James F. Getz
Chairman & Chief Executive Officer

VIA E-MAIL

August 27, 2015

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

RE: RIN 3064–AE37

Dear Mr. Feldman:

TriState Capital Bank ("TSCB") appreciates the opportunity to comment on the FDIC's proposed revisions to the deposit insurance assessment system for established small banks ("NPR"). TSCB is an FDIC-insured commercial and private bank headquartered in Pittsburgh, Pennsylvania with approximately $3 billion in assets. TSCB is among the banks subject to the NPR.

TSCB fully agrees with the FDIC's goal of increasing the risk-sensitivity of the deposit insurance assessment system, thereby reducing subsidies from lower-risk banks to higher-risk banks. However, in six key areas, described below, we believe the proposed revisions do not capture risk in the most accurate and appropriate manner, and would otherwise produce unwarranted results. In each case, we suggest specific improvements to more accurately capture risk and more fairly allocate assessment burden.

1. **The Loan Mix Index does not adequately capture risk mitigation or underwriting quality.**

    - Recommendation: Adjust the Loan Mix Index based on a bank's CAMELS component rating for Asset Quality and/or recent charge-off history.

The Loan Mix Index attempts to measure the riskiness of a bank's lending activities based on the types and amounts of loans provided. For each category of loans, the index assigns a risk factor based on historical, industry-wide charge-off rates. The loan categories originate from Schedule RC-C of the Call Report.

TSCB believes that the Schedule RC-C loan categories are too broad to accurately reflect risk. For example, the loan categories do not recognize the amount or quality of available risk mitigation, such as collateral or guarantees. Certain loan categories, including Commercial & Industrial loans and Other Consumer loans, do not consider risk mitigation at all. As a result, some loans that are fully secured by cash on deposit would receive the same risk factor as unsecured loans.

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More broadly, the Schedule RC-C loan categories overlook underwriting quality. For example, a portfolio of subprime auto loans would receive the same risk factor as a portfolio of prime auto loans. In many cases, differences in loan quality within a loan category will exceed differences between loan categories. The Schedule RC-C loan categories simply were not designed to measure risk. As a result, the charge-off rates associated with these broad categories are overstated for higher quality loan portfolios, resulting in an over-allocation of assessments based on this measure.

To mitigate this problem, TSCB recommends including within the Loan Mix Index an adjustment based on the bank's CAMELS component rating for Asset Quality. In addition to this adjustment, or as an alternative, the FDIC might consider an adjustment based on the bank's recent (e.g., rolling four-quarter) charge-off history (as recorded in Schedule RI-B) compared to its peers. Either or both of these adjustments will capture to a greater extent the kinds of variations in underwriting practices described above. TSCB understands that the NPR already incorporates Asset Quality in the Weighted Average CAMELS Component Rating. However, implementing an additional, more focused adjustment within the Loan Mix Index will ensure that the aspects of lending risk management not adequately captured by the Schedule RC-C loan categories receive sufficient weight.

2. **The Core Deposits / Total Assets ratio does not appropriately distinguish reciprocal deposits from brokered deposits.**

    - Recommendation: Clarify that 1- and 2-rated banks may count reciprocal deposits as "core deposits."

Under the NPR, the Core Deposits / Total Assets ratio would partially replace the current Adjusted Brokered Deposit Ratio. As currently implemented, the latter ratio excludes reciprocal deposits from the definition of "brokered deposits" applicable to well-capitalized, CAMELS 1- or 2-rated banks. The preamble to the FDIC's 2009 final rule amending the assessment system explains the reciprocal deposit exclusion as follows:

> *The FDIC is persuaded that reciprocal deposits . . . should not be included in the adjusted brokered deposit ratio applicable to institutions in Risk Category I. . . . The FDIC recognizes that reciprocal deposits may be a more stable source of funding for healthy banks than other types of brokered deposits and that they may not be as readily used to fund rapid asset growth.*

The current NPR seems to reverse this well-considered decision without discussion. Specifically, it omits language that would continue the existing exclusion of reciprocal deposits from the definition of "brokered deposits."

TSCB believes the same considerations that guided the FDIC's exclusion of reciprocal deposits in 2009 remain equally relevant to the proposed Core Deposits / Total Assets ratio. Therefore, the FDIC should clarify that 1- and 2-rated banks may count reciprocal deposits as "core deposits" for purposes of this ratio.

3. **The financial ratios do not adequately capture investment portfolio risk.**

   - Recommendation: Include an additional financial ratio that measures investment portfolio risk.

The Loan Mix Index and Core Deposits / Total Assets ratio, discussed above, are among eight measures included in the NPR's financial ratios method. Notably, none of the measures focuses on investment portfolio risk. The Weighted Average CAMELS Component Rating may reflect this risk to some extent through the Sensitivity to Market Risk and Asset Quality component ratings. However, investment portfolio risk is only one factor that may influence these component ratings, and in most cases its impact on the overall Weighted Average CAMELS Component Rating will be highly attenuated.

