HOWARD BANK

6011 University Blvd., Suite 370
Ellicott City, Maryland 21043
P 410.750.0020 F 410.750.8588
www.howardbank.com

Mary Ann Scully
Chief Executive Officer
mascully@howardbank.com

September 16, 2015

FEDERAL DEPOSIT INSURANCE CORPORATION
Mr. Robert Feldman
Executive Secretary
550 17TH St., NW
WASHINGTON DC 20429

Mr. Feldman,

Thank you for the opportunity to comment on the recently proposed changes in the deposit assessment calculations.

I attach letters from the American Bankers Association and the Independent Community Bankers Association with which you are undoubtedly familiar. I am very much in support of most of the positions taken here but, as a member of the FDIC community advisory committee, wanted to go on record in writing about certain particular concerns to support those raised verbally by me at the last advisory meeting. I am focused particularly on the newly added loan mix calculations and am focused on those both from an equity perspective- equity in the sense of fairness as well as equity/capital allocation in our country.

The unintended consequences of impugning certain business models - one, for example, devoted to helping small and medium sized businesses and their owners in their commercial as well as real estate activities - will ultimately affect the long term health and, therefore, viability of banks that have chosen that model. Our charge off experience for CRE loans in particular has been very different than the historical peer results which would be utilized to determine our assessments. Our CAMELS ratings would demonstrate that; however in the proposed model, those CAMEL ratings would simply be diluted by the loan mix assessments. That seems patently unfair-inequitable.

Community banks- especially those serving growing markets and thus expected to grow themselves- are fighting for not just customers , market share, employees and relevance but for investors. A higher deposit assessment says to an investor- present or existing- that that bank is less efficient and will generate lower returns than under today's formulae. Growth of portfolios seems to be viewed not just as a risk factor- deserving of higher scrutiny and normally receiving that scrutiny from their own management team- but as an evil to be rooted out given the level of penalty associated with both growth and mix in this proposal. If a bank is deemed prudent by safety and soundness examiners, should it then be penalized no matter how well they have executed on their chosen business model?

Some Basel 3 proposals fortunately fell by the roadside when the unintended resource allocation consequences of favoring one chosen business model over another was better understood. Any focus on models vs. business results or of strategy vs. execution will be consequential in the allocation of capital- both equity capital allocated to companies and debt capital allocated by some of those companies.

Therefore, I encourage you to reconsider the premise or at least the magnitude of these changes on the short term allocation of capital to a commercially focused bank like mine as well as the long term implications for the allocation of credit by banks like mine forced to reconsider their focus on the SME market. Please place a different lens on the practical repercussions of capital allocation and credit access as well as credit costs.

Once again, I always appreciate the FDIC receptivity to comments as well as the good intentions behind all proposals.

Sincerely

Mary Ann Scully

Mary Ann Scully
Chairman and CEO
Howard Bancorp
Howard Bank

September 11, 2015

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

Re: Assessments: RIN 3064-AE37

Dear Mr. Feldman:

The FDIC is proposing to revise the method its uses to calculate deposit insurance assessments for insured depository institutions with total assets of less than $10 billion that have been federally insured for at least five years ("small banks"). The new method would revise the financial ratios that are currently used to calculate assessments and would eliminate the current risk categories. The revisions are intended to better capture the risk that an established small bank poses to the Deposit Insurance Fund. The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the FDIC's proposal.

ICBA supports a risk-based deposit insurance assessment system and appreciates the FDIC's efforts to meet its statutory mandate by periodically introducing improvements in the deposit insurance assessment system's ability to differentiate for risk. Community bankers who know that their assessments would go down if the proposal was adopted are generally supportive of the proposal. However, there is a vocal group of community bankers who have concerns about the proposal's unintended consequences and who question whether the changes will more accurately reflect the risk that small banks pose to the Deposit Insurance Fund.

1 The Independent Community Bankers of America®, the nation's voice for more than 6,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.

With 52,000 locations nationwide, community banks employ 700,000 Americans, hold $3.6 trillion in assets, $2.9 trillion in deposits, and $2.4 trillion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

Current Assessment Method

Under the current assessment rules, a small bank is assigned to one of four risk categories based on capital levels and supervisory ratings. Established small banks that are well capitalized and well managed (i.e. the majority of community banks) are assigned to Risk Category I. Initial base assessment rates for banks in Risk Category I are determined by the financial ratios method, which combines supervisory CAMELS component ratings with six financial ratios. These six financial ratios include (1) tier 1 leverage ratio, (2) net income before taxes/risk weighted assets, (3) nonperforming assets/gross assets, (4) adjusted brokered deposit ratio, (5) net loan charge-offs/gross assets, and (6) loans past due 30-89 days/gross assets. The current assessment schedule is as follows:

Total Base Assessment Rates*
(In basis points per annum)

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV	Large & Highly Complex Institutions
Initial Assessment Rate	5 – 9	14	23	35	5 – 35
Unsecured Debt Adjustment	-4.5 to 0	-5 to 0	-5 to 0	-5 to 0	-5 to 0
Brokered Deposit Adjustment	N/A	0 to 10	0 to 10	0 to 10	0 to 10
Total Assessment Rate	2.5 to 9	9 to 24	18 to 33	30 to 45	2.5 to 45

*Total base assessment rates do not include the DIDA.

