DECISION
OF THE
ASSESSMENT APPEALS COMMITTEE

CASE NO. 2021-01

*** (the "Bank") filed an appeal with the Assessment Appeals Committee ("AAC" or "Committee") of the Federal Deposit Insurance Corporation ("FDIC") by letter dated June 17, 2021. The Bank is appealing a determination issued by the FDIC's Division of Insurance and Research ("DIR") dated May 19, 2021. In that determination, DIR denied the Bank's *** request for an adjustment to its Core Earnings ratio calculation, as described below, or to otherwise adjust the Bank's assessment rate for the *** quarter 2020 assessment period.

The Committee met to consider the Bank's appeal on October 20, 2021. After carefully considering the Bank's submission and the facts of this case, the Committee has denied the appeal.

I. APPLICABLE LAWS AND REGULATIONS

A. Large Bank Assessment Methodology

The Bank is considered a "large bank" for assessment purposes.[1] As a large bank, the Bank's assessment rate is calculated using the Large Bank Pricing Scorecard (the "Scorecard") in the FDIC's assessment regulations.[2] The Scorecard uses a bank's CAMELS ratings[3] and certain

[1] A "large institution" for assessment purposes is a bank with "assets of $10 billion or more, excluding assets [related to the Paycheck Protection Program and Money Market Mutual Fund Liquidity Facility], as of December 31, 2006. *See* 12 CFR 327.8(f). In this decision, the term "bank" is synonymous with the term "insured depository institution" as it is used in section 3(c)(2) of the Federal Deposit Insurance Act, 12 U.S.C. 1813(c)(2).
[2] *See* 12 CFR § 327.16(b)(1).
[3] A financial institution is assigned a CAMELS composite rating based on an evaluation and rating of six essential components of an institution's financial condition and operations. These component factors address the adequacy of

forward-looking financial ratios to calculate a total score.[4] The total score is then converted to the bank's initial assessment rate, which is subject to a series of additional adjustments to arrive at a total assessment rate.[5] To calculate the amount of a bank's quarterly assessment, the total assessment rate is divided by four and then multiplied by the bank's assessment base.

One of the ratios used to calculate a bank's total score is the Core Earnings/Average Quarter-end Total Assets ratio, or simply the Core Earnings ratio.[6] Core earnings are defined as net income less extraordinary items and tax-adjusted realized gains and losses on available-for-sale and held-to-maturity securities, adjusted for mergers.[7] The ratio takes a four-quarter sum of merger-adjusted core earnings and divides it by an average of five quarter-end total assets (most recent and four prior quarters).[8] Any loan loss provision required under United States Generally Accepted Accounting Principles ("GAAP") that reduces net income reported on the Bank's Consolidated Reports of Condition and Income ("Call Report") would thus affect its Core Earnings ratio.

B. <u>Request for Assessment Review and Adjustment</u>

A bank that believes the assessment rate provided by the FDIC is incorrect and seeks to change it must submit a written request for review of its assessment within 90 days from the date the assessment being challenged appears on the institution's quarterly invoice.[9] Upon completion of the review, the Director of DIR shall promptly notify the institution in writing of his or her

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capital (C), the quality of assets (A), the capability of management (M), the quality and level of earnings (E), the adequacy of liquidity (L), and sensitivity to market risk (S).

[4] *See* 12 CFR § 327.16(b)(1).

[5] *Id*.

[6] *Id*.

[7] *See* Appendix A to Subpart A of Part 327, VI. Description of Scorecard Measures.

[8] *Id*.

