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FDIC Proposes New Premium Assessment System for Small Banks

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On June 16, the ***Federal Deposit Insurance Corporation*** (FDIC) released a proposal to amend 12 CFR part 327 to refine the deposit insurance assessment system for small banks that have been federally insured for at least five years. In general, a "***small bank***" is one with less than $10 billion in total assets. The FDIC proposed that a final rule would go into effect the quarter after a final rule is adopted; by their terms, however, the proposed amendments would not become operative until the quarter after the ***Deposit Insurance Fund*** (DIF) reserve ratio reaches 1.15 percent, which is not expected to occur until 2016. The proposal, among other things, changes the factors that are relevant to a determination of an institution's total assessment rate.

The FDIC has provided a calculator (a link is provided below) so that institutions can determine just how the proposal will affect their deposit assessments. The FDIC believes that its proposal is revenue neutral and, therefore, would not in total increase the amount of assessments the FDIC collects; however, some banks will pay somewhat more and some somewhat less as suggested above, and would better reflect the actual risk to the FDIC on an institution-by-institution basis. The proposal does not require small banks to report any new data in their Reports of Condition and Income.

To determine how much a bank will pay to the FDIC for its insurance assessment, the FDIC has established risk categories. Most small banks fall into what is known as Risk Category I, which generally consists of banks that are both well-capitalized and have achieved CAMELS ratings of 1 or 2 — the best of the five numerical risk categories. Within Risk Category I, those institutions that pose the least risk are charged a minimum initial assessment rate, and those that pose the greatest risk are charged an initial assessment rate that is four basis points higher than the minimum. All other banks within Risk Category I are charged a rate that varies between these rates. (In contrast, all banks in Risk Category II are charged the same initial assessment rate, which is higher than the maximum initial rate for Risk Category I. A single, higher, initial assessment rate applies to each bank in Risk Category III and another, higher, rate to each bank in Risk Category IV.) Notwithstanding an institution's category, its total assessment rate may vary from an "initial assessment rate" as the result of possible adjustments, including an unsecured debt adjustment, a depository institution debt adjustment, and a brokered deposit adjustment.

The "financial ratios method" currently in use determines the assessment rates for banks in Risk

Category I using a combination of weighted CAMELS component ratings and a series of financial ratios and metrics. Here is a comparison of the factors that currently are used and the new factors that FDIC proposes to use; notably, the core deposits/total assets ratio, one-year asset growth and the loan mix index are new.

Comparison of Current and Proposed Measures in the Financial Ratios Method:

Current Risk Category I Financial Ratios Method	**Proposed Financial Ratios Method**
Weighted Average CAMELS ComponentRating	Weighted Average CAMELS ComponentRating
Tier 1 Leverage Ratio	Tier 1 Leverage Ratio
Net Income Before Taxes/Risk-Weighted Assets	Net Income Before Taxes/Total Assets
Nonperforming Assets/Gross Assets	Nonperforming Loans and Leases/GrossAssets
Adjusted Brokered Deposit Rating	Other Real Estate Owned/Gross Assets
Net Loan Charge-Offs/Gross Assets	Core Deposits/Total Assets
Loans Past Due 30-89 Days/Gross Assets	One-Year Asset Growth

According to the American Bankers Association, the proposal:

would introduce a new measure of the loan mix index, measuring the extent to which a bank's loan portfolio holds higher risk categories – following the industry charge-off rates in the last recession. C&D loans would be most penalized, with lesser impact for C&I loans and leases, consumer loans and loans to foreign governments; rewarded loan categories would include agricultural production and real estate loans and loans to other banks. The proposed rule would also replace the brokered deposit ratio in the financial ratios method and use the ratio of core deposits to total assets instead. Core deposits are defined as domestic office deposits excluding time deposits over the deposit insurance limit and the amount of brokered deposits below $250,000. The FDIC expects that using this ratio instead of the brokered deposit ratio will lower assessments for most small banks. However, it will penalize banks with brokered deposits above $250,000.

Further, the FDIC is requesting comment on alternatives to the proposal that distinguish between banks with CAMELS I and II ratings. The first alternative would lower the maximum initial assessment rate for CAMELS composite I-rated banks from 16 basis points to 12 basis points. In the second alternative, the minimum initial assessment rate applicable to CAMELS composite IV- and V-rated banks would be lowered from 16 basis points to 12 basis points. The FDIC also is specifically requesting comments on the following questions:

- Are there other variables, besides the eight included in the statistical model and proposal, that both predict the likelihood of bank failure with statistical significance and do not have perverse incentive effects?

- Are there variables that can be shown to predict likely losses given failure with statistical significance?

- Should the upper end of the assessment rate range decline from 35 basis points to 30 basis points as proposed, or should higher assessment rates continue to apply to the riskiest banks?

The FDIC has provided an online assessment calculator to measure the effect the new rule would have on an institution's assessment level. The calculator may be accessed here.

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