September 11, 2015

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, DC 20429
comments@fdic.gov
RIN 3064-AE37

Re: **Proposal to Refine the Deposit Insurance Assessment System for Small Insured Depository Institutions; RIN 3064-AE37**

Dear Mr. Feldman,

First National Bank – Fox Valley is a $420 million community institution in Neenah, Wisconsin. I appreciate the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC's) proposal to refine the deposit insurance assessment system for small insured financial institutions that have been federally insured for at least five (5) years and have assets of less than $10 billion.

I recognize FDIC is required under the Federal Deposit Insurance Act (FDI Act) to establish an assessment system that is risk-based. In particular, a system meant to: (1) reduce the assessment a lower-risk financial institution pays than an institution FDIC considers to be higher-risk; and (2) provide incentives for financial institutions to monitor the risks FDIC believes could increase potential losses to the Deposit Insurance Fund (DIF).

I also recognize the proposed revisions are overall net neutral in that there is not an increase in the amount collected by FDIC from small insured financial institutions, collectively. Additionally, I am very mindful of the mixed treatment financial institutions in Wisconsin would receive under FDIC's proposed changes. **For our institution however, the assessment will likely go up upon implementation. In order to control those assessment costs better we will likely do less lending in our local community.** I appreciate FDIC's efforts to limit, where possible, the negative impact of the proposal—especially given the significantly added costs borne by small financial institutions as they continue to implement regulations required under the Dodd-Frank Act.

While some financial institutions in Wisconsin will benefit from the proposed changes, I believe some of the proposed changes to the assessment formula do not reliably differentiate the risk of an individual bank failure through future economic cycles, or outperform the current formula. To assist FDIC with promulgating its rule, I offer the following specific recommendations.

CAMELS Rating Weight

I believe there is no mathematical formula based on a few items from the Call Report that can gauge the performance and condition of an individual financial institution, and the likelihood that it will fail in the future, as thoroughly as regulators do during regular on-site examinations. It is through the examination process that examiners review the myriad of components which make up a financial institution's risk profile as they examine each institution and assign its CAMELS rating.
I believe that financial institutions rated CAMELS I or II by regulators should not be subject to a base rate that is potentially as high as 16 basis points once the DIF reaches 1.15 percent. The proposal

asks whether the base assessment rate once the DIF reaches 1.15 percent should have a maximum of 12 basis points for composite CAMELS I institutions or a minimum of 12 basis points for composite CAMELS IV and V institutions. I believe the issue is not whether the assessment schedule should be different based on CAMELS ratings, but rather that CAMELS ratings should be weighted higher in the assessment formula. Since an institution's CAMELS rating is a more accurate reflection of an institution's risk rather than a few items from a Call Report, I recommend the CAMELS rating of a financial institution be given the highest weight in FDIC's small bank assessment formula—much higher than what is proposed.

Tier 1 Leverage Ratio Weight

I believe the extreme elevation of weighting for tier 1 leverage ratio in the proposed assessment formula, as compared to the current formula, would unfairly penalize many financial institutions that meet all the regulatory standards of "well-capitalized." I believe the proposal would result in an institution carrying a capital buffer over existing Tier 1 standards. It is baffling why FDIC would require an institution to carry more capital for FDIC assessment purposes than is otherwise required under capital rules.

In addition to the tier 1 leverage factor, capital already carries additional weight in the assessment formula (current and proposed) as the "C" component of CAMELS. I believe an elevated weighting for tier 1 leverage may be fitting for institutions that are less than "well-capitalized." However, for financial institutions that have reached the status of "well-capitalized", the weighting should be much lower, more in line with the current formula. I recommend FDIC reduce the weight of tier 1 leverage ratio within its proposed formula.

Core-Deposits-to-Total-Assets Weight

Under the proposed assessment system, core deposits include all domestic office deposit balances up to the $250,000 insurance limit less those classified as brokered deposits. However, it is important to note that many deposits in excess of $250,000 truly are "core deposits" in that they are with long-standing depositors who are less rate-sensitive. This fact is further evidenced when examiners take a closer review of those deposits during the examination process.

I believe FDIC is taking too broad of an approach in what it considers to be brokered deposits and that FDIC must reconsider this. The issue of what deposits FDIC considers to be "brokered deposits" was recently exacerbated by FDIC's FIL-2-2015, under which even stable deposits resulting from bank-affiliate relationships or obtained by contract employees could be considered brokered.

Additionally, "reciprocal deposits" would count as brokered deposits under FDIC's proposal. This proposed treatment will result in increased assessment costs for many financial institutions than may otherwise be the case. In Wisconsin, 115 FDIC-insured financial institutions offer reciprocal deposits to their customers who generally are not highly rate sensitive. These institutions have experienced reciprocal deposits to be a stable source of cost-effective funding. I believe FDIC has failed to demonstrate with data or analysis how reciprocal deposits are so risky that the deposits should not be treated in the same way as traditional deposits. I believe data actually shows that reciprocal deposits have no effect on the probability of a financial institution's failure. Reciprocal deposits should be considered to be core deposits.
I am also concerned over FDIC's treatment of Federal Home Loan Bank (FHLB) advances in the proposed core-deposits-to-total-assets calculation. Many Wisconsin institutions prudently use FHLB advances as an additional funding source tool and they, too, will experience increased assessment costs than may otherwise be the case. Similar to reciprocal deposits, the proposal does not

demonstrate with data or analysis how FHLB advances are so risky that the advances should not be treated in the same way as traditional deposits.

