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Federal Deposit Insurance Corporation
Comment on RIN 3064-AD35
An Amendment to Risk Base Assessment System

The FDIC proposes increasing a financial institution's base assessment rate for the use of secured liabilities in excess of 15% of domestic deposits. In summary the FDIC believes that the use of secured liabilities, such as repurchase agreements and Federal Home Loan Advances instead of deposits can lead to insurance assessment inequity. The following is a summary of the example provided by the FDIC in support of their position. There are two banks, A and B, both with $100.0 million in deposits and identical assessment rates; A utilizes deposits for 100% of its funding and B obtains 50% of its funding from secured liabilities. B will pay less in deposit insurance premiums, as shown by its identical assessment rate, despite the same risk of failure as A, and in the case of failure, will probably result in an increased loss to the insurance fund.

Isabella Bank Corporation (ISBA) believes that the FDIC's underlying premise is flawed because the financial ratio calculations for the assessment rate uses Tier 1 capital rather than the Risk Base Capital ratio. *The Risk Base Capital ratio is a better measurement of the financial risk to the fund.* Appendixes A uses the assumptions from the summary above, both banks have a 8.00% Tier 1 capital ratio and a 100% loan to deposit ratio. Bank A has a loan to asset ratio of 92% and no secured liabilities while Bank B has a 46% loan to asset ratio and 50% of its funding is from secured liabilities. Under this scenario Bank A has a Risk Based Capital ratio of 10.39% and is still considered well capitalized under the Risk Base Capital standards, while Bank B has a Risk Based Capital ratio of 15.47%. Since the insurance fund losses have historically been due to loan losses clearly in the case of both banks failing, the net loss from Bank A will probably greater than Bank B. As a matter of fact the risk of failure, despite identical assessment rates is greater for Bank A.

To further illustrate our point Appendix B uses the same assumptions as in Appendix A except compares Bank A to Bank C. Bank C has an identical Tier 1 capital ratio, loan to asset ratio, and Risk Based Capital ratio as Bank A, but obtains 50% of its funding from secured borrowing, resulting in a 200% loan to deposit ratio. In this example the FDIC is correct in its belief that should both Bank A and Bank C fail, Bank C will probably result in greater loss despite paying less in deposit premiums. Additionally, it's clear when examining the risk profiles of Bank B and Bank C, funds borrowed to invest in securities results in a lower risk to the insurance fund than borrowing to fund loans. Under the current FDIC proposal both Bank B and Bank C will be assessed the same secured liability adjustment, which is also inequitable.

ISBA recommends one of two alternative methods that the FDIC should consider to assure that assessment rates are equitable and reflect the loss potential of each unique institution to the insurance fund. They are, (1) FDIC replaces the Tier 1 capital ratio used in the financial ratio assessment calculation with Risk Base Capital ratio or (2) change the proposed assessment factor for use of secured liabilities in excess of 15% by a factor of a banks excess Risk Base Capital over the 10% that is required to be consider well capitalized. Either method would recognize that the risk associated from utilizing secured liabilities for funding depends on the use of those funds.

Of the two proposed methods to correct the inequity of the current FDIC proposal, ISBA believes method (1) is a superior method for adjusting premiums for risk assessment but also realizes it would be complicated, would affect the premiums of all financial institutions, and would require an analysis of the overall effect on premiums. Method (2) has the advantage of simplicity. The proposed rule could be amended to reduce the surcharge on base premiums by the amount of capital a bank has in excess of the amount needed to be considered well capitalized or eliminate the adjustment if Risk Base Capital is equal to or over a certain threshold such as 14.0%.

Respectfully Submitted

Dennis P Angner
President and CEO

Appendix A

Institution A

	Balances	Risk Factor (note 1)	Risk Based Assets
Assets:			
Investments	$0	20.00%	$0
Loans	92,000	75.00%	69,000
Non earning assets	8,000	100.00%	8,000
Total	$100,000		$77,000
Liabilities:			
Deposits	$92,000		
Borrowings	0		
Primary capital	8,000		
Total	$100,000		

Loan to asset ratio	92.00%
Loan to deposit ratio	100.00%
Tier 1 capital ratio	8.00%
Risk base capital	10.39%

Institution B

	Balances	Risk Factor (note 1)	Risk Based Assets
Assets:			
Investments	$46,000	20.00%	$9,200
Loans	46,000	75.00%	34,500
Non earning assets	8,000	100.00%	8,000
Total	$100,000		$51,700
Liabilities:			
Deposits	$46,000		
Borrowings	46,000		
Primary capital	8,000		
Total	$100,000		

Loan to asset ratio	46.00%
Loan to deposit ratio	100.00%
Tier 1 capital ratio	8.00%
Risk base capital	15.47%

Note 1:

The Risk Based factors were based on the premise that all investments are federal agencies nad municipal general obligations and 50% of the loans ar commercial and 50% are residential mortgage loans.

Appendix B

Institution A

	Balances	Risk Factor (note 1)	Risk Based Assets
Assets:			
Investments	$0	20.00%	$0
Loans	92,000	75.00%	69,000
Non earning assets	8,000	100.00%	8,000
Total	$100,000		$77,000
Liabilities:			
Deposits	$92,000		
Borrowings	0		
Primary capital	8,000		
Total	$100,000		

Loan to asset ratio	92.00%
Loan to deposit ratio	100.00%
Tier 1 capital ratio	8.00%
Risk Base Capital	10.39%

Institution C

	Balances	Risk Factor (note 1)	Risk Based Assets
Assets:			
Investments	$0	20.00%	$0
Loans	92,000	75.00%	69,000
Non earning assets	8,000	100.00%	8,000
Total	$100,000		$77,000
Liabilities:			
Deposits	$46,000		
Borrowings	46,000		
Primary capital	8,000		
Total	$100,000		

Loan to asset ratio	92.00%
Loan to deposit ratio	200.00%
Tier 1 capital ratio	8.00%
Risk base capital	10.39%

Note 1:

The Risk Based factors were based on the premise that all investments are federal agencies nad municipal general obligations and 50% of the loans ar commercial and 50% are residential mortgage loans.