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MID-SIZE BANK COALITION OF AMERICA

January 5, 2016

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

Re: **RIN 3064—AE40: Assessment Surcharges for Insured Depository Institutions with $10 Billion or More in Consolidated Assets**

Dear Mr. Feldman:

On behalf of the Mid-Size Bank Coalition of America ("MBCA"), I write to provide the MBCA's comments on the above-referenced notice of proposed rulemaking (the "Proposal") of the Federal Deposit Insurance Corporation ("FDIC") published in the *Federal Register* on November 6, 2015.[1]

I. Background on the MBCA

The MBCA is a non-partisan economic and financial policy alliance comprising mid-size banks with consolidated assets of less than $50 billion doing business in the United States. The MBCA was founded in 2010 for the purpose of informing legislators, regulators, and other policymakers of the perspectives of mid-size banks regarding financial regulatory matters. The MBCA's 59 member banks, which have combined assets of approximately $985 billion, provide services to consumers through more than 8,500 branches in 44 states, the District of Columbia, and three U.S. territories. Together, MBCA member banks maintain nearly $775 billion in deposits and approximately $640 billion in total loans, while employing roughly 155,000 individuals across the United States.

The MBCA has submitted comments previously to the FDIC on the funding and maintenance of the FDIC's Deposit Insurance Fund ("DIF"),

[1] Assessments, 80 Fed. Reg. 68,780 (Nov. 6, 2015).

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and we appreciate this opportunity to provide comments on the Proposal. As noted in our prior submissions, we respect the ongoing efforts of the FDIC and its staff in restoring the DIF to ensure that the FDIC is able to meet its obligations with respect to bank failures and insured deposits. We also understand that the mandates imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") regarding the strengthening of the DIF present certain challenges.[2] However, for the reasons discussed below, we believe the Proposal as presently drafted fails to adequately consider the interests of the full spectrum of depository institutions responsible for funding the DIF and we encourage the FDIC to consider the improvements and alternatives to the Proposal discussed below.

II. Summary of the Proposal

Pursuant to Section 334 of the Dodd-Frank Act, the Proposal seeks to (i) increase the minimum DIF reserve ratio from 1.15 percent to 1.35 percent by September 30, 2020 and (ii) offset the effect of the anticipated increase in the DIF reserve ratio on depository institutions referred to in the Proposal as "small banks" — *i.e.*, those with total assets of less than $10 billion.[3]

To meet these goals, the FDIC proposes an annual surcharge of 4.5 basis points (or 1.125 basis points per quarter) on the quarterly assessments of mid-size and large banks, beginning the quarter after the DIF reserve ratio first reaches or exceeds 1.15 percent and continuing until the earlier of (i) the quarter in which the DIF reserve ratio first reaches or exceeds 1.35 percent or (ii) December 31, 2018. Under the Proposal, if the DIF reserve ratio does not reach 1.35 percent by December 31, 2018, a shortfall assessment would be imposed on March 31, 2019 and collected on June 30, 2019. Each mid-size or large bank's share of the shortfall assessment would be proportional to the average of its surcharge assessment bases during the surcharge period.[4]

To satisfy Section 334(e) of the Dodd-Frank Act, the Proposal would provide small banks with a share of an aggregate assessment credit to offset

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2 *See* Dodd-Frank Act § 334, 12 U.S.C. § 1817.

3 *See* Proposal at 68,782 (noting that the term "small bank" is synonymous with the term "small institution" as defined under the FDIC's regulations, 12 C.F.R. § 327.8(e)). As discussed further below, we refer throughout this submission to banks with total assets of between $10 billion and $50 billion as "mid-size banks," and banks with total assets of $50 billion or greater as "large banks."

4 We understand that for purposes of applying an assessment surcharge, a mid-size or large bank's surcharge assessment base would equal its regular quarterly assessment base with two adjustments. First, the regular assessment bases of any affiliated small banks would be added to the bank's assessment base. Second, $10 billion would be deducted from the resulting amount. For organizations with more than one large or mid-size bank, the assessment bases of affiliated small banks and the $10 billion deduction would be apportioned to each large and mid-size bank based on its regular assessment base.

the effect of contributing to the above-described increase in the DIF reserve ratio. To determine the amount of the aggregate assessment credit, the FDIC proposes to calculate 0.2 percent of estimated insured deposits on the date the DIF reserve ratio first reaches 1.35 percent and subtract surcharges paid during the surcharge period. This amount would then be multiplied by small banks' portion of all regular assessments paid by large, mid-size, and small banks during the surcharge period. Individual credits would be allocated in amounts proportional to the average of a small bank's regular assessment bases during the surcharge period.

