DECISION
OF THE
ASSESSMENT APPEALS COMMITTEE

CASE NO. 2018-02

*** (the "Bank") filed an appeal with the Assessment Appeals Committee ("AAC" or "Committee") of the Federal Deposit Insurance Corporation ("FDIC") by letter dated June 28, 2018. The Bank is appealing a determination issued by the FDIC's Division of Insurance and Research ("DIR") dated May 30, 2018. In that determination, DIR denied the Bank's request to either eliminate the effect of an *** branch acquisition on its one-year asset growth rate, or treat the branch acquisition as a bank merger for assessment purposes for the fourth quarter of 2017 (*i.e.*, October 1 to December 31).

The Committee met to consider the Bank's appeal on September 17, 2018. After carefully considering the Bank's oral presentation, the FDIC staff's oral presentation, written submissions, and the facts of this case, the Committee denies the appeal.

BACKGROUND

*** is a *** located in ***. As of ***, it had approximately $*** in total assets. On ***, the Bank acquired all the assets and liabilities of the *** branch office in ***.

The Bank's assessment rate is calculated under the small bank pricing methodology in the FDIC's assessment regulations.[1] One measure used to determine a small bank's assessment rate is the "one-year asset growth rate," which is defined as "growth in assets (adjusted for mergers) over the previous year in excess of 10 percent."[2] After the Bank's acquisition of the

[1] 12 CFR 327.16(a). In this decision, the term "bank" is synonymous with the term "insured depository institution" as it is used in section 3(c)(2) of the Federal Deposit Insurance Act, 12 U.S.C. 1813(c)(2), and the term "small bank" is synonymous with the term "small institution" as it is used in 12 CFR 327.8. In general, a "small bank" is one with less than $10 billion in total assets. 12 CFR 327.8(e).
[2] 12 CFR 327.16(a)(1)(ii).

*** branch, the Bank's assets increased from $*** to $***. This caused the Bank's one-year asset growth rate to increase significantly, contributing to an increase in the Bank's assessment rate by approximately *** basis points, from *** basis points in the third quarter of 2017 to *** basis points in the fourth quarter of 2017. Because asset growth is measured over one year, the branch acquisition will affect the Bank's assessment rate for four quarters (i.e., through the third quarter of 2018). Assuming no other changes to the Bank's fourth quarter 2017 Call Report data, this means that the Bank's assessments increased by approximately $*** for the fourth quarter of 2017, and would increase by a total of approximately $*** over four quarters (based on fourth quarter 2017 data).

In a letter dated April 17, 2018, the Bank requested review of its assessment rate for the fourth quarter of 2017 under procedures set forth in section 327.4(c) of the FDIC's regulations. [3] The Bank requested that "the growth ratio adjustment be eliminated or that its branch acquisition receive the same treatment as a bank merger/acquisition." The Bank reasoned that the branch acquisition was "very similar to a whole bank acquisition/merger in that all assets and liabilities were acquired." On May 30, 2018, DIR denied the request to adjust the Bank's assessment rate, which was calculated in accordance with current assessment regulations and applied correctly to the Bank using properly filed Call Report data.

The Bank timely appealed DIR's denial by letter dated June 28, 2018. In its appeal, the Bank reiterated that there was a capital injection of $*** at the same time as the branch acquisition to maintain the Bank's well-capitalized status and to remain in Supervisory Group – Risk Category 1. The Bank stated that in order for the "Leverage Ratio to have offset the One Year Growth factor, Leverage Capital would have to be in excess of *** percent. This would

[3] 12 CFR 327.4(c). The Bank timely filed and met other requirements set forth in the regulations, including timely payment, to obtain review of its assessment rate for the fourth quarter of 2017.

have required the bank to increase its capital by ***% of the total Assets purchased." The Bank asked whether, in denying its request for review, the FDIC met the policy objective in the final rule "...to improve the risk-based deposit assessment system applicable to established small banks to more accurately reflect risk" and whether the increase in the Bank's assessment "more accurately reflect[s] risk."[4] The Bank explained that the final rule did not discuss or explain why branch acquisitions are treated differently than whole bank mergers and acquisitions.

ANALYSIS

Under the Guidelines for Appeals of Deposit Insurance Assessment Determinations, the burden of proof as to all matters at issue rests with the institution.[5] In this case, the Bank does not contest the application of the rule and does not dispute the underlying Call Report data used to determine the assessment rate. The Committee understands that the Bank, in its appeal, asks whether the increased assessment accurately reflects risk in light of the policy objectives of the final rule implementing the current small bank assessment system. The Bank requests that the FDIC remove the effect of the one-year asset growth measure on its assessment rate, or alternatively treat the branch purchase as a merger for assessment purposes.

