FDIC Deposit Insurance Assessments for Small Banks

Summary of Final Rule

On April 26, 2016, the FDIC adopted a final rule that changes the method of calculating assessments for established small banks with total assets less than $10 billion that have been federally insured for at least five years.

Effective Date of the Final Rule: The new rule is effective July 1, 2016. If, as expected, the reserve ratio of the Deposit Insurance Fund (DIF) reaches 1.15 percent by that date, the final rule will become operative on July 1, 2016. If the DIF reserve ratio does not reach 1.15 percent by that date, the new assessment method will become operative the first day of the calendar quarter after the reserve ratio reaches 1.15 percent. At the end of March 31, 2016, the DIF reserve ratio was 1.13 percent.

Description of the Final Rule: Under the new method, various measures will be used to calculate a small bank's assessment. All of the measures are based on a statistical model that estimates a bank's probability of failing within three years. Several of these measures are currently used to assess banks in Risk Category I—the category that most community banks are in. A comparison of the current ratios and the new method is below:

Comparison of Current and Final Rule Measures

Current Risk Category I Financial Ratios Method	Final Rule Financial Ratios Method
Weighted Average CAMELS Component Rating	Weighted Average CAMELS Component Rating
Tier 1 Leverage Ratio	Leverage Ratio
Net Income before Taxes/Risk-Weighted Assets	Net Income before Taxes/Total Assets
Nonperforming Assets/Gross Assets	Nonperforming Loans and Leases/Gross Assets
	Other Real Estate Owned/Gross Assets
Adjusted Brokered Deposit Ratio	Brokered Deposit Ratio
	One Year Asset Growth
Net Loan Charge-Offs/Gross Assets	
Loans Past Due 30-89 Days/Gross Assets	
	Loan Mix Index

As you can see from the list, three of the measures—the weighted average CAMELS component rating, the leverage ratio and the net income measure—are very similar if not identical to the measures currently used to assess Risk Category I banks. The nonperforming assets/gross assets measure has been divided into two measures—nonperforming loans and leases/gross assets and

OREO/gross assets. The new measures that the FDIC introduced are (1) the brokered deposit ratio, (2) the one-year asset growth measure, and (3) the loan mix index.

Brokered Deposit Ratio: Under the final rule, only brokered deposits in excess of 10 percent of total assets will impact assessment rates. For institutions that are well capitalized and have a CAMELS composite rating of 1 or 2, reciprocal deposits are deducted from brokered deposits. For a bank that is less than well capitalized or has a CAMELS composite rating of 3, 4 or 5, however, reciprocal deposits will be included with other brokered deposits.

Originally, the FDIC had proposed a core deposit ratio as one of the financial ratios. The umerator of the core deposit ratio would have excluded reciprocal deposits. Because of ICBA's advocacy, the FDIC scrapped the core deposit ratio and substituted the brokered deposit ratio which treats reciprocal deposits as they are treated under current rules.

One-Year Asset Growth Measure: Under the final rule, the one-year asset growth measure increases an established small-bank's assessment rate only if the bank has had one-year asset growth greater than 10 percent. Therefore, banks with average growth rates will not be penalized. Originally, the FDIC proposed that any asset growth would have adversely impacted a bank's assessment but, because of ICBA's advocacy, the FDIC changed the rule.

Loan Mix Index: This index divides a bank's loan portfolio into different categories. Each loan category is then divided by the bank's total assets to determine the percentage of the bank's assets represented by that category of loan. Then each percentage is multiplied by the historical weighted average industry-wide charge off rate for that category of loans. The products are then summed to determine the loan mix index.

Despite ICBA's advocacy, this index was not changed from the original proposal. Consequently, the loan mix index does <u>not</u> rely on a bank's own indicators of loan quality and underwriting or take into account geographic variations in charge-off rates. Instead, the weighted average industry-wide charge off rate is a national average that is weighted heavily by the charge-offs that occurred during the most recent recession. Banks with high concentrations of construction and development loans and commercial and industrial loans will be the most impacted by the loan mix index.