III. MBCA Views Regarding the Proposal

Notwithstanding the MBCA's general support of the FDIC's efforts to further stabilize the DIF, we believe that the Proposal places a disproportionate amount of responsibility on mid-size banks for subsidizing the cost of bank failures through funding of the DIF. Accordingly, the MBCA encourages the FDIC to reconsider the scope and design of the Proposal.

A. Mid-Size Banks Should Not Be Subject to the Assessment Surcharge

The assessment surcharges imposed under the Proposal would apply to "large"[5] and "highly complex"[6] banks as defined under the FDIC's regulations. However, there is a substantial difference between "large" banks — which under the Proposal includes mid-size banks — and the truly large, money-center banks that present the highest degree of risk. This difference is measured not only in terms of the amount of a bank's insured deposits, but with respect to the nature and value of its overall balance sheet, the extent of its banking activities, and its corporate structure. The FDIC has in recent years recognized the shortcomings of a principally size-based deposit insurance assessment system through the implementation of its DIF Restoration Plan, and in particular, through its adoption of a more

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5 In general, a "large institution" is defined under the FDIC's regulations as a depository institution with $10 billion or more in assets. *See* 12 C.F.R. § 327.8(g).

6 A "highly complex institution" is defined as:

> An insured depository institution (excluding a credit card bank) that has had $50 billion or more in total assets for at least four consecutive quarters that is controlled by a U.S. parent holding company that has had $500 billion or more in total assets for four consecutive quarters, or controlled by one or more intermediate U.S. parent holding companies that are controlled by a U.S. holding company that has had $500 billion or more in assets for four consecutive quarters; or (ii) [a] processing bank or trust company.

Id. § 327.8(h).

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sophisticated, risk-based approach to deposit insurance assessments.[7] Nevertheless, for purposes of imposing assessment *surcharges*, the FDIC reverts in its Proposal to relying only on the size of an institution in terms of its total assets.

We believe this to be inconsistent with the FDIC's established approach to restoring the DIF and one that will create significant burdens for mid-size banks. We therefore encourage the FDIC to impose any assessment surcharge on "highly complex" banks only.

The Proposal notes, at the time of publication, there were 108 banks with total assets of $10 billion or more.[8] However, the vast majority of bank assets are held by an even smaller number of the largest and most complex banks and banking organizations. FDIC data indicate that of the $14.76 trillion in total assets held by commercial banks, approximately 71 percent are held by the fewer than 25 banks with $100 billion or more in total consolidated assets.[9] The supervisory framework employed by the FDIC and the other banking agencies generally accounts for the risks presented by this dynamic. For example, bank holding companies with $50 billion or more in total consolidated assets are subject to a supervisor-driven Comprehensive Capital Analysis and Review ("CCAR"), while banks with $10 billion or more in total assets must conduct a self-administered "stress test" pursuant to applicable regulations (Dodd-Frank Act Stress Testing or "DFAST").[10] Although the resource burdens of the DFAST process are not insignificant, the CCAR is more intensive because of the complexity and risk profiles of CCAR-covered banking organizations.

Nevertheless, the proposed assessment surcharges would apply equally to mid-size and large banks alike, and would impose substantial incremental costs on mid-size banks, particularly those with $25 billion or less in assets. These costs would depress earnings, limit banks' ability to pay dividends throughout the assessment surcharge period, and, ultimately, impede growth. Members of the House-Senate Conference Committee responsible for debating final passage of the Dodd-Frank Act expressed exactly these

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7 *See generally* Assessments, Large Bank Pricing, 76 Fed. Reg. 10,672 (Feb. 25, 2011) ("Risk-Based Assessment Rule").

8 *See* Proposal at 68,786.

9 FDIC, Key Statistics (data as of Sept. 30, 2015), https://www5.fdic.gov/idasp/KeyStatistics.asp?tdate=12/23/2015&pDate=12/22/2015 (last visited Dec. 30, 2015); *see also* American Bankers Association, *Largest 50 Institutions By Consolidated Banking Assets* (Sept. 2015), *available at* https://www.aba.com/Tools/Research/Documents/LargestInstitutionsbyAssetSize.pdf.

10 *See*, *e.g.*, 12 C.F.R. pt. 325, Subpart C.

concerns when considering whether to grant the FDIC the authority to impose assessment surcharges:

> Over the life of [the Dodd-Frank Act] — maybe you're not affected by it today, but you could be if you grow and do the right thing — your institution grows to $10 billion and . . . you're going to be affected by it . . . . So more and more financial institutions, hopefully, if we're not disincenting growth here in the financial institutions and banks, are going to fall into this tranche. And so more and more of our community bankers and local job producers and small-business [lenders] are going to be [subject to assessment surcharges]. ... [C]ommunity bankers and others have come to my office over the last three years and are straining under the cost of the FDIC fees and the special assessment that they just had over the last year. It's been a difficult thing, I think, in difficult times.[11]

The Proposal's cost burden is exacerbated by the fact that most mid-size banks are anticipating *reduced* assessments when the assessment schedules adopted by the FDIC through its Risk-Based Assessment Rule become effective.[12] The Proposal would nullify these expected cost savings.

