NORTH DAKOTA
BANKERS
ASSOCIATION

September 3, 2015

Mr. Robert Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington DC 20429

Via: comments@ fdic.gov

RE: **RIN 3064-AE37**

Proposed Rule on Assessments

The North Dakota Bankers Association ("NDBA") welcomes this opportunity to comment upon the recent proposal to change the deposit insurance assessment regulations for small banks. All but two NDBA member banks qualify as small banks as defined by the FDIC for purposes of this proposal. Because banks that do not fail are the ones to actually bear all costs for FDIC insurance coverage and bank failure resolution, there is no group with a greater interest in "getting it right" than banks.

With this in mind, we do appreciate the effort FDIC to develop an assessment formula that better reflects risks to the fund and that is expected to maintain overall revenue neutrality for the affected banks. Nonetheless, NDBA is not unable to endorse the proposal as it has been made because material flaws to the approach taken by FDIC outweigh potential benefits to either the FDIC or small banks. **Accordingly, we urge that the proposal be reconsidered and substantially revised.**

The FDIC describes its proposal as being intended to be superior to its predecessor by: better estimating risk by basing the formula on "recent experience with over 500 bank failures" and "updating parameters" and adding "some new factors". Bankers disagree; many see the proposal as addressing the last round of bank failures rather than rather accurately predicting future risks and as another regulatory attempt to manipulate bank business models by rewarding those models that conform to the FDIC's vision of what is a "good" source of funding or "good" investment of banks' assets and punish those that vary from the FDIC's favored model. Although banks categorically reject this approach to "supervision" and "regulation, if it is implemented many will respond in the manner FDIC appears to desire, i.e., by reducing or ceasing to make the types of loans that are made undesirable in the proposal. In this way the proposal is similar and will achieve the same result as occurred when regulatory over - reaction to mortgage lending forced many small banks to stop making mortgage loans after that line of business was made too complex and risky by regulatory "reform".

The proposal also appears to be yet another "one size fits all" regulatory scheme that misses the mark and, in fact, turns out neither to be beneficial for many small banks nor their customers whose businesses happen to be in a disfavored assessment category. If the proposal is adopted, it may well

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drive economic distortions. One banker participant in a call about the rule noted that bank failures have also been rooted in difficult agriculture economics. That situation may be developing again. The banker wondered if now is really the time for FDIC to be encouraging banks to expand investments in ag loans by treating those loans (as well as mortgage loans) more favorably than others in the rule. That banker has exposed a substantial flaw in the premises underlying the proposal and should be taken very seriously. NDBA trusts bankers as the persons best suited to deciding what business their banks should pursue. FDIC insurance rules should accommodate those banker made decisions as long as a bank is implementing its own business model in a safe and sound manner,

Setting rules for assessments requires FDIC to predict the future; NDBA acknowledges the difficulty of that task because no one knows what, exactly, will trigger the next economic downturn. But, history shows us the next trigger is not likely to be the same thing as the last once. However, we do know the factors that enable successful banks through those downturns – good management, strong capital, sound asset management, and reliable sources of funding. And, we suggest that these are the elements that should be the foundation of any new small bank assessment rule. This alternate approach, if adopted, can be more firmly based on the risk an individual bank presents to the fund and can better respect banker's good decisions about the type of banking business in which to engage.

CAMELS Ratings: Because CAMELS ratings are based on an actual examination of an individual bank and represent a supervisory agency's assessment of how a bank manages risks, CAMELS ratings should factor much more heavily into the small bank assessment formula than is proposed. CAMELS ratings are not "one size fits all" and should reflect the agency's actual judgment about risks presented by a particular bank to the fund. CAMELS 1 and 2 rated banks should not be facing a base rate that can be as high as 16 basis points as the fund achieves the 1.15% benchmark. We also doubt that setting a minimum 12 basis point rate for 4 and 5 rated banks will have any material effect on the likelihood that these banks will address their problems successfully. Additionally, since capital is one of the most heavily weighted factors in the CAMELS rating, increasing the weight given to the CAMELS rating effectively reflects the importance of capital to a bank's sound operation.

Well-capitalized Bank Status: Bankers accept the principle that one vital function of capital is the absorption of loss; this does, of course, also protect the fund. Over the past several years, regulatory agencies have shifted their appraisal of capital adequacy from a leverage ratio to risk-based capital concept and the "well-capitalized" bank and have assured bankers and the public that the risk-based approach is a substantial improvement. However, this proposal takes "an about face" by its heavy weighting of Tier 1 leverage capital and is inconsistent with the risk-based approach to capital. Since the purpose of the small bank assessment is the development of a system that measures a bank's risk to the fund, If the risk-based approach to capital better measures risk than does leverage, then we suggest FDIC should maintain consistency in the regulatory approach to capital by giving due credit to small banks that are "well-capitalized" and, for those banks, reducing the weight given to leverage capital. However, because there are acknowledged quirks in the new capital standards, we agree that banks that have not yet achieved "well-capitalized" status should be credited with a strong leverage capital position.