I believe it is a very realistic possibility that under FDIC's proposal a financial institution with a CAMELS III rating may pay less in FDIC assessment than a CAMELS I rated institution that is well-capitalized merely because it uses reciprocal deposits and/or FHLB advances. This simply is a wrong result.

Again, I believe FDIC's proposed core deposit factor overlooks the risk-mitigation effects of diversification of funding sources. While core deposits bring franchise value for the institution, funding diversification can lower illiquidity risks. I believe financial institutions that balance long-term assets against FHLB advances and term brokered CDs, in place of low-denomination deposits, should not be punished for sound rate-risk management. Consideration must be given to an assessments formula factor for FHLB advances and term brokered deposits as paired with loan maturities.

The above proposed change whereby reciprocal deposits and FHLB advances may be considered "brokered" is especially troubling to my institution. We prudently use reciprocal deposit programs to acquire local deposits, primarily from local municipalities, towns, etc. Those public entities require either FDIC insurance or some other form of collateral. We have found these deposits to be reasonable in cost and very stable.

Our alternative to retain these deposits is to pledge our securities portfolio, reducing our banks liquidity. Does that make sense?

One-Year Asset Growth Factor Measure

I believe the one-year-asset-growth factor is a crude measure that intends to capture something that is better reflected in the "A" for asset quality component of CAMELS. Relatively rapid but sound growth can occur for many healthy, legitimate reasons. These could include when a local competitor fails or sells out to another financial institution that is not appreciated locally, or the institution hires a strong lender, or a large deposit comes in and the funds are placed in high-quality securities. A fixed parameter that ties risk of failure to asset growth cannot be appropriate over time, because a sound financial institution grows with the economy in its market. Certainly, robust growth in a strong business environment does not signal weakness any more than tepid growth in a weak marketplace signals strength.

Faster growth naturally triggers sooner and/or closer regulatory scrutiny. Thus, if a financial institution has not handled growth well this will be reflected in the CAMELS "A" component. If, nonetheless, a short-term growth figure is used, it should be used for loan growth, instead of asset growth. If a financial institution is going to mishandle growth, I believe it would likely be in the loan portfolio.

Moreover, the fixed coefficient on the growth factor would mean that <u>any</u> growth would raise assessments. I believe this effect does not square with a sound financial institution's role to fund growth in and grow with its local economy. If a short-term growth factor is used in the assessment formula, I recommend it should not affect assessments until the growth exceeds a norm determined based on industry performance.

This is another troubling piece of the proposal. The FDIC will be restricting lending in communities that may be growing faster than others. Really?

Loan Portfolio Distribution Factor

I believe the proposed loan portfolio distribution factor is of questionable value in forecasting the failure of financial institutions. This factor was derived based only on the past performance of institutions that failed. Not every institution with construction and development (C&D) loans and/or commercial and industrial (C&I) loans fail; the factor ignores the performance of the vast majority of financial institutions that have not failed yet have significant C&D and C&I loan portfolios. The factor overlooks the quality of loan underwriting, portfolio management, and risk hedging in an institution. I believe risk comes less from the loan portfolio itself, but rather stems from the quality of loans in the portfolio and their management—factors that are best measured by regulators and included in the "A" (for asset quality) and "S" (for sensitivity to market risks) components of CAMELS.
As previously stated, the FDI Act requires FDIC's assessment system to be risk-based. However, under the loan portfolio distribution factor, FDIC fails to incorporate each institution's risk-based analysis of its own loan portfolio and the management of that portfolio and paints all institutions with the same broad loan portfolio risk based upon assumptions created from past activity.

Respectfully, I believe this type of analysis is flawed. The proposed loan portfolio distribution factor is a backwards-looking factor. The past has seen significant variances in economic cycles and bank failures that may accompany them. Future bank failures may well be characterized by different portfolio mixes than in the last recession. Alternatively, FDIC should avoid policies that encourage institutions to concentrate in certain loan categories—even if unintentionally. I recommend FDIC remove the proposed loan portfolio distribution factor from its assessment formula.

Conclusion

I recognize FDIC is required under the FDI Act to establish a deposit insurance assessment system that is risk-based. I am very mindful of the mixed treatment financial institutions in Wisconsin would receive under FDIC's proposed changes and I appreciate FDIC's efforts to limit, where possible, the negative impact of the proposal—especially given the extra costs borne by small financial institutions as they continue to implement regulations required under the Dodd-Frank Act.

While some financial institutions in Wisconsin will benefit from the proposed changes], I believe some of the proposed changes to the assessment formula do not reliably differentiate the risk of an individual bank failure through future economic cycles, or outperform the current formula.

If it is necessary for FDIC to make a change to the current formula, I recommend FDIC: (1) give the CAMELS rating of a financial institution the highest weight in FDIC's small bank assessment formula; (2) reduce the weight of the tier 1 leverage ratio; (3) reconsider the treatment of reciprocal deposits and FHLB advances under the proposed core-deposits-to-total-assets formula; (4) not have a short-term growth factor affect assessment until the growth exceeds a norm determined based on industry performance; and (5) remove the loan portfolio distribution factor from the proposal.

Once again, I appreciate the opportunity to comment on FDIC's proposal.

Sincerely,

Peter J Prickett
President/CEO