FDIC Proposal

Under the FDIC proposal, risk categories for small banks would be eliminated and the financial measures used in the financial ratios method would be revised consistent with a new statistical model. This new statistical model would estimate the probability of failure of a small bank over three years. The financial ratios method would be used to determine assessment rates for all banks not just those in Risk Category I.

Two of the proposed measures—the weighted average CAMELS component rating and the tier 1 leverage rate—would stay the same. The proposed net income before taxes/total asset measure would be identical to the current measure, except that the denominator would be risk-weighted assets rather than total assets. Nonperforming assets/gross assets would be replaced by nonperforming loans and leases/gross assets. In the proposal, other real estate owned/gross assets would be a measure separate from nonperforming loans.

The other proposed measures—core deposit/total assets, one-year asset growth, and the loan mix index—would be new. The loan mix index would be a measure of the extent to which a bank's total assets include higher-risk categories of loans such as construction and development loans or commercial and industrial loans. The table below shows the assessment rate schedule established for small banks that, under the proposal, would go into effect when the reserve ratio reaches 1.15 percent:

Initial and Total Base Assessment Rates* (In basis points per annum)
[Once the DIF reserve ratio reaches 1.15 percent]

	Established Small Banks			Large & Highly Complex Institutions*
	CAMELS Composite			
	1 or 2	3	4 or 5	
Initial Base Assessment Rate	3 to 16	6 to 30	16 to 30	3 to 30
Unsecured Debt Adjustment	-5 to 0	-5 to 0	-5 to 0	-5 to 0
Brokered Deposit Adjustment	0 to 10	0 to 10	0 to 10	0 to 10
Total Base Assessment Rate	1.5 to 26	3 to 40	11 to 40	1.5 to 40

*Total base assessment rates in the table do not include the DIDA.

ICBA's General Comments and Concerns

While individual bank assessments would differ, the FDIC states that the proposal would be revenue neutral for established small banks in the aggregate. Based on a comparison of assessment rates of small banks as of the end of 2014 with assessment rates under the proposal, the FDIC notes that 92.5 percent of established small banks would have rate decreases and only 7.5 percent of small banks would have rate increases.

ICBA surveyed its leadership bankers and asked that they use the FDIC's assessment calculator to determine what the impact the proposal would have on their bank's assessment assuming the proposal was adopted. The survey results generally confirmed the FDIC's research noted above. Of the 64 responses, 53, or 78 percent, indicated that their assessments would go down under the proposal and 11, or about 16 percent, indicated that the assessments would stay the same. Only 4 respondents (i.e. 6 percent) indicated that the rates would be higher. Furthermore, 75 percent of the respondents generally thought the proposal would adequately capture the risk that an established small bank poses to the Deposit Insurance Fund.

However, there was a number of community bankers that still expressed concerns about the proposal particularly since they realized that part of the rate decrease was due to the across the board rate decrease scheduled once the DIF reserve ratio reaches 1.15 percent. Several bankers expressed concerns that the proposal was too "backward looking" and would not accurately reflect the source of future failures. As one banker said:

"While the model may reflect historic risk, it is doubtful that it can predict future risk. Too many additional and critical management factors come into play, including learning from the past."

Some bankers said that basing assessments on a statistical model reminded them of Basel III and the regulators' attempt to calculate risk weights based on past experience of an asset's riskiness. Bankers pointed out that past experience can often be a poor indicator of what will happen in the future and that the things that "went wrong during the past economic cycle are not likely to be the same during the next downturn." ICBA has expressed strong concerns to the regulators about the use of modeling to determine capital requirements or to determine "expected losses" in connection with a bank's allowance for loan and lease losses (ALLL).

