SUMMITBANK

# MEMO

**To:** FDIC

**From:** Ann Marie Mehlum, President and CEO, and
Scott Goldstein, Senior Financial Officer

**Date:** September 21, 2006

**CC:** ABA, ICBA, OBA

**Re:** FIL-46-2006

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The deposit insurance reform proposal seems conceptually sound as an effort to better match failure risk among FDIC insured institutions with the rates that institutions pay for deposit insurance coverage. However, we have identified two aspects of the proposal that we see as serious flaws.

First and most important is the arbitrary maximum rate that would be paid by banks less than 7 years old. For most young banks (Summit being one of these), financial ratios and measures of performance are relatively strong (capital ratios tend to be high, asset quality is generally strong, etc) and thus, if the FDIC's proposed assessment formulas are applied, the resultant assessment rate would be at or near the minimum rate. Applying the maximum rate for these newer banks, then would logically suggest that the FDIC considers the failure risk for banks under 7 years old to be nearly twice that of banks under $10B in assets as a group. We find this to be extremely difficult to justify with any kind of historical failure rate data. If the FDIC's position on newer banks is that their financial performance measurements (such as non-performing asset ratios) do not yet accurately reflect the true measure of risk of the banks assets, it would seem that a fairer method of assessment could be created using the FDIC's proposed system of measurements. For example, the non performing loans or charge-offs as a percentage of Gross Assets could have a minimum value (perhaps the median figure for all banks in the Small Bank Group) for a bank under 7 years old. This would have the effect of simulating the risk associated with a non-seasoned loan portfolio.

The other facet of the proposal that is cause for concern is the fact that some of the relative weightings of the various financial performance measurements seem of dubious logic. The assessment proposal suggests that, for example, capital ratios are correlated with failure risk equal to volatile funds ratios. This relationship should be examined more closely, with a heavier weighting placed on capital (or lessen the impact of Volatile Funds as Capital already is incorporated into the CAMELS portion of the assessment scheme). The other questionable aspect of the assessment formula is the relative

weighting of Past Due Loans vs Charge-Offs. The proposed scheme would consider a charged-off loan to have only slightly more than twice the impact (71 bps vs 37 bps) of a loan 30 days past due on a bank's likely failure risk. This seems difficult to justify.
We hope the FDIC will consider a system that more accurately estimates the additional risk associated with newer banks as opposed to the arbitrary "penalty" system in the current proposal. Also, we think that the current proposal represents a reasonable attempt to identify riskier institutions, but the assessment rate calculation scheme could be refined somewhat to make it more effective.

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