The absence of a measure specifically targeting investment portfolio risk seems unjustified. The investment portfolio may comprise a material portion of a bank's balance sheet, with proportionate implications for a bank's overall risk profile. By effectively de-emphasizing the importance of investment portfolio risk, the financial ratios method may skew the overall assessment calculation in favor of banks that take aggressive investment risks and against those with conservative investment practices.

Therefore, TSCB recommends that the FDIC include in the financial ratios method a measure of investment portfolio risk. The measure could draw from investment data contained in Call Report Schedule RC-B or Schedule RC-R. The measure should also adjust for a bank's CAMELS component rating for Sensitivity to Market Risk, and perhaps also Asset Quality.

4. **The One Year Asset Growth measure does not adequately distinguish growth fueled by aggressive underwriting from other types of growth.**

   - Recommendation: Remove the One Year Asset Growth measure or adjust it for a bank's CAMELS component rating for Asset Quality and/or recent charge-off history.

The One Year Asset Growth measure is designed to increase a bank's insurance assessment in proportion to its rate of growth during the preceding year. This measure is premised on the idea that, all else equal, a faster growing bank takes more risk. As proposed, this measure does not appear to involve a lower or upper threshold for growth rates; all growth results in a higher assessment.

TSCB believes this measure overestimates the tie between growth and risk. It is true that, heading into the recent financial crisis, some banks achieved rapid growth through lax underwriting practices. But this "race to the bottom" approach to asset growth is less common today. In fact, many banks that maintained conservative underwriting standards through the pre-crisis era emerged from the crisis with both the capacity and opportunity for strong growth. Their growth does not reflect increased risk but rather patience during a prior period of exuberance that ultimately forced less careful competitors to retrench.

Furthermore, as a general matter, growth will result from innovation in the design or delivery of banking products and services. Successful innovation has no fixed relationship to risk. Further, it should be encouraged, since it benefits both bank customers and the banking industry. Yet the One Year Asset Growth measure effectively penalizes it.

To mitigate these problems, TSCB recommends either removing the One Year Asset Growth measure or adjusting it for a bank's CAMELS component rating for Asset Quality and/or recent charge-off history. Fundamentally, the One Year Asset Growth measure should target growth driven by poor asset quality, not all growth in general.

As with the Loan Mix Index, discussed above, TSCB urges the FDIC to make appropriate adjustments within this financial ratio, and not to rely exclusively on separate financial ratios or the CAMELS composite rating to correct unintended consequences. Unless each individual financial ratio has integrity, the overall assessment calculation will tend to produce incongruous results.

5. **The overall assessment formula over-weights broad statistical data relative to bank-specific, qualitative judgments.**

    - Recommendation: Increase the weight given to the Weighted Average CAMELS Component Rating in the overall assessment calculation.

The four specific areas for improvement discussed above illustrate the general difficulty of capturing risk using broad statistical data. First, the right combination of data elements must be identified. Even then, the Call Report simply does not capture certain key aspects of risk. Moreover, those risks that are captured may have less predictive power today than in the past. Due to subsequent changes in bank products, technology, business models, and the market environment, certain statistical bank characteristics may influence the likelihood of failure less today than in prior years. For all these reasons, statistical data simply cannot substitute for qualitative judgments – particularly the nuanced, bank-specific examiner judgments underlying supervisory ratings.

Each of the qualitative refinements suggested earlier in this comment letter will help address this larger problem. But TSCB urges the FDIC to go further. In particular, we encourage the FDIC to increase the weight given to the Weighted Average CAMELS Component Rating in the overall assessment calculation. We would also support other steps to ensure that insurance assessments reflect the qualitative, bank-specific judgments of bank examiners at least as much as broad statistical findings.

6. **The NPR would cause some highly-rated banks to experience a severe year-over-year assessment increase.**

    - Recommendation: For 1- and 2-rated banks that would experience a severe increase (e.g., exceeding 20%), provide for a more gradual phase-in over several years.

The overall distribution of projected assessment rates under the NPR may indicate that most banks would either benefit or experience modest increases. However, some banks with unique characteristics

could experience a substantial jump in assessments. These include banks that remain eligible for Risk Category I under current rules.

TSCB believes this outcome raises questions about the accuracy of the proposed assessment system. Our suggestions above target specific concerns of this nature.

Nevertheless, the final assessment system may cause some highly-rated banks' assessments to spike solely due to changes in the assessment methodology. For individual 1- and 2-rated banks in this position, a year-over-year assessment increase exceeding, for instance, 20 percent seems excessive.

Therefore, TSCB suggests that the FDIC impose a temporary cap on year-over-year assessment increases for 1- and 2-rated banks caused by the new methodology. Any increases above a certain severity threshold – perhaps 20% – that are attributed to a change in methodology should be phased in gradually over a period of several years.

* * * *

We appreciate the opportunity that you have provided us to comment on the proposed revision. If you have any further questions on our observations, please feel free to contact us.

Sincerely,

James F. Getz

Chairman & CEO