We also note that Section 334 of the Dodd-Frank Act requires only that the FDIC offset the effect of the required increase in the DIF reserve ratio for banks with $10 billion or less in total assets. Congress did not mandate that *all* banks with assets of $10 billion or more be responsible for achieving the statutorily-established minimum DIF reserve ratio. The FDIC therefore has the discretion to prescribe an approach to increasing DIF funding that applies only to certain banks with assets above the $10 billion threshold — namely, as discussed more fully in Part III.B. — the large banks and banking organizations that pose a significant proportional bank failure risk.

If the FDIC does not modify the Proposal's definition of "large bank" to provide relief to mid-size banks, it should increase the amount of the $10 billion deduction applied to the calculation of the assessment surcharge base

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11 *See House-Senate Conference Committee Markup, H.R. 4173, Wall Street Reform and Consumer Protection Act of 2009, 111th Cong. (2010)* (statement of Rep. Shelley Moore Capito).

12 *See generally* Risk-Based Assessment Rule (establishing that reduced risk-based assessment schedules become effective when the DIF reserve ratio reaches 1.15 percent, which is expected to occur early in 2016).

to afford relief to a greater number of mid-size banks. Should the FDIC proceed with its proposed design, we recommend that the $10 billion assessment base reduction be increased to a minimum of $25 billion.

Finally, if mid-size banks are not exempted from the Proposal in part or entirely, we believe the aggregate cost of any assessment surcharge should not exceed mid-size banks' cost savings from the pending reduction in regular assessment rates under the FDIC's Risk-Based Assessment Rule, if implemented. Such a result would undermine the objectives of the Risk-Based Assessment Rule, particularly in light of the FDIC's decision to suspend the payment of dividends from the DIF indefinitely.

B. <u>Assessment Surcharges Should Account for Risk Exposure to the DIF</u>

The FDIC employs a risk-based assessment system for the purpose of calculating and imposing banks' regular assessment rates. Although we understand that this system will remain in effect for purposes of calculating banks' regular assessments, the Proposal would impose fixed quarterly surcharges in addition to those regular assessments without any consideration of risk-based factors. We believe that any assessment surcharges should themselves be calibrated to account for the capital and supervisory factors considered when determining banks' risk-based regular assessment categorizations.

Banking practitioners and scholars have observed that even the risk-based assessment system employed currently does not adequately account for the risk of bank failures. For example, it is argued that the only actuarially-fair deposit insurance assessment system is one that increases assessments not only in relation to the individual bank failure risk posed by an institution, but also in relation to the joint, or systemic, risk posed by an institution's failure.[13] Thus, to the extent that the FDIC intends to subject mid-size banks to the Proposal's assessment surcharges, we encourage its consideration of a more equitable, risk-based approach to calculating those surcharges.

To this end, we commend to the FDIC recent guidance issued by the Office of the Comptroller of the Currency ("OCC") on the risk assessment system for national banks. This guidance clarifies the relationship between the OCC's risk assessment system and the CAMELS rating system and expands upon several core risk assessment and risk management concepts. Notably, the OCC's guidance defines "risk" as "the potential that events will have an adverse effect on a bank's current or projected financial condition and

13 Viral V. Acharya, Joao A. C. Santos, and Tanju Yorulmazer, *Systemic Risk and Deposit Insurance Premiums*, FED. RESERVE BANK OF N.Y. ECON. POL'Y REV. (Aug. 2010), *available at* https://www.stern.nyu.edu/sites/default/files/assets/documents/con_039431.pdf.

resilience" and notes that "under this broader definition, financial condition includes impacts from diminished capital [including potential impacts from losses, reduced earnings, and market value of equity] and liquidity . . . [and] [r]esilience recognizes the bank's ability to withstand periods of stress."[14] We believe that the OCC appropriately contemplates not only the more-easily-quantifiable aspects of risk, but the benefits of sound risk management practices. Consideration of the OCC's guidance may assist the FDIC in designing an assessment surcharge system that is not unnecessarily adverse to well-run, risk-averse mid-size banks.