Several bankers were particularly concerned with the loan mix index and the broad assumptions that the model makes about the riskiness of certain types of loans. As one banker put it:

"*This assessment matrix will arbitrarily place one bank's loan type (say for us, agriculture) at the same risk level as another's or at some arbitrary number that regulators select. Without using exam data for the source but only loan type, I think this will make the assessment reactionary and will essentially deem all loans of a certain type equal despite underwriting differences or different classes of same loan types (an example would be crop loans vs. livestock loans where one currently is experiencing an economic downturn and the other an upturn yet both would be lumped together as agricultural loans.)*"

ICBA is concerned that the proposal essentially tries to pick winners and losers in the financial services industry based on historical data that will invariably change over time. While the proposal is a legitimate effort to reflect the risk posed by small banks, if adopted, it will have the consequence of making certain types of loans and certain types of deposits less desirable than others based on general historical assumptions that may be flawed. For instance, although construction and development lending may have been instrumental in the failures of community banks during the recent crisis, in the future it may turn out to be a very high quality asset with relatively low past dues and low charge-off rates particularly in the hands of those community banks that understand how to manage that risk.

It will, therefore, be important for the FDIC to continuously test the assumptions behind the statistical model to verify that it accurately reflects recent failure and charge-off data. With regard to its statistical model, the FDIC states on page 39 of the proposal that:

"The statistical analysis used bank financial data and CAMELS ratings from 1985 through 2011, failure data from 1986 through 2014 and loan charge-off data from 2001 through 2014. The FDIC proposes to retain the flexibility to update the statistical model from time to time using financial, failure and charge-off data from later years and publish a new loan mix index, uniform amount and pricing multipliers based on the updated model without further notice-and-comment rulemaking."

ICBA urges that before the FDIC updates its statistical model, the agency should formally propose the changes in accordance with notice-and-comment rulemaking.

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org

This will give bankers a chance to review and comment on both the FDIC's statistical model and its assumptions including its failure and charge-off data. Furthermore, the review process should consider the impact of the proposal on community banks and any unintended consequences.

Specific Comments about the Proposal

The Loan Mix Index. The loan mix index will play an integral part in the proposed financial ratios method used to assess community banks. The loan mix index is designed to measure the extent to which a bank's total assets include higher-risk categories of loans. Each loan category in a bank's portfolio (i.e., construction and development loans, agricultural loans, etc.) is divided by the bank's total assets to determine the percentage of the bank's assets represented by that loan category. Each percentage is then multiplied by that category's historical weighted average industry-wide charge-off rate. (For instance, the weighted charge-off rate for construction and development loans is 4.5 percent and for commercial and industrial loans is 1.6 percent. This is based on charge-off data from 2001 through 2014.) The products are then summed to determine the loan mix index value for that bank.

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

ICBA recommends the charge-off rates be yearly averages over a period of time (i.e., average charge-off rates from 2001-2014) and not be weighted yearly based on the number of bank failures in that year. Furthermore, broad based charge off rates do not reflect experience from different regions of the country, nor account for a bank's management of the risk, or its underwriting criteria. The recession affected construction and C&I loan charge-off ratios much more severely than their long term historical charge-off ratios, and different banks and regions of the country were much more severely affected than others.

The high charge-off rates in the construction loan and C&I segments will create a very high loan mix index and therefore a higher deposit insurance assessment for those banks that participate in that type of lending activity. **The proposed rule, if adopted, will force community banks to reduce lending activity in the construction and C&I segments, both of which are critical to a strong and growing economy.**

Core Deposits to Total Assets. Another important part of the FDIC's proposed new financial ratios method is the ratio of core deposits over total assets. Many community bankers are concerned that "core deposit" is too narrowly defined in the proposal, and that, more specifically, **the FDIC should consider reciprocal deposits as part of "core deposits."**

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org

Under the current system, reciprocal deposits are subtracted from a bank's brokered deposits to determine an adjusted brokered deposit ratio. The FDIC adopted this approach in 2009 after recognizing that reciprocal deposits "may be a more stable source of funding for healthy banks" and concluding that the assessment system should not treat reciprocal deposits as unfavorably as other brokered deposits.

Nevertheless, the proposed new model, which eliminates the adjusted brokered deposit ratio, adds a new ratio of core deposits to total assets that treats reciprocal deposits as *non*-core. The effect of this treatment would be to penalize those banks with reciprocal deposits.

ICBA recommends that, consistent with the recognized characteristics of reciprocal deposits and the current adjusted brokered deposit ratio, the ratio of core deposits to total assets in the new model should be adjusted by including in the numerator, along with core deposits, reciprocal deposits as defined at 12 C.F.R. § 327.8(q). Such an adjustment would preserve all the benefits that the FDIC attributes to the new model, but would do so without penalizing community banks that have reciprocal deposits.

