



Old-fashioned Innovation

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September 10, 2021

Nicholas Podsiadly
General Counsel
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

**RE: 12 C.F.R. Part 363
Independent Audits and Reporting Requirements**

Dear Mr. Podsiadly:

On October 23, 2020, the FDIC issued an interim final rule providing temporary relief to certain insured depository institutions from the requirement to comply with part 363 of the FDIC's regulations because the affected institutions may have experienced temporarily increased total assets due to their participation in COVID-related government stimulus efforts. Unless it is extended by the FDIC, the interim final rule will expire on December 31, 2021. The relief provided is applicable to Sutton Bank because our total assets exceeded the sum of \$1 billion dollars, triggering application of part 363, for the first time in the Bank's history this past year.¹ The purpose of this letter is to urge the FDIC to consider whether the foregoing asset size threshold, which was last revised nearly 16 years ago in November 2005,² remains appropriate in light of the regulation's primary purpose of protecting the Federal Deposit Insurance Fund from the risk of loss.³

Sutton Bank is chartered in the State of Ohio and was founded in 1878. The history of Sutton Bank is fundamentally linked to the development of southeastern Seneca and western Huron Counties. We have long served as a community pillar, staying strong through the Great Depression, times of war, and fluctuating economies. A progressive, privately held, and

¹ As of August 31, 2021, Sutton Bank had \$1.15 billion in total assets.

² *Independent Audits and Reporting Requirements*, 70 Fed. Reg. 71,226 (Nov. 28, 2005) (to be codified at 12 C.F.R. pt. 363).

³ *Id.* at 71,267.

independent community bank,⁴ Sutton Bank has consistently been named one of the top small business and agricultural lenders in the State of Ohio. We are supervised by the FDIC and the Division of Financial Institutions – Ohio Department of Commerce, and take pride in conducting our activities in compliance with both the letter and the spirit of the law.

I. Banks with total assets greater than \$1 billion do not pose systemic risk to the Federal Deposit Insurance Fund.

As a threshold matter, we note the distinction between “microprudential” regulations, which apply to all banks and focus “mainly on the individual institution’s safety and soundness,” and “macroprudential” regulations such as part 363, which only apply to larger banks, based on asset size, and focus “mainly on the broader systemic risk that large institutions pose. . .”⁵ As is further explained below, Sutton Bank believes it is abundantly clear that banks with total assets of up to \$10 billion do not pose systemic risk.

In November 2005, when the FDIC raised the asset size threshold of part 363 to its current amount of \$1 billion, the FDIC noted in the Federal Register that when it adopted part 363 in 1993, “covered institutions held approximately 75% of the assets of insured institutions. . .”⁶ To this end, the FDIC further noted Congress’ intent that the regulation be focused on “those institutions posing the greatest potential risk to the insurance funds administered by the FDIC.”⁷ The FDIC then proceeded to explain that increasing the threshold was warranted because “due to consolidation in the banking and thrift industry and the effects of inflation” covered institutions in November 2005 held “approximately 90 percent of the assets of insured institutions.”⁸ Today, covered institutions

⁴ Although Sutton Bank engages in certain prepaid card activities on a nationwide basis, we fall squarely within the FDIC’s definition of a “community bank” based on our overall banking activities and asset size. *FDIC Community Banking Study, December 2020*, p. A-1, <https://www.fdic.gov/resources/community-banking-report-2020-cbi-study-full.pdf>; U.S. Congressional Research Service, *Over the Line: Asset Thresholds in Bank Regulation*, R46779, May 3, 2021, Marc Labonte and David Perkins, <https://sgp.fas.org/ers/misc/R46779.pdf>, p. 2, accessed on September 9, 2021. We further note that Sutton Bank, with current total assets just over the \$1 billion threshold, is a “small bank” as defined in the Community Reinvestment Act regulations, which provides that any bank with total assets of less than \$1.322 billion in the prior two calendar years is a small bank (12 C.F.R. § 345.12(u)(1)), and “small institution” for purposes of deposit insurance assessments. https://www.fdic.gov/deposit/insurance/assessments_institutions.html

⁵ U.S. Congressional Research Service, *Enhanced Prudential Regulation of Large Banks*, R45711, May 6, 2019, Marc Labonte, <https://crsreports.congress.gov/product/pdf/R/R45711/1>, pp. 27-29, accessed on September 9, 2021, noting, inter alia, that if a bank does not pose systemic risk in the case of a macroprudential regulation, “the main benefit of enhanced regulation is not present, and it is subjected to unnecessary costs without any offsetting benefits.” (quoting, Testimony of James Barth, senior fellow Milken Institute, before the House Financial Services Committee, hearing on *Examining the Designation and Regulation of Bank Holding Company SIFIs*, July 8, 2015, at <https://republicansfinancialservices.house.gov/calendar/eventsingle.aspx?EventID=399302>).

⁶ 70 Fed. Reg. 71,226.

⁷ *Id.* at 71,267.

⁸ *Id.*

hold approximately 95% of total assets.⁹ Furthermore, based on the FDIC's most recent report of deposits held by insured institutions according to asset size, banks with total assets between \$1 billion and \$3 billion hold just 5% of all insured deposits.¹⁰ Based on the foregoing, we suggest that a significant increase the existing threshold amount is long overdue.

II. Any increase in the existing asset size threshold should be targeted to providing relief from the burden of performing internal control assessments.

