

**DECISION  
OF THE  
ASSESSMENT APPEALS COMMITTEE**

**CASE NO. 2008-03**

\*\*\* (\*\*\* “the Parent”), \*\*\*, \*\*\*, parent company of the former \*\*\* (Bank A), and \*\*\*, \*\*\*, \*\*\* (Bank B), successor to Bank A, filed appeals with the Assessment Appeals Committee (Committee) of the Federal Deposit Insurance Corporation (FDIC) by letters dated October 23 and 24, 2008, respectively. Both appealed a September 24, 2008, determination issued by the FDIC’s Division of Insurance and Research (DIR), denying Bank A’s requested assessment reduction for the period from January 1, 2008, through March 11, 2008. Bank A had sought assignment to Risk Category I for the 71 days at issue. DIR determined that Bank A should remain in Risk Category III because its requisite supervisory ratings upgrade was not transmitted to Bank A until March 12, 2008. Bank A’s deposit insurance assessment for those 71 days was approximately \$38,000 higher in Risk Category III than it would have been in Risk Category I. These appeals followed.

At its meeting held on December 9, 2008, after carefully considering all of the written submissions and facts of this case, the Committee has determined that the appeals of the Parent and Bank B must be denied.

**BACKGROUND**

The FDIC began an examination of Bank A on November 19, 2007. That examination uncovered major problems, including fraudulent loan activity and a resulting capital deficiency. As a consequence, the FDIC issued an Interim Rating Change downgrading Bank A’s CAMELS composite rating from “1” to “5.” Notice of this rating change was hand delivered to Bank A management on December 5, 2007.

About this same time, Bank A was issued a Prompt Corrective Action (PCA) letter requiring it to submit a Capital Plan by December 11, 2007. Bank A timely submitted a plan, which included an agreement for Bank A’s sale to the Parent. The Parent purchased Bank A on \*\*\* \*\*\*, 2007, injecting \$16 million in capital - which proved sufficient to restore Bank A to Well Capitalized status - and making management changes.

The management changes and capital injection that followed the Parent’s purchase were considered during the FDIC’s examination and were factored into Bank A’s final ratings. The examination report mailed to Bank A on March 12, 2008, upgraded its CAMELS composite rating from “5” to “2.”

With these two composite ratings for the January to March 2008 assessment period, Bank A was placed in Risk Category III for the first 71 days of that period and in Risk Category I for the final 20 days. Its deposit insurance assessment for the period totaled \$54,859, which it paid.

On August 4, 2008, Bank A timely requested review by DIR of its assessment rate for the January to March 2008, assessment period, seeking placement in Risk Category I for the entire period. As grounds, Bank A pointed out that by January 1, 2008, it was owned by the Parent, which it described (evidently meaning Bank B) as well capitalized with both an excellent CAMELS rating and reputation. Acknowledging the complexity of its problems, as well as the additional time and FDIC personnel required to complete the examination, Bank A nevertheless argued for a lowered assessment, citing the Parent's investment, the ratings upgrade in the final examination report, and Bank A's well capitalized status on January 1, 2008.

By letter dated September 24, 2008, DIR denied Bank A's request. In that determination, DIR noted the Parent's purchase of Bank A and the \$16 million capital injection. According to DIR, however, the complexity of Bank A's problems required the FDIC to expend a great deal of time and effort to complete the examination report, which was then subject - as are all examinations - to secondary review before finalization and transmittal to the institution. DIR cited the FDIC's regulations, which provide that risk assignment changes resulting from a ratings change become effective as of written notification to the institution. Bank A's risk assignment change, DIR ruled, became effective March 12, 2008, the date the examination was finalized and the ratings upgrade was transmitted to Bank A. Denial of Bank A's request, DIR concluded, was "consistent with the treatment of similarly situated institutions."