Apart from this conceptual approach to risk, we encourage the FDIC to consider the following specific amendments to the Proposal:

- Impose assessment surcharges only on banks with weak CAMELS ratings or impose higher surcharges on banks with deficient management practices or those that present justifiable supervisory concerns as observed through the examination process. This approach could be based on a bank's overall managerial, operational, financial, and compliance performance or could be tailored to individual component ratings.[15]

- Consider the most recent results of banks' DFAST and CCAR tests when determining which banks should be responsible for covering the cost of bank failures through increased contributions to the DIF.

- Implement the reduced regular assessment schedule under the FDIC's Risk-Based Assessment Rule for *low-risk banks only* (*e.g.*, Risk Categories 1 and 2 under the Rule) and continue with the current assessment schedule for higher-risk banks. Even if assessment surcharges are levied as proposed, this would reduce the overall funding burden for low-risk mid-size banks.

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[14] OCC Bulletin 2015-48 (Dec. 3, 2015) (emphasis added), *available at* http://www.occ.gov/news-issuances/bulletins/2015/bulletin-2015-48.html.

[15] We note that other commentators have suggested similar approaches, such as the imposition of special risk-based premium assessments for banks based on a targeted risk profile. For example, subprime lending, rapid growth, or *de novo* banks could be assessed an annual surcharge for each such profile. Moreover, commentators have suggested that systemically-important banks be charged a higher special assessment based not only on total assets, but also according to their risk profile, and importantly, those assessments would be levied at market rates, perhaps based on actuarial studies of risk exposure or the value of the "Too Big To Fail" taxpayer subsidy. *See* Kenneth H. Thomas, *Alternative to Big-Bank Tax: Higher Deposit Insurance Premiums*, AMER. BANKER (Mar. 13, 2014), *available at* http://www.americanbanker.com/bankthink/alternative-to-big-bank-tax-higher-deposit-insurance-premiums-1066219-1.html?zkPrintable=true.

- Assign a variable risk-based surcharge rate, rather than the proposed fixed-rate surcharge of 4.5 basis points per year, to banks' regular assessment bases according to their Risk Categorization or other specific risk factors.

C. <u>The Assessment Surcharge Schedule Should be Modified</u>

If the FDIC finalizes the Proposal without substantial revision to its scope or the underlying methodologies for calculating assessment surcharges, we encourage the FDIC to consider certain revisions to the mechanics of the proposed quarterly assessment surcharge schedule.

First, notwithstanding the Proposal's conclusion that the proposed surcharge will produce no significant capital effects,[16] quarterly assessment surcharges must necessarily have an adverse impact on mid-size banks' capital and earnings and their corresponding ability to pay dividends in each quarter during which the assessment surcharge is in effect. Thus, if applied to all mid-size and large banks as proposed, we believe the annual assessment surcharge of 4.5 basis points should be reduced and any resulting shortfall in the DIF reserve ratio below 1.35 percent as of June 30, 2020 should be funded by "highly complex" banks through a one-time shortfall assessment payable by September 30, 2020. The Proposal states that the FDIC believes an annual surcharge of 4.5 basis points will be sufficient to raise the DIF reserve ratio to 1.35 percent in eight quarters (by December 31, 2018).[17] It is reasonable to conclude that the FDIC could achieve the same funding objective by imposing a lower assessment surcharge for a longer period of time. As a means of reducing the amount of the assessment surcharge, we therefore encourage the FDIC to extend the surcharge collection period to the end of 2019. Despite the longer collection period, we believe a reduced surcharge would lessen the adverse impact of the Proposal on the capital and earnings of mid-size banks in each quarter during which assessment surcharges are imposed.

Second, rather than implementing the reduced assessment schedule prescribed under the Risk-Based Assessment Rule, the FDIC could retain the current assessment schedule for all large and mid-size banks until the DIF reserve ratio reaches 1.35 percent. This approach would mitigate the need for assessment surcharges. The difference between the current and reduced regular assessments would be treated as a *de facto* surcharge. Again, we would recommend that any shortfall in the DIF reserve ratio resulting from this alternative be funded by "highly complex" banks. Although this approach would deprive many mid-size banks of anticipated reductions in regular

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16 *See* Proposal at 68,786.

17 *See id.* at 68,781.

assessment rates, it would nonetheless reduce the effective cost burden of the Proposal.

IV. Conclusion

The MBCA supports the FDIC's efforts to ensure that the DIF is recapitalized and that it remains stable in the face of future crises. However, we continue to be concerned about the strain imposed on mid-size banks by the FDIC's assessment rate system. The Proposal compounds these concerns and we therefore encourage the FDIC to seriously consider the merits of the comments and recommendations provided above.

We appreciate the opportunity to submit comments on the Proposal and we invite discussion on these matters in the future.

Sincerely,

Brent Tjarks
Executive Director