Although the Committee understands the Bank's position, the Committee concludes that, for the reasons set forth below, the circumstances of this case do not warrant the relief requested.

One-Year Asset Growth Measure

The measures in the small bank pricing methodology are derived from a statistical model that estimates a bank's probability of failure within three years.[6] Each of the measures, including the one-year asset growth measure, is statistically significant in predicting a bank's

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[4] *See* Assessments, Final Rule, 81 Fed. Reg. 32,180 (May 20, 2016).
[5] *See* Guidelines for Appeals of Deposit Insurance Assessment Determinations, Paragraph H, 77 Fed. Reg. 17,055, 17,060 (Mar. 23, 2012).
[6] *See* 81 Fed. Reg. at 32,183.

probability of failure over that period.[7] The statistical model uses bank financial data and CAMELS ratings from 1985 through 2011, failure data from 1986 through 2014, and loan charge-off data from 2001 through 2014.[8] The one-year asset growth measure increases a bank's assessment rate when annual asset growth (other than through merger or failed bank acquisition) exceeds 10 percent.[9] It does not penalize banks for normal asset growth, but it may increase a small bank's assessment rate when reported annual asset growth exceeds 10 percent.[10] A correlation between rapid credit growth and bank distress has been well documented in academic research.[11]

The one-year asset growth rate may increase a small bank's assessment if a bank reports any type of annual asset growth over 10 percent. The only adjustments to the one-year asset growth rate are for mergers and failed bank acquisitions. As the FDIC stated in the proposed rule, "[m]ergers of troubled banks into healthier banks and purchases of failed banks help limit losses to the [Deposit Insurance Fund]. Penalizing banks for growth that occurs through the acquisition of troubled or failed banks would create a disincentive for such mergers. Consequently, bank asset growth [is] adjusted to remove growth resulting from mergers and failed bank acquisitions."[12]

Further, mergers are distinct from branch acquisitions in other ways. Unlike branch acquisitions, where one bank sells another bank certain assets and liabilities, mergers are distinct in that the selling bank merges with or is acquired by the other, leaving a single, surviving

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[7] *Id*.
[8] *Id*. For a detailed description of the statistical model and the derivation of these measures, see Assessments, Proposed Rule, 80 Fed. Reg. 40,838, 40,857-72 (Jul. 13, 2015) (Supplementary Information, Appendix 1); Assessments, Proposed Rule, 81 Fed Reg. 6108, 6124-35 (Feb. 4, 2016) (Supplementary Information, Appendix 1), 81 Fed. Reg. at 6153-55 (Appendix E).
[9] 12 CFR 327.16(a)(1)(ii).
[10] *See id.*
[11] 80 Fed. Reg. at 40,858.
[12] 81 Fed. Reg. at 6125; 80 Fed. Reg. 40,838, 40,859 (Jul. 13, 2015).

institution. As a result, the surviving institution of a merger is subject to specific assessment rules and processes that do not apply in cases of other types of asset purchases, such as branch acquisitions.[13] In addition, Call Report data, on which the FDIC relies to calculate a bank's assessment rate, reflects merger information, but it does not include the level of detail that would be required to identify asset balances associated with branch acquisitions versus other types of asset acquisitions.

Committee's Findings

While the Committee is sympathetic to the Bank's situation, it is the Committee's view that consistent application of the assessment rules is required for transparency, predictability, and fairness.[14] The small bank assessment regulations apply uniformly to all small banks – approximately 5,500 of them – and the Committee notes that in this case, those regulations were applied correctly based on the Bank's underlying Call Report data.[15]

Although the assessment regulations do not provide flexibility to grant the relief requested by the Bank, the Committee at times has considered whether unique circumstances – generally circumstances beyond a bank's control – prevented a bank from complying with the relevant regulations.[16] The Committee also has considered whether application of the regulations in a particular case would be inequitable.[17]