By letter dated October 23, 2008, the Parent appealed to this Committee. The Parent discusses the problems at Bank A found during the FDIC examination, Bank A's "impending closure" by the FDIC, and the Parent's open bank purchase. The Parent asserts that it received no formal notification that Bank A's CAMELS composite rating was "5" until March of 2008, and that it was assured by FDIC examiners that Bank A's assessment for the January to March 2008, assessment period would be lowered on appeal. The Parent recounts improvements made to Bank A: the capital injection, removal of more than \$18 million in fictitious loans, and the recent merger of Bank A into Bank B on \*\*\* \*\*\*, 2008. Failure to reduce Bank A's assessment, according to the Parent, penalizes the Parent for the purchase of Bank A.

Bank B also appealed to the Committee, by letter dated October 24, 2008. Bank B reiterates the various improvements resulting from the Parent's purchase of Bank A and requests that the Parent not be penalized for its efforts on behalf of Bank A.<sup>1</sup>

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<sup>1</sup> In addition, an October 23, 2008, letter from the \*\*\* Department of Financial Institutions (DFI) in support of the Parent and Bank B appeals was received and has been

### ANALYSIS

the Parent and Bank B ask the Committee to elevate Bank A from Risk Category III to Risk Category I for the period from January 1 to March 11, 2008, based on examination results that became final and were transmitted to Bank A on March 12, 2008.

In considering this issue, the Committee looks first to the relevant FDIC regulations. The effective date for changes to risk assignments is governed by 12 C.F.R § 327.4(f)(1). That section provides: “[c]hanges to an insured institution’s risk assignment resulting from a supervisory ratings change become effective as of the date of written notification to the institution by its primary federal regulator ....” Our interpretation of this provision is informed by its history.

Section 327.4(f)(1) was added in 2006 as part of major revisions to the FDIC’s assessment regulations prompted by the Federal Deposit Insurance Reform Act of 2005 (FDIRA).<sup>2</sup> Under the assessment system in effect prior to FDIRA, an insured institution retained its supervisory and capital group ratings throughout a semiannual period. Any changes to supervisory ratings were not reflected in the institution’s assessment until the following semiannual period. Accordingly, an examination could remain the basis for an institution’s assessment rating long after newer information had become available. *See* 71 Fed. Reg. 69270, 69271 (Nov. 30, 2006).

Under the former assessment system, Bank A would have been charged Risk Category III rates not only from January 1 through March 11, 2008, but for the entire six month period from January through June, 2008.

In its 2006 rulemaking, the FDIC determined that changes to an institution’s assessment rate should be made closer in time to changes in the institution’s risk profile. 71 Fed. Reg. 28790, 28791 (May 18, 2006). The FDIC initially proposed that changes to an institution’s supervisory rating would be reflected as of the date the examination began (the examination “start date”); if no start date existed, an institution’s supervisory ratings would have changed as of the date the institution was notified of its ratings change. Comments received in the 2006 rulemaking, however, favored (and none opposed) making ratings changes effective when ratings changes occur, that is, when the bank is

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considered by the Committee. DFI urges that Bank A be assessed at the Risk Category I rate for the full January through March 2008 assessment period.

<sup>2</sup> Federal Deposit Insurance Reform Act of 2005, Public Law 109-171, 120 Stat. 9; Federal Deposit Insurance Conforming Amendments Act of 2005, Public Law 109-173, 119 Stat. 3601.

notified of its supervisory ratings change (the “transmittal date”). 71 Fed. Reg. at 69271-72.

Adopting the final rule in 2006, the FDIC noted significant benefits from the transmittal date approach. First, federal banking agencies do not all define and record an examination start date the same way; using the examination start date for ratings changes would treat similarly situated institutions differently (and potentially unfairly) simply because they have different primary federal regulators. In addition, use of start dates could potentially produce ratings changes in many prior quarters, with resultant adjustments to prior assessments paid; this could be especially troublesome for an institution in the event of a supervisory ratings downgrade. Further, use of the transmittal date is simpler and more uniform. The effective date of a ratings change is defined the same for all institutions, large or small, and is more cohesive. Moreover, a trade group in 2006 had specifically recommended that in all cases the effective date for recognition of a change in supervisory ratings should be the date the institution is notified of the change. 71 Fed. Reg. 69272.