As currently drafted, by imposing a penalty on reciprocal deposits and folding the deposits in with traditional brokered deposits and other wholesale funding, many community banks believe the proposal discriminates against them and impairs their ability to compete with large banks. The proposal does not state a justification for this treatment. For instance, the FDIC does not argue that reciprocal deposits are as risky as traditional brokered deposits, nor does it present data that reciprocal deposits increase the risk of loss to the Deposit Insurance Fund**. ICBA therefore recommends retaining the current system's exclusion of reciprocal deposits from the definition of "brokered" for assessment purposes.**

One-Year Asset Growth Measure. The one-year asset growth measure is a new measure added to the financial ratios method and will tend to raise assessment rates for small banks that grow significantly over a year other than through merger or by acquiring failed banks. ICBA is concerned that this measure may penalize those banks that are growing fast solely because of economic factors and that are quite able to manage the growth. Those banks should not be penalized just because the economic growth in their area has caused them to grow rapidly. **ICBA recommends that the FDIC consider mitigating factors when calculating this measure. For instance, the one-year asset growth rate could be reduced by a percentage—say 10% or 20%--if it appears to be due to a very strong local economy with sustainable growth.** This way, the measure will more accurately determine the risk to the DIF from rapidly growing community banks.

Federal Home Loan Bank (FHLBank) Participation. Community bankers are also concerned about including anything in the proposal that would impair the ability of community banks to be active participants in the FHLBank System. FHLBanks demonstrated their reliability as a liquidity provider during the recent crisis notwithstanding tremendous market dysfunction and extreme stress. FHLBank advances play a crucial role in helping to strengthen the banking system during periods of stability as well as crisis. Advances serve an instrumental role in helping banks with their liquidity needs, and the variety of advance products, programs and terms enable member banks to manage interest rate risk. In a future rising interest rate environment, FHLBank advances should continue to play an important role in helping banks control their asset liability and liquidity exposures.

FHLB members use advances to fund new originations and existing portfolios of mortgages, to purchase mortgage-backed securities, and to manage the substantial interest rate risk associated with holding mortgages in portfolio. By enabling members to effectively manage their balance sheets, FHLBank advances help members lower their risk as well as the cost of extending credit to American consumers. FHLBank advances can also be a source of funding to smaller lenders that may not have access to all of the funding options available to larger financial institutions. The proposal should not unduly discourage community banks from using FHLBank advances.

Conclusion

ICBA supports the FDIC's efforts to improve the risk-based deposit insurance system to more accurately reflect risk. ICBA's recent survey of its leadership bankers confirmed that rates generally would go down for community banks if the proposal was adopted. However, bankers expressed several general concerns about the proposal. Some bankers believe that it is backward looking and will not accurately predict future failures. They are also concerned that it is based completely on a statistical model whose assumptions might turn out to be inaccurate.

ICBA is generally concerned that the proposal picks winners and losers in the financial services industry based on historical data that will invariably change over time. It will, therefore, be important for the FDIC to continuously test the assumptions behind its statistical model to verify that it accurately reflects recent failure and charge-off data. Before the FDIC significantly updates its statistical model, the agency should formally propose the changes in accordance with notice-and-comment rulemaking. This will give bankers a chance to review and comment on both the FDIC's statistical model and its assumptions as well as its impact on community banks.

ICBA has specific comments about the loan mix index, the ratio of core deposits to total assets, and the one-year asset growth measure. With regard to the loan mix index, we recommend that the charge-off rates not be a weighted average and instead be based on an average over a period of years. Otherwise, the proposed rule will force community banks to reduce lending activity in the construction and C&I segments, both of which are critical to a strong and growing economy.

With respect to the ratio of core deposits to total assets measure, ICBA recommends that reciprocal deposits as defined at 12 C.F.R. § 327.8(q) be included as "core deposits" or as part of the numerator in that ratio. Such an adjustment would avoid penalizing community banks that have reciprocal deposits.

WASHINGTON, DC ▪ SAUK CENTRE, MN ▪ NEWPORT BEACH, CA ▪ TAMPA, FL ▪ MEMPHIS, TN

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org

With respect to the one-year asset growth measure, ICBA is concerned that this measure may penalize those banks that are growing fast solely because of economic factors. We suggest the FDIC consider mitigating factors such as local economic growth to reduce or offset the impact of the measure. And finally, ICBA also urges the FDIC not to include anything in the proposal that would impair the ability of community banks from being active participants in the FHLBank System.

ICBA appreciates the opportunity to comment on the FDIC's proposal to revise the method its uses to calculate deposit insurance assessments for insured depository institutions with total assets of less than $10 billion. If you have any questions or would like additional information, please do not hesitate to contact me by email at Chris.Cole@icba.org.

Sincerely,
/c/Christopher Cole

Christopher Cole
Executive Vice President and Senior Regulatory Counsel