May 18, 2020

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

RE: <u>(RIN 3064-A) FDIC Notice of Proposed Rulemaking</u>: Assessments, Mitigating the Deposit Insurance Assessment Effect of Participation in the Paycheck Protection Program (PPP), the PPP Lending Facility, and the Money Market Mutual Fund Liquidity Facility

Dear Mr. Feldman:

Flagstar Bank, FSB ("Flagstar") appreciates the opportunity to provide its comments in response to the above-noted Notice of Proposed Rulemaking ("NPR") issued by the Federal Deposit Insurance Corporation ("FDIC") on May 12, 2020 with respect to mitigating the impact on a bank's assessment rate of its loan originations under the Small Business Administration's Paycheck Protection Program ("PPP) and its related borrowings under the Federal Reserve's PPP Loan Facility.

As background, Flagstar is a federally-chartered savings bank with $26.8 billion in assets as of March 31, 2020 and whose deposits are federally insured to the extent permitted by law and FDIC regulation. Flagstar is headquartered in Troy, Michigan and provides small business and consumer banking services through 160 bank branches in five states, residential mortgage loans in all 50 states, and commercial loans in all 50 states throughout the country. At March 31, 2020, Flagstar had an aggregate of $4.9 billion in commercial loans, comprised of $3.0 billion in commercial real estate loans and $1.9 billion in commercial and industrial loans. Also, at March 31, 2020, Flagstar had approximately $16.1 billion on deposit.

Through its participation in the PPP during April and May 2010, Flagstar originated approximately $400 million in PPP loans. Flagstar believes that its loans will be reported on several different lines in it Call Report, including lines RC-C line 3, "Loans to finance agricultural production and other loans to farmers," line 4a, "Commercial and industrial loans to U.S. addresses," line 6, "Other consumer loans," line 9a, "Loans to nondepository financial institutions" and line 9b(2), "All other loans." Flagstar intends to borrow from the Federal Reserve Bank of Chicago through the PPP Liquidity Facility for substantially all of the funding for these loans.

Alternatives to Reporting PPP Loans in the Call Report. We have reviewed the NPR and appreciate the FDIC's purpose of mitigating the effect of a bank's participation in the PPP loan program and its borrowings under the PPP Liquidity Facility on its deposit insurance assessment as applied by the FDIC. In particular, we understand from the NPR that the FDIC intends that (i) a bank's participation in the PPP and PPP Loan Facility programs should not affect any risk measures used to calculate its assessment rate, (ii) a bank's participation in the PPP Loan Facility should not impact adjustments to its assessment rate, (iii) any increase in a bank's assessment base attributable to the PPP Loan Facility would be offset, and (i) a bank's participation in the PPP Loan Facility would not affect the bank's classification for assessment purposes.

To accomplish these objectives, the FDIC proposes to use a waterfall approach in estimating the amount of PPP loans contained in the existing loan categories of Call Reports filed by banks that originated and hold the PPP loans. That is, it will assume that PPP loans are included in existing categories in a bank's Call Report and reduce the loan category by the amount of PPP loans originated by the bank, starting with the commercial and industrial loan category. If the PPP loans

of a bank exceed that category's balance, then the FDIC will assume that the remaining PPP loans were included in the agriculture loan category, and thereafter in the All Other Loans category.

However, this approach ignores loans that will fall into line 9a, "Loans to nondepository financial institutions" and line 9b(2), "All other loans." These loan categories carry a loss severity factor of 51%, more than double the loss severity factor that applies to the primary category being reduced under the waterfall approach, i.e., loans falling into line 4a, "Commercial and industrial loans to U.S. addresses.". As such, by not reducing the PPP loan balances in those categories with the higher loss severity factors, the waterfall approach will not fully eliminate the adverse impact of the PPP loans on a bank's assessment rate. Additionally, we believe that this waterfall approach injects unneeded complexity in the overall calculation, as indicated in the examples in the NPR itself that suggest scenarios where PPP loans would exceed commercial and industrial loans and even All Other Loans.