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[13] *See, e.g.*, 12 CFR 327.5(a)(1)(iii); 327.5(a)(2)(iii); 327.6.
[14] *See, e.g.*, AAC Case No, 2018-01; AAC Case No. 2000-01.
[15] The Committee has previously denied requests in which the institution contests an assessment premium based on accurate Call Report data. *See* AAC Case No. 2018-01 (denying bank's request to treat commercial and industrial (C&I) loans differently for assessment purposes, even though they were correctly reported as C&I loans on the Call Report); AAC Case No. 2010-01 (rejecting bank's argument that its capital evaluation for assessment purposes should be based on Call Report data that initially contained goodwill reporting errors, rather than the amended Call Reports in which the bank reported goodwill correctly; the Committee reasoned that the bank is responsible for accurate reporting); AAC Case No. 2009-01 (denying bank's appeal to upgrade its capital evaluation, which was based on data reported on its Call Report).
[16] *See, e.g.*, AAC Case No. 2002-02 (granting relief where the terrorist attacks on September 11, 2001, prevented the bank from consummating a previously arranged transaction that would have made the bank well capitalized on the cutoff date); and AAC Case No. 2004-02 (granting relief where the primary federal regulator's delay in granting a needed approval prevented the bank from consummating a previously arranged transaction that would have made

The Committee found that application of the assessment regulations in this case is equitable and consistent with the treatment of other banks in similar situations. Specifically, the FDIC has consistently applied the one-year asset growth measure to all small banks that have purchased a branch or branches from another bank. The Bank's branch purchase transaction is not a unique circumstance of the type that the Committee has found to warrant relief in the past. The Committee notes that between October 2016 and December 2017, at least 59 banks subject to the small bank assessment system purchased branches from other banks. Of these, 47 banks reported an increase in their one-year asset growth rate from the quarter prior to the quarter in which they acquired the branches, and 23 banks saw an increase in their assessment rates. Thus, removing the effect of the one-year asset growth rate from the Bank's assessment rate, or treating the branch acquisition as a merger for assessment purposes in this case, would provide an adjustment that is not provided to other banks in the same or similar circumstances, and would result in inequitable treatment across small banks.

The Committee acknowledges the Bank's CAMELS composite rating and appreciates the Bank's efforts to maintain its well-capitalized status by injecting $*** in capital before the branch acquisition. The capital injection and the Bank's CAMELS composite rating were both taken into account (through the leverage ratio and the weighted average CAMELS component ratings) in determining the Bank's assessment rate under the assessment regulations.

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the bank well capitalized on the cutoff date). *But see, e.g.*, AAC Case No. 2004-06 (denying bank's appeal to upgrade its capital evaluation, in part, because the bank was correctly assigned to a lower capital group based on its Call Report data); AAC Case No. 2008-02 (denying bank's appeal to upgrade its capital evaluation because the timing circumstances related to the bank's public stock offering process, which the bank argued caused its capital ratio to fall, was in the full discretion of the bank and not based on any regulatory constraint); AAC Case No. 2009-01 (denying bank's appeal to upgrade its capital evaluation because there was no unusual delay in approval of the bank's capital plan by its primary federal regulator and that the decision to hold certain securities that were declining in value was in the bank's control).

[17] *See e.g.*, AAC Case No. 2009-01; AAC Case No. 2008-02; AAC Case No. 2004-06.

Allowing for individualized assessment rates or different treatment for particular banks would undermine the reliability of the risk-based assessment system. As the Committee has stated before, "while exceptions to the rule may, under compelling circumstances, be considered, such must be both rare and well supported if the system is to maintain credibility."[18] Here, the Bank has not established unique or compelling circumstances that would justify an exception to the rule.

CONCLUSION

After considering the facts and arguments the Bank presented in its appeal, the Committee finds that the circumstances in this case are neither unique nor inequitable so as to warrant the removal of the effect of the one-year asset growth measure on the Bank's assessment rate, or the treatment of the Bank's branch acquisition as a merger for assessment purposes. The Bank's assessment rate was correctly calculated under the FDIC assessment regulations using data reported in its Call Report.[19] Although the Committee is sympathetic to the Bank's position, the Committee does not have a basis for granting relief from the application of the FDIC's assessment regulations. Accordingly, for the reasons set forth in this decision, the Bank's appeal is denied.

By direction of the Assessment Appeals Committee, dated November 20, 2018.

Valerie J. Best
Assistant Executive Secretary

[18] *See, e.g.*, AAC Case No. 2018-01; AAC Case No. 2000-01.
[19] The Committee encourages the Bank to contact the FDIC or take advantage of other assessment-related resources that the FDIC provides to understand how future transactions may affect their assessments, such as the online assessment calculator. https://www.fdic.gov/deposit/insurance/calculator.html (last visited October 3, 2018)