[9] 12 C.F.R. § 327.4(c).

determination of whether a change is warranted.[10] If the institution requesting review disagrees with DIR's determination, it may appeal to the Committee.[11]

In addition to requesting a review of its assessment, a large bank may also request a total score adjustment under the *Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions* ("Adjustment Guidelines").[12] As further described in the Adjustment Guidelines, the FDIC may adjust a large bank's total score up or down by no more than 15 points, based upon significant risk factors that may not be adequately captured in the Scorecard.[13] The Adjustment Guidelines also provide that a bank's total will be adjusted only if the comprehensive analysis of a bank's risk factors warrant a material adjustment of the institution's score.[14] For the purpose of the Adjustment Guidelines, a material adjustment is an adjustment of five points or more.[15]

C. Standard of Review for Appeal to the AAC

Under the Guidelines for Appeals of Deposit Insurance Assessment Determinations, the burden of proof as to all matters at issue in this appeal rests with the Bank.[16] While the FDIC's assessment regulations do not provide for an individualized methodology for calculating a bank's assessment rate or, more specifically, for modifying the calculation of the Core Earnings ratio, the Committee at times has considered whether unique circumstances—generally circumstances

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[10] *Id*.
[11] *Id*.
[12] *See* 76 Fed. Reg. 57992, 57994 (Sept. 19, 2011).
[13] *Id*.
[14] *Id*.
[15] *Id*.
[16] *See* Guidelines for Appeals of Deposit Insurance Assessment Determinations, Paragraph H, 77 Fed. Reg. 17,055, 17,060 (Mar. 23, 2012).

beyond a bank's control—prevented a bank from complying with the relevant regulations.[17] The Committee also has at times considered whether application of the regulations in a particular case would be inequitable.[18] For the reasons set forth in Section IV below, the Committee concludes that the circumstances of this case do not warrant the relief requested.

II. FACTUAL AND PROCEDURAL BACKGROUND

*** is a *** bank. As of ***, it had approximately *** in total assets. As a large bank under the assessment regulations, the Bank's assessment rate is calculated using the large bank Scorecard. Its *** quarter 2020 assessment invoice totaled ***.

In a letter to the Director of DIR, dated ****, the Bank requested review of its assessment rate for each assessment period between the *** quarter of 2020 through the *** quarter of 2021. The Bank explained that, in ***, it completed a merger with *** and acquired *** branches from ***, which resulted in the Bank acquiring loans that were not purchased credit deteriorated ("PCD"), also referred to as non-purchased credit-deteriorated ("non-PCD") loans.[19] The Current

[17] *See, e.g.*, Case Nos. 2002-02 (granting relief where the terrorist attacks on September 11, 2001, prevented the bank from consummating a previously arranged transaction that would have made the bank well capitalized on the cutoff date); and 2004-02 (granting relief where the primary federal regulator's delay in granting a needed approval prevented the bank from consummating a previously arranged transaction that would have made the bank well capitalized on the cutoff date). *But see, e.g.*, Case Nos. 2004-06 (denying bank's appeal to upgrade its capital evaluation, in part, because the bank was correctly assigned to a lower capital group based on its Call Report data); 2008-02 (denying bank's appeal to upgrade its capital evaluation because the timing circumstances related to the bank's public stock offering process, which the bank argued caused its capital ratio to fall, was in the full discretion of the bank and not based on any regulatory constraint); 2009-01 (denying bank's appeal to upgrade its capital evaluation because there was no unusual delay in approval of the bank's capital plan by its primary federal regulator and that the decision to hold certain securities that were declining in value was in the bank's control).

[18] *See, e.g.*, AAC Case No. 2009-01; AAC Case No. 2008-02; AAC Case No. 2004-06.

[19] The term "non-PCD loans" is the industry terminology for purchased loans that do not meet FASB's definition of a "Purchased Financial Assets with Credit Deterioration," which FASB defines as financial assets "that as of the date of acquisition have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer's assessment." *See* FASB Accounting Standards Codification Master Glossary. Thus, "non-PCD loans" refers to purchased financial assets that have *not* been determined to have a more than insignificant credit deterioration at the time of acquisition.

Expected Credit Losses[20] ("CECL") accounting standard issued by the Financial Accounting Standards Board ("FASB") in 2016, required the Bank to assign a fair value to the non-PCD loan portfolio and to also establish an allowance for credit losses on day-one of the acquisition.