Rather, we suggest that PPP loans originated by banks be reported in a separate, newly-established category entitled "PPP" or similar name in Schedule RC-C of the Call Report to ensure that PPP loans and PPP Loan Facility borrowings thereunder are not mis-counted so as to inadvertently increase a bank's deposit insurance assessments.

As an alternative, FDIC may wish to allow for memo disclosure only of PPP loans in the Call Report rather than revising the Call Report category structure, especially given the tight time frame before the second quarter 2020 Call Report must be filed. Either of these two approaches, rather than the waterfall approach, would allow the FDIC to more readily identify and account for the PPP loans and PPP Loan Facility and thus meet its goals in the proposed rule noted above.
While not covered by the NPR, we also note that separate PPP information in the Call Report will assist banks in calculating regulatory capital ratios pursuant to an Interim Final Rule issued April 9, 2020 by the federal bank regulatory agencies, including the FDIC, so that such ratios are not adversely impacted by a bank's participation in the PPP.

For these reasons, we respectfully request that the FDIC allow PPP loans to be separately reported in the Call Report, either by a new, separate category in the loan section or in a memo form, rather than combined into existing categories and then determined using the waterfall method.

Incomplete Netting of PPP Liquidity Facility. The NPR also discusses mitigating the effect of a bank's borrowings under the PPP Loan Facility, such as with respect to the core earnings ratio used in the Large Bank Pricing ("LBP") model and with respect to an offset to the assessment base. Both adjustments are necessary, because the PPP Loan Facility would otherwise cause an increase in the assessment rate arising from those increases in the LBP and the assessment base, respectively.
However, we believe that each of these two adjustments are incomplete and thereby effectively penalize a bank that did not utilize the PPP Liquidity Facility to fund the PPP loans, because only the amount of PPP loans pledged to a PPP Liquidity Facility would be excluded from the core earnings ratio and the assessment base.

It is unclear why PPP loans funded from sources other than the PPP Liquidity Facility would not similarly be deducted when calculating the core earnings ratio and the assessment base. Many banks have multiple sources of liquidity available and use different sources to fund loans depending upon various factors, such as their cost of funds, contingent liquidity strategy and collateral needs. Such decisions are made in the normal course of a bank's operations, and funding PPP loans with a source other than the PPP Loan Facility does not create a heightened risk with respect to PPP loan originations that would necessitate a higher assessment rate.

This could then impose on banks an adverse financial impact of originating and holding the PPP loans in a manner not contemplated or intended at the time the PPP loan program was commenced. For instance, in Flagstar's specific situation as it relates to the PPP loans it originated and carries on its balance sheet, but which would not be funded under the PPP Loan Facility:

i. Flagstar's FDIC premium costs for the loans would rise by 10 basis points, adding 30% to the carrying cost of the asset; and
ii. A higher premium would also decrease Flagstar's return on asset for its PPP loans by at least 15%, undercutting the financial benefit that Flagstar must consider in making prudent lending decisions.

Such a result would also provide an unfair economic advantage to non-bank lenders that also participated in the PPP lending program, because those lenders are not subject to FDIC premiums and so would not have the same adverse financial impact from participating in the same loan program.

We urge the FDIC to consider including all PPP loans, not just those pledged to a PPP Liquidity Facility, in adjustments to the core earnings ratio and the assessment base otherwise allowed under this NPR.

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We appreciate the opportunity to comment on the NPR and assist the FDIC in its approach to mitigate the effects on the banks' assessment rates because of their participation in the PPP and their borrowings under the PPP Loan Facility. If you have any questions, please do not hesitate to contact me at (248) 312-6133.

Very truly yours,

James K. Ciroli
Executive Vice President and
Chief Financial Officer

cc: Alessandro DiNello, Chief Executive Officer
Paul Borja, Deputy General Counsel