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Housing Finance & Regulatory Affairs

David L. Ledford
Executive Vice President

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

Attention: RIN 3064-AE37

Re: *Assessments*
Notice of Proposed Rulemaking and
Request for Comment

Submitted via Electronic Delivery

Dear Mr. Feldman:

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to respond to the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking and Request for Comment on Assessments. NAHB has reviewed the proposed revisions to the deposit insurance assessment system for established small insured depository institutions[1] and requests that FDIC consider some adjustments to the proposal.

NAHB is a Washington, DC-based trade association representing more than 140,000 members involved in all aspects of single family and multifamily residential construction. The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on an efficiently operating housing finance system that offers home buyers access to affordable mortgage financing and home builders access to acquisition, development and construction (AD&C) financing at reasonable costs through all business conditions. NAHB's members rely to a significant degree on their community banks for their AD&C financing needs.

Background

Between January 2008 and December 2011, 414 insured U.S. banks failed. Of these, 85 percent (353) were banking institutions with less than $1 billion in assets.[2]

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[1] Established small insured depository institutions generally are considered to be those with less than $10 billion in assets that have been federally insured for at least five years.

[2] GAO Testimony Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 13, 2013. Statement of Lawrance L. Evans, Jr., Director, Financial Markets and Community Investment

The considerable number of failures led to a study by the Government Accounting Office (GAO) in 2013 to determine the contributing factors and consequences of these failures. The study focused on 10 states with 10 or more failures between 2008 and 2011. GAO determined the failures of small and medium-sized banks to be associated largely with high concentrations of commercial real estate (CRE) loans, in particular, AD&C loans secured by real estate to finance land development and construction. However, a study by FDIC's Inspector General found that other banks with high AD&C concentrations were successful in keeping their banks financially sound. It was determined these banks benefited from "strong management, sound credit administration and underwriting practices, and adequate capital".[3]

The FDIC's proposal to adjust the model underlying the small bank deposit insurance assessment system is intended to improve and update the model based on data resulting from the numerous small bank failures during the recent financial crisis. FDIC believes the data suggest it should calibrate deposit insurance assessments to a bank's risk profile to ensure that banks taking on greater risks will pay higher premiums and eliminate cross-subsidization of high-risk banks by low-risk banks. Using the data from the significant number of recent small bank failures, the proposed deposit insurance assessment system model is intended to more accurately reflect the probability of a bank failure within three years than the model currently in place, which uses a proxy for bank failure, i.e. the probability of a bank being downgraded in its CAMELS (Capital, Assets, Management, Earnings, Liquidity, and Sensitivity) rating. The proxy was used previously because there had not been enough recent bank failures to incorporate into the development of the earlier model.

The FDIC proposes to use a "financial ratios method" to calculate the deposit insurance assessment on all established small banks – eliminating the previous four risk categories, which allowed the financial ratios method to be used only for banks categorized as Risk Category I. The financial ratios method calculates ratios of a bank's various financial data or components of a bank's portfolio that are considered statistically significant in predicting a bank's probability of failure within three years. FIDC's proposal adds three new measures that must be used in the calculation of the deposit insurance assessment. Of concern to NAHB is the Loan Mix Index.

The loan mix index is a measure of the extent to which a bank's total assets include higher-risk categories of loans. Each category of loan in a bank's loan portfolio is divided by the bank's total assets to determine the percentage of the bank's assets represented by that category of loan. Each percentage is then multiplied by that category of loan's historical weighted average industrywide charge-off rate. The totals are added together to determine the loan mix index value for that bank to be included in the calculation of the deposit insurance assessment.

For each loan category, the weighted average charge-off rate weights each industry-wide charge-off rate for each year by the number of bank failures in that year. Thus, charge-off rates from 2009 through 2014, during the recent banking crisis, have a much greater influence on the weighted average charge-off rate than charge-off rates from the years before the crisis, when

[3] FDIC Office of the Inspector General, Office of Audits and Evaluations, *Acquisition, Development and Construction Loan Concentration Study*, no.EVAL-13-001 (October 2012).

few failures occurred. Construction & Development (C&D)[4] loans have a significantly higher weighted charge-off rate than other categories of loans in the loan mix index due to their poor performance during the recent banking crisis. This will create a large loan mix index for small established banks with significant portfolios of C&D loans and cause their deposit insurance assessment rates to increase.

NAHB Comments

Charging higher deposit insurance assessment rates to banks that have assumed more risk in their portfolios may have merit, however, the FDIC's proposal assumes the nationwide performance of C&D loans in the past will continue to present an increased, and equal, level of risk to all small established banks in the future. The proposal does not recognize well-run banks with substantial capital and rigorous risk-management practices nor does it acknowledge that lessons learned during the crisis could mitigate future charge-offs. NAHB believes this approach will discourage banks from making AD&C loans across the board rather than encouraging them to make AD&C loans in a prudent manner.

NAHB believes using a weighted-average charge-off rate, which gives more weight to the years when the market was experiencing an unprecedented level of financial stress, is not an appropriate measure of future risk. In addition, applying a nationwide charge-off rate does not recognize the significant variations in geographic economic factors that impact the performance of an individual bank's portfolio.

NAHB is concerned that the threat of increased deposit insurance assessments due to engaging in AD&C lending would inhibit the nascent recovery in AD&C financing by small community banks. Community banks considering AD&C lending as a new opportunity or contemplating a return to AD&C lending after leaving the market may determine it will be too expensive in light of FDIC's proposal. The proposed rule would penalize banks for future AD&C lending based on past industry events over which many had no control or involvement, i.e. the severe financial crisis and the risky past business practices of some banks engaged in AD&C lending.

NAHB Recommendations

NAHB believes charge-off rates applied to a bank's C&D portfolio for purposes of calculating the loan mix index should be based on an individual bank's actual charge-off rate for its C&D portfolio rather than FDIC's proposed industrywide weighted average. This would incent banks to make good loans and implement sound risk management practices since the performance of their loans would have a direct impact on their deposit insurance assessments. At the very least, charge-off rates should be calculated on a regional basis rather than on a nationwide basis in recognition of the significant impact of local economic factors on area businesses.

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[4] C&D loans include 1-4 family residential construction loans, other construction loans, and all land development and other land loans.

Conclusion

Thank you for your consideration of NAHB's comments. If you have questions, please contact Becky Froass, Director, Financial Institutions and Capital Markets, at 202-266-8529 or rfroass@nahb.org.

Sincerely,

David L. Ledford