The Bank asserted that, because it adhered to the CECL standard by marking the acquired non-PCD loans to fair value and also recording an allowance for credit losses, there was a "double counting" of expenses that lowered the Bank's net income and Core Earnings ratio. The Bank therefore requested that DIR make "an adjustment to its Core Earnings calculation to remove the double counting since it does not reflect additional risk to the Bank or the FDIC's Deposit Insurance Fund."[21] The Bank calculated that the assessment adjustment should total approximately *** over *** quarters starting in *** through ***.[22] The Bank, however, did not assert that the FDIC applied the assessment regulations incorrectly.

By letter dated May 19, 2021, DIR denied the Bank's request for review.[23] DIR's response stated that the financial ratios used to determine a bank's assessment rate are defined in the FDIC assessment regulations and calculated using data from the Bank's Call Report, which the FDIC used to correctly calculate the Bank's Core Earnings ratio as provided by those regulations. DIR also stated that granting the Bank's request would provide an adjustment not prescribed by the assessment regulations and that has not been provided to other banks in similar circumstances. DIR also considered whether the Bank would be eligible for an assessment rate

[20] FASB Accounting Standards Update No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.
[21] *** request for review, ***.
[22] *Id.*
[23] At the time of its initial request, the Bank had only received an invoice for the *** quarter 2020. Accordingly, DIR's denial was specific to the Bank's *** quarter 2020 assessment.

adjustment under the Adjustment Guidelines and determined that the adjustment did not meet the five point materiality threshold set forth in those Guidelines.

The Bank timely appealed DIR's denial by letter dated June 17, 2021. In its appeal, the Bank reiterated the arguments set forth in its request for review. Additionally, the Bank asserted that the accounting standard applicable to non-PCD loans—CECL—has been subject to controversy and that two of seven FASB board members dissented when it was adopted.

III. ANALYSIS

In this case, the Bank requests that DIR adjust the calculation of the Bank's Core Earnings ratio to remove what the Bank characterizes as a duplicative effect caused by the CECL standard applicable to non-PCD loans. The Bank does not assert that the FDIC applied the assessment regulations incorrectly, nor does it assert that the FDIC calculated the Core Earnings ratio erroneously. The Bank does not dispute the underlying Call Report data used to determine the assessment rate.

The Core Earnings ratio is one factor in the Scorecard used to calculate a large bank's assessment rate. The Core Earnings ratio is calculated using information reported by a bank on its Call Report related to net income and average quarter-end total assets. The Core Earnings ratio decreases when net income decreases or total assets increase, all else equal. From a bank's perspective, a higher Core Earnings ratio is generally preferable because it yields a lower assessment rate, all else equal.

The Bank argues that its Core Earnings ratio was negatively affected because the Bank both booked non-PCD loans at fair value and established an allowance for credit losses, as required by the CECL standard promulgated by FASB. The Bank asserts that this accounting treatment double counted the credit risk associated with the non-PCD loans, which understated its net income and therefore reduced its Core Earnings ratio, and thus increased its assessment rate. Consequently, the Bank requests that the FDIC adjust its Core Earnings ratio.

To the extent the application of the CECL standard affected the Bank's net income negatively due to the calculation of credits risk associated with non-PCD loans, that result is caused by the accounting methodologies established by FASB, not the FDIC assessment regulations. The purported double counting of credit risk with which the Bank takes issue arises at the financial accounting level and is reflected on the Bank's financial statements notwithstanding the FDIC's assessment regulations. The assessment regulations use the Bank's financial information as a component in determining the assessment rate only after the Bank applies CECL and other GAAP standards, and files the financial information according to the Call Report instructions.[24] Thus, to the extent the CECL standard causes the Bank to report financial information that the Bank believes does not accurately reflect its financial position, FASB is the entity in the best position to address that issue.

Additionally, any effect of the CECL standard on the Bank's net income may be mitigated across subsequent quarters if the non-PCD loans mature and perform. In particular, as the non-PCD loans mature and perform, the fair value discount the Bank booked in the *** quarter of 2020 will accrete back into the Bank's earnings in future quarters. All else equal, this will increase the Bank's net income and Core Earnings ratio and reduce its future assessments.