Core Deposits: It is our view that the proposal gives too much weight to "core deposits", a concept that may be too simplistic to apply so rigidly, even within the small bank universe. The proposal then compounds the problem by a too restrictive delineation of what FDIC will consider to be a "core deposit". Specifically, we can discern no objective basis for the FDIC to penalize small banks that use reciprocal deposits and FHLB advances as part of their funding mix.

Bankers recognize the value of stable deposits and acknowledge there can be substantial risks that come with large deposits that are rate sensitive and from a source outside a bank's local territory. However, reciprocal deposit programs such as CDARS have produced reciprocal deposits that are stable, relatively rate insensitive, and a popular with larger depositors. Yet, the proposal treats reciprocal deposits as "brokered deposits", i.e., as if they are hot money and have caused problems for participating banks. Approximately one-third of NDBA member banks participate in a reciprocal deposit network. North Dakota banks have found reciprocal deposits to be a valuable way to serve larger depositors needs and to diversify funding sources. This is responsible banking. If FDIC has clear evidence that reciprocal deposits are harmful to banks and to the fund, it should disclose that evidence to the benefit of all banks. But, if that evidence is not there, then there is not good reason not to accord reciprocal deposits the same treatment as core deposits under the proposal.

The rationale for treating FHLB advances as being undesirable is also unclear. Banks find FHLB advances and term CDs to be a useful to soundly manage interest rate risk. Here again, banks should not be punished for being good managers of risk.

Core deposits do have significant franchise value for a bank and are desirable for that reason. Nonetheless, the assessment process should focus on demonstrated risk and risk management. We submit that the assessment formula should be based on a more objective view of reciprocal deposits, FHLB advances, and, even brokered deposits, should recognize the value of these funding tools for diversification and managing liquidity and rate risks, and should focus on the uses to which a bank puts these types of funds.

In the absence of evidence that establishes reciprocal depositors behave in ways that are materially different than core depositors, reciprocal deposits should be treated as core deposits for purposes of assessment. Serious consideration should also be given to developing an assessment factor to match FHLB advances and term brokered deposits with loan maturities.

One Year-Asset Growth: The proposal equates relatively rapid growth with a higher risk of failure. We submit this approach generalizes too much and will have the effect of raising a growing bank's assessments, no matter how well the bank is managing its growing assets. Over virtually the entire period of the bank crisis, banks in North Dakota experienced strong and rapid growth. The reason for that growth was not that our banks were being reckless; rather, North Dakota was experiencing an economic boom and our banks were serving their communities' growing needs. In this boom era, not one North Dakota bank has failed. In fact, virtually all have prospered. Nonetheless, the proposed assessment factor for asset growth would penalize banks such as ours. We believe banks that are serving their communities and managing growth should be encouraged, not punished. Toward that end, we suggest that any assessment factor for growth be based on loan growth, rather than asset growth, since it is poor loan management that jeopardizes a bank's future. However, if FDIC is going to pursue short-term growth as a factor that increases a growing bank's assessment, that negative effect should not occur unless "excessive" growth is determined by measurement against the growth of peers operating in the same area.

Loan Portfolio Distribution: The only thing that FDIC will achieve by adopting the loan portfolio distributions factor as proposed is to cause banks to stop making loans in categories that are negatively weighted and to divert funds to loan categories that are more favored by FDIC. NDBA categorically rejects this approach to assessment. The FDIC assessment formula should neither guide banks toward lines of business that are favored by the formula nor induce a bank to stay away from particular lines of loan business, even if that result is "incidental". The assessment formula must not be used to direct how a well-capitalized, soundly managed bank deploys assets because to do so simply substitute the agency's conclusions about what are "good" loans and "bad" loans for those of the bank's management.

The proposed loan distribution factor is also faulty in that it is devoted to addressing elements underlying the last bank crisis. Unless, the FDIC can predict with certainty that the future will replicate the past, basing the assessment formula on the past will not "get it right".

The things that go wrong differ from economic cycle to economic cycle and are not likely to be the same for a next downturn. But, even if they are the same, most banks did not fail during the last crisis. Instead, even without FDIC guiding them away or toward certain types of loans, banks' management worked through problems that were presented by the economic downturn by attending to loan quality (irrespective of loan type) , managing the portfolio of loans and hedging risks. These are all things that are evaluated and measured by the CAMELS ratings based on supervisory evaluations of the individual banks and are more meaningful than loan category for the purpose of threats and protection of the insurance fund.

If it's to be successful, the assessment formula must focus on the future and the characteristics of banks that will enable successful operations under new circumstances. Bankers tell us the proposed formula does not adequately do so. They and we ask FDIC to re-evaluate the proposal, particularly as it pertains to the loan distribution factor, one-year growth factor and, core deposit factor, and, essentially, to improve the proposal by more thoroughly incorporating into the assessment process, the results of supervisory evaluations of individual banks in the form of the CAMELS rating system.

Thank you for your consideration of our comments.

Sincerely,

NORTH DAKOTA BANKERS ASSOCIATION

Rick Clayburgh

Rick Clayburgh
President / CEO