In the final rule, the transmittal date approach was incorporated as Section 327.4(f)(1): changes to an institution’s supervisory risk assignment resulting from a supervisory ratings change become effective as of the date of written notification to the institution by its primary federal regulator or state authority of its supervisory rating.

With this background, we turn to the primary issue presented in these appeals. The Parent and Bank B urge the Committee to depart from the requirements of Section 327.4(f)(1) so that the ratings change transmitted to Bank A on March 12, 2008, would become effective 71 days earlier. The Committee is mindful of the reasoning behind this argument and the import of the Parent’s actions towards Bank A: as of January 1, 2008, the Parent had begun working to change and improve Bank A to ensure its safety and soundness. Bank A faced “impending closure” as the Parent states in its appeal. The Parent’s actions improved Bank A’s condition and ultimately produced a supervisory ratings upgrade (on March 12, 2008) and merger into Bank B (in \*\*\* of 2008). The Committee recognizes and appreciates these efforts on behalf of Bank A and sympathizes with the Parent’s position on appeal.

Nevertheless, as Bank B acknowledged in its request for review, the examination report, which dealt with “the complexity of the problems incurred by Bank A,” including fraudulent loan activity, did take a “tremendous amount of time and manpower just to complete,” including time for necessary secondary review within the FDIC. The final examination report was issued on March 12, 2008, promptly following the completion of the FDIC’s internal review of the examination findings.

While efforts to improve the condition of ailing institutions are encouraged and appreciated, they must be weighed against the need to finalize examinations so that any resulting improvements and upgrades may be confirmed. In the Committee’s view, the

application of Section 327.4(f)(1) in this case strikes an appropriate balance because it corresponds both with the purposes set out in the FDIC's 2006 rulemaking and the timing of the examination report establishing Bank A's improved condition and upgrading its supervisory rating.

The Committee finds that Bank A's risk assignment was correctly changed from Risk Category III to Risk Category I prospectively on March 12, 2008.

Two issues remain. The Parent contends that until March of 2008, it received no formal notification of Bank A's CAMELS composite "5" rating. On December 5, 2007, the FDIC appropriately notified Bank A - not the Parent - of this change in risk assignment resulting from Bank A's supervisory ratings change. At that time, Bank A's composite rating was confidential information that could not be disclosed to the Parent. 12 C.F.R. §§ 309.5(g)(8), 309.6, 327.4(d). With the Parent's December 31, 2007 purchase of Bank A, the impediment of confidentiality no longer existed and Bank A was free to share its CAMELS composite rating with the Parent.

The Parent also contends that FDIC examiners assured it that Bank A's assessment would be lowered on appeal. In its letter to the Committee, however, the Tennessee Department of Financial Institutions stated somewhat less definitely that Bank A was told an appeal "would *likely* revert the levied assessment." (Emphasis added.) Some misunderstanding on this point is unfortunately evident. In any event, even if such statements were made by FDIC examiners, this Committee has ruled in similar circumstances that the statements are not correct and would not bind the Committee. AAC Case No. 2004-04 (Sept. 7, 2004).

Finally, the Committee notes that these last two arguments were not raised by Bank A in its request for review. Under the Guidelines for Appeals of Deposit Insurance Assessment Determinations, only matters previously reviewed at the Division level may be appealed to the Assessment Appeals Committee. Guidelines, ¶ G. Arguments not previously reviewed at the Division level are not properly before the Committee and cannot provide the grounds to sustain an appeal. AAC Case No. 2005-02 (July 1, 2005). In any event, they would not change the result the Committee has reached.

### **CONCLUSION**

Under the FDIC's assessment regulations, changes to an institution's supervisory risk assignment resulting from a supervisory ratings change become effective as of the date of written notification to the institution by its primary federal regulator of its supervisory rating. Because Bank A received written notification of its upgraded supervisory rating on March 12, 2008, its risk assignment was correctly changed from Risk Category III to Risk Category I prospectively on that date. Accordingly, for the reasons set forth in this decision, the appeals filed by the Parent and Bank B are denied.

By direction of the Assessment Appeals Committee, dated December 22, 2008.

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Robert E. Feldman  
Executive Secretary