Calculating the Initial Assessment Rate: Under the final rule, the weighted CAMELS components and financial ratios will be multiplied by statically derived pricing multipliers, the products summed, and the sum added to a uniform amount that is also statistically derived. The total will equal the bank's initial assessment rate. The bank's initial assessment rate can't be less or more than the minimum or maximum rates applicable to the bank's CAMELS composite rating. These minimum and maximum rates are as follows:

	Established Small Banks		
	CAMELS Composite		
	1 or 2	3	4 or 5
Initial Base Assessment Rate	3 to 16	6 to 30	16 to 30
Unsecured Debt Adjustment [1]	-5 to 0	-5 to 0	-5 to 0
Total Base Assessment Rate	1.5 to 16	3 to 30	11 to 30

Expected Impact of the Final Rule: The FDIC says that the final rule would have been revenue neutral as of the fourth quarter of 2015 for established small banks in the aggregate even though individual bank assessments would have differed. Furthermore, after the reserve ratio reaches 1.15 percent, the aggregate assessment revenue collected from established small banks under the final rule is expected to be approximately the same as would be collected under the current method for calculating assessments. Because overall assessment rates will decline when the reserve ratio reaches 1.15 percent, 93 percent of established small banks should have lower total assessment rates and 7 percent should see rate increases, compared to current rates.

FDIC Calculators: Bankers that want to estimate the impact of the final rule on their bank's assessment rate should go to https://www.fdic.gov/deposit/insurance/calculator.html and click on "Current and Future Assessment Rate Calculators for Small Institutions."

[1] The unsecured debt adjustment (which is an adjustment for holding unsecured debt issued by another depository institution) cannot exceed the lesser of 5 basis points or 50 percent of an insured depository institution's initial base assessment rate; thus, for example, an insured depository institution with an initial base assessment rate of 3 basis points will have a maximum unsecured debt adjustment of 1.5 basis points and cannot have a total base assessment rate lower than 1.5 basis points.

Summary of Final Rule to Increase the FDIC Deposit Insurance Fund Reserve Ratio to Statutorily Required Level

On March 26, 2016, the FDIC Board approved a final rule to increase the reserve ratio of the Deposit Insurance Fund (DIF) to the statutorily required minimum level of 1.35 percent. The Dodd-Frank Wall Street Reform and Consumer Protection Act increased the minimum for the DIF reserve ratio, the ratio of the amount in the fund to estimated insured deposits, from 1.15 percent to 1.35 percent and required that the ratio reach that level by September 30, 2020. Further, the Dodd-Frank Act also required that banks with $10 billion or more in total assets be responsible for the increase from 1.15 percent to 1.35 percent.

Surcharge on Banks $10 Billion or More: To implement the Dodd-Frank mandate that banks with $10 billion or more in total assets be responsible for increasing the DIF reserve ratio from 1.15 percent to 1.35 percent, the final rule will impose on these banks an annual surcharge of 4.5 cents per $100 of their assessment base. The FDIC expects the reserve ratio will likely reach 1.35 percent after approximately two years of surcharge payments. In other words, if the surcharge goes into effect on July 1, 2016, the reserve ratio should reach 1.35 percent by July 1, 2018. If the DIF doesn't reach 1.35 percent by December 31, 2018, the FDIC plans to impose a shortfall assessment on banks with $10 billion or more in assets on March 31, 2019 and collect it on June 30, 2019.

To avoid a "cliff effect" for banks near the $10 billion threshold, the final rule deducts $10 billion from a large bank's regular assessment base.

Effective Date of the Rule: The final rule will become effective on July 1, 2016. If the DIF reserve ratio reaches 1.15 percent before that date, surcharges will begin July 1. If the DIF reserve ratio has not reached 1.15 percent by that date, surcharges will begin the first quarter after the reserve ratio reaches 1.15 percent.

Credits to Banks Under $10 Billion: Since banks under $10 billion in assets will be contributing to the DIF while the reserve ratio remains between 1.15 percent and 1.35 percent and the larger banks are paying a surcharge, the FDIC will provide assessment credits to the smaller banks for the portion of their assessments that contribute to the increase. The amount that smaller banks contributed to this increase in the DIF reserve ratio will equal their portion of all large and small bank regular assessments during the credit calculation period times an amount equal to the increase in the DIF, less surcharges. The FDIC will assume that all non-assessment revenue (i.e., investment income) during the credit calculation period will be used to maintain the fund at a 1.15 percent reserve ratio, thus attributing reserve ratio growth to assessment revenue as much as possible and maximizing the aggregate amount of the smaller bank assessment credit. The FDIC projects that the aggregate amount of credits will total approximately $1 billion.

Use of Credits: Once the reserve ratio reaches 1.38 percent, the FDIC will automatically apply a smaller bank's credits to reduce its regular deposit insurance assessment up to the full amount of the bank's credits or assessment, whichever is less.