution Measure is Unlikely to Predict Future Bank Failures

The proposed loan portfolio distribution measure is unlikely to be a useful gauge in forecasting future bank failures. The measure is backward looking in terms of focusing on prior bank failures and does not account for the performance of the vast majority of banks that did not fail. It overlooks the quality of loan underwriting, portfolio management, and risk hedging in a bank. Risk comes less from the loan portfolio itself, but rather from the quality of loans in the portfolio and their management. We have seen significant variance in economic cycles and bank failures that accompanied them. Future bank failures may well be characterized by different loan portfolio mixes than in the last recession.

4. Core Deposits To Total Assets is of Doubtful Value in Forecasting Bank Failures

The proposed new measure of core-deposits-to-total-assets is of doubtful value in forecasting bank failures and should be reconsidered. In the proposed Rules, core deposits would include all domestic office deposits less time deposits over the $250,000 insurance limit and those that classify as brokered deposits (under $250,000). Many time deposits with balances above $250,000 are from long-standing depositors who are less rate sensitive; thus these deposits could be considered "core" but are not. Further, much of what the FDIC considers to be brokered deposits should not be classified as such. This issue has been exacerbated by the FDIC's recent FIL-2-2015, under which even stable deposits resulting from bank-affiliate relationships or obtained by contract employees could be considered brokered. "Reciprocal deposits," such as those in the CDARS program, (see below) would also count as brokered deposits under the proposal, raising further doubt as to the ability of the new core-deposits-to-total-assets measure to accurately forecast failure.

It is worth noting that the proposed core deposits factor also overlooks the risk-mitigation effects of diversification of funding sources. While core deposits bring franchise value for a bank, funding diversification can lower illiquidity risk.

5. Reciprocal Deposits Should Be Excluded From Brokered Deposits

In Oregon, at least 18 FDIC-insured institutions offer reciprocal deposits to their customers. These banks rely on reciprocal deposits as a stable source of cost-effective funding. Considerable concern has been raised regarding how reciprocal deposits would be treated under the proposed Rules. The FDIC should continue to treat reciprocal deposits as it does under the current system, which is to exclude reciprocal deposits from the category of brokered deposits for assessment purposes. If the proposed Rules were to go into effect, reciprocal deposits would be treated as brokered deposits and banks would have to pay premiums higher than would otherwise be the case.

Just as with the current system, the new system is required by law to be risk-based. In other words, premium assessments for each individual institution are supposed to reflect the specific and measurable risks of loss to the Deposit Insurance Fund (DIF) posed by the bank's assets and liabilities. The key question is whether reciprocal deposits do in fact increase an institution's risk profile. Data that show that reciprocal deposits increase the risk of loss to the DIF does not exist. On the contrary, the studies that have been conducted on the issue conclude that reciprocal deposits have either no effect or a salutary effect on the probability of bank failure – and for good reasons.

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Reciprocal deposits share three characteristics that define core deposits. First, reciprocal deposits are overwhelmingly gathered within a bank's geographic footprint through established customer relationships. Second, they have a high reinvestment rate. Third, banks set their own interest rates on reciprocal deposits, rates that reflect a bank's funding needs and local market.

Because reciprocal deposits are built on established local customer relationships and are insulated from rate volatility, they are the functional equivalent of a core deposit and do not increase an institution's risk profile beyond what any core deposit would.

The stated purpose of the proposal is to more accurately match the perceived risk to the DIF of certain banking practices with a premium that better reflects that perceived risk. By lumping reciprocal deposits in with traditional brokered deposits, the proposal would discourage bankers from holding reciprocal deposits. The FDIC should exempt reciprocal deposits from the definition of brokered deposits in its proposed assessment rule.

6. <u>The Proposal Does Not Adequately Account for a Bank's Natural and Healthy Growth</u>

The proposed one-year asset growth provision fails to adequately take into account the normal and healthy growth of a bank and is of questionable value in terms of forecasting the potential for bank failures. Tying risk to asset growth is not appropriate over time because a sound bank grows with its local market. Robust growth in a strong business environment does not signal weakness any more than slower growth in a weak marketplace signals strength. Relatively rapid but sound growth can result when a local competitor fails or sells out to another bank, the bank hires a strong new loan officer, or a large deposit comes in and the funds are placed in high-quality securities. A fixed measure on asset growth would mean that any growth raises assessments. It also should be noted that faster growth will naturally trigger closer supervisory scrutiny.

Conclusion

Some of the proposed changes to the assessment formula will not reliably identify and measure the risk of failure among America's smaller local banks. It is highly questionable whether the proposal would outperform the current calculation for deposit insurance assessment. CAMELS ratings should be the truest measure of an individual bank's potential to fail and should be given the highest weight in the FDIC's small bank assessment formula. OBA encourages the FDIC to reconsider its proposed new assessment formula.

Thank you for the opportunity to comment on the proposed Rules. If you have any questions, please feel free to contact me.

Very best regards,

Linda M Navarro

Linda Navarro
President & CEO
Oregon Bankers Association &
Independent Community Banks of Oregon

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