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[24] The Call Report Instructions are generally consistent with GAAP as set forth in the FASB's Accounting Standards Codification. *See* 12 U.S.C. 1831n; FFIEC: Reports of Condition and Income Instructions for the FFIEC 031 and 041 Report Forms (September 30, 2021). With respect to the treatment of PCD loans specifically, the Call Report Instructions follow GAAP standards. *See id.* at page A-102.

IV. COMMITTEE'S FINDINGS

While the Committee understands the Bank's concerns regarding the CECL standard and the effect of CECL on its assessment rate, it is the Committee's view that consistent application of the assessment rules is required for transparency, predictability, and fairness.[25] The assessment regulations and the calculation of the Scorecard's financial ratios apply uniformly to all large banks. The Committee notes that in this case, those regulations were applied correctly and the Bank's assessment rate was calculated correctly based on the Bank's underlying Call Report data.[26]

The Committee finds that application of the assessment regulations in this case is equitable and consistent with how other large banks are treated. Specifically, the CECL standard for non-PCD loans under GAAP is applicable to any bank. To the extent the CECL standard reduces net income reported on the Call Report because of a merger or acquisition, it is not unique to the Bank. Thus, removing the effect of the CECL standard from the Bank's Core Earnings ratio would provide an adjustment that is not provided to other banks in the same or similar circumstances.

Allowing for individualized assessment rates or different treatment for particular banks would undermine the reliability of the risk-based assessment system. As the Committee has

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[25] *See, e.g.*, AAC Case No, 2018-01; AAC Case No. 2000-01.

[26] The Committee has previously denied requests in which the institution contests an assessment premium based on accurate Call Report data. *See* AAC Case No. 2018-01 (denying bank's request to treat commercial and industrial (C&I) loans differently for assessment purposes, even though they were correctly reported as C&I loans on the Call Report); AAC Case No. 2010-01 (rejecting bank's argument that its capital evaluation for assessment purposes should be based on Call Report data that initially contained goodwill reporting errors, rather than the amended Call Reports in which the bank reported goodwill correctly; the Committee reasoned that the bank is responsible for accurate reporting); AAC Case No. 2009-01 (denying bank's appeal to upgrade its capital evaluation, which was based on data reported on its Call Report).

stated before, "while exceptions to the rule may, under compelling circumstances, be considered, such must be both rare and well supported if the system is to maintain credibility."[27] Here, the Bank has not established unique or compelling circumstances that would justify an exception to the rule. The Committee notes that the FDIC provides assessment-related resources, including an online calculator that banks may use to understand the assessment effects of future transactions, such as mergers.[28]

The Committee also finds that the Bank has not established unique or compelling circumstances that would justify deviating from the Adjustment Guidelines as promulgated by the FDIC Board. Granting the Bank's requested relief would reduce its total score by less than one point, which is short of the five-point materiality threshold described in the Adjustment Guidelines.

V. CONCLUSION

After considering the facts and arguments the Bank presented in its appeal, the Committee finds that the circumstances in this case are neither unique nor inequitable so as to warrant adjusting the Bank's Core Earnings ratio. Additionally, the circumstances do not warrant deviating from the materiality threshold described in Adjustment Guidelines. The Bank's assessment rate was correctly calculated under the FDIC assessment regulations using data reported in its Call Report. Although the Committee understands the Bank's position, the Committee does not have a basis for granting relief from the application of the FDIC's

[27] *See, e.g.*, AAC Case No. 2018-01; AAC Case No. 2000-01.
[28] The Committee encourages the Bank to contact the FDIC or take advantage of other assessment-related resources that the FDIC provides to understand how future transactions may affect their assessments, such as the online assessment calculator. https://www.fdic.gov/deposit/insurance/calculator.html (last visited November 3, 2021).

assessment regulations. Accordingly, for the reasons set forth in this decision, the Bank's appeal is denied.

By direction of the Assessment Appeals Committee, dated December 17, 2021.

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