When the FDIC raised the asset threshold of part 363 from \$500 million to \$1 billion in November 2005, the FDIC retained the financial statement audit and reporting requirements for all institutions with \$500 million or more in total assets. In addition, the FDIC noted in its Federal Register final rule commentary that the "managements of all covered institutions would remain responsible for establishing and maintaining an adequate internal control structure," consistent with the requirements of part 364, appendix A of the FDIC's regulations.¹¹ We believe that as in 2005, the above "strikes an appropriate balance" in adjusting the requirements of part 363 and encourage the FDIC to take a similar approach if the regulation is revised.

Requiring small banks to conduct internal control assessments is unnecessary for purposes of controlling systemic risk to the Federal Deposit Insurance Funds institutions and may have the effect of imposing on small banks highly burdensome risk management requirements that were developed for banks with \$50 billion or more in total assets. In this regard, pursuant to the requirements of Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, in 2014 the Federal Reserve issued part 253.33 (Risk-management and risk committee requirements), which requires a bank holding company with \$50 billion or more in total assets to establish and maintain a formal "risk management framework" under the leadership of a chief risk officer. In addition, also in 2014, the OCC promulgated *Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations and Insured Federal Branches* that similarly apply to banks with \$50 billion or more in total assets.¹² The latter describe a "three lines of defense" risk management structure, under the leadership of a chief risk executive, that would be impractical and unduly costly for any privately held small bank to attempt to maintain.¹³ Yet, in conducting an internal control assessment at a \$1 billion bank, auditors are likely to apply the same "standard" risk management expectations that they apply when auditing much larger institutions.

⁹ *Over the Line: Asset Thresholds in Bank Regulation*, R46779, p. 26.

¹⁰ Deposits of all FDIC-Insured Institutions, National Totals by Asset Size, June 30, 2021
<https://www7.fdic.gov/sod/sodSumReport.asp?barItem=3&InfoAsOf=2021>

¹¹ 12 C.F.R. § 364, Appendix A (Interagency Guidelines Establishing Standards for Safety and Soundness).

¹² 12 C.F.R. § 30, Appendix D.

¹³ This is particularly true for a small bank located in a rural area, such as Sutton Bank, where finding and retaining qualified staff is a constant challenge.

In increasing the asset threshold amount in 2005, the FDIC noted that over half of the institutions which would not be required to conduct an internal control assessment were public companies subject to the SEC's 404 rule, which significantly overlaps with the requirements of part 363. In addition, regarding all covered institutions, the FDIC noted that examiners' assessment of a internal controls in the ordinary course of a safety and soundness examination encompass "not only internal control over financial reporting, but also internal control as it relates to the effectiveness and efficiency of the institution's operations and its compliance with laws and regulations."¹⁴ Finally, the FDIC possesses the ability to impose additional risk management requirements on a case-by-case basis for any aspects of a bank's operations that are deemed complex or otherwise present heightened risk.¹⁵ In view of the above factors, exempting banks with under \$10 billion in total assets from the need to conduct an internal control assessment would not result in weaker controls. Exempt banks would remain subject to all other requirements of part 363, the expectations for internal controls set forth in part 364, appendix A, plus other applicable FDIC and interagency risk management guidance.

III. \$10 billion represents a more appropriate asset size threshold for requiring internal control assessments.

Any insured bank with total assets of \$10 billion or more is considered a "large institution" for purposes of deposit insurance assessments.¹⁶ Given that assessment rates are risk-based, with larger institutions paying more, we suggest it makes sense for the application of part 363, which is intended to target "those institutions posing the greatest potential risk to the potential risk to the insurance funds administered by the FDIC"¹⁷ would be limited to large institutions. In support of this position, we note that accordingly to the FDIC's most recent statistics on insured deposits, 83.71% of all such deposits are held at banks with greater than \$10 billion in total assets.¹⁸

We further note that \$10 billion is the applicable asset threshold for the following:

- CFPB primary regulator for consumer compliance
- Durbin Amendment interchange fee cap
- Volker Rule applicability
- Home Mortgage Disclosure Act exemptions

¹⁴ 70 Fed. Reg. 71,229.

¹⁵ For example, Sutton Bank is supervised by the FDIC as a "highly complex institution" solely for purposes of our prepaid card activities, with the result that heightened attention is given to our consumer compliance controls.

¹⁶ <https://www.fdic.gov/deposit/insurance/assessments/institutions.html>

¹⁷ 70 Fed. Reg. 71,227.

¹⁸ <https://www7.fdic.gov/sod/sodSumReport.asp?barItem=3&slInfoAsOf=2021>

- Community Bank Leverage Ratio (CBLR) eligibility
- Swap margin and capital requirements
- Mortgage escrow requirements

In recommending a higher asset threshold for part 363, we appreciate that section 36 of the Federal Deposit Insurance Act requires the FDIC to consult with the other federal banking agencies before making any revisions. Moreover, we further appreciate that no changes to part 363 could be made in the absence of notice of proposed rulemaking in the Federal Register and careful consideration of the resulting public comments. In light of these needs, we suggest that the existing temporary relief from part 363 be extended for an additional year. That would allow the FDIC additional time to reconsider the continued appropriateness of requirements that have not been closely scrutinized or materially revised since November 2005.

Thank you for your careful consideration of this letter. Please feel free to call or email me at mdabertin@suttonbank.com if you have any questions regarding the above.

Sincerely yours,



Mark T. Dabertin
General Counsel and Chief Compliance Officer

Cc: J. Anthony Gorrell, Chief Executive Officer, Sutton Bank

The Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation