INTRODUCING YOUR NEW FDIC ASSESSMENT

by Steve Brown

The long-awaited assessment calculation proposal was released by the FDIC yesterday and it has community bankers talking. At the direction of the Dodd-Frank law, the FDIC moved its assessment calculation from being based off insured deposits (as it has been since 1935) to being based off the complete liability structure of a bank (technically fees will be based on a bank's average total consolidated assets, minus tangible equity, such as Tier 1 capital components). The new assessment system, if approved, will start on Apr 1, 2011, for payment in Sep of 2011.

For community banks, this is a net positive, as the calculation is revenue neutral to the DIF. That means it is designed not to increase overall fees. For larger banks that fund themselves using more short and long term debt relative to community banks (such as corporate bonds and commercial paper), their assessments will go up on a relative basis. As a result, most community bank's assessments will go down, as a percentage of their liabilities. Our quick back-of-the-napkin calculation projects that for the 10 largest banks, the net impact will equate to approximately $1.6B more in fees. The ICBA takes their calculations a step further and notes community banks will save $4.5B over 3Ys.

While the proposal is 108 pages long and we don't have room to go into all of the details, there are some worth noting. The proposal eliminates the adjustment to the rate paid for secured liabilities (such as FHLB advances), since these will be part of the new assessment base. The proposal also creates a new depository institution debt adjustment (DIDA) that increases the assessment rate (by 50bp) of an institution that holds long-term unsecured debt issued by another insured depository institution (further drying up the subordinated debt/trust preferred/holding company loan market). The good news is that the proposal also has additional carve outs for custodial banks (such as State Street) and for bankers' banks (such as Pacific Coast Bankers' Bank) to address the unique businesses these largely pass-through entities operate in.

For the average bank, because of the wider assessment base and relative reduction, assessment fees will drop from the last published FDIC assessment structure that went into effect April of last year. If you are at the minimum risk category, for example, fees will drop from 12bp to 5bp. For the average bank that was in a Risk Category II, fees will drop from 27bp to 18bp. Another way to look at this is because there is an approximate $1.65 of assets-less-tangible-capital for each $1 of domestic deposits in the industry, shifting the methodology should result in a 30% to 40% assessment fee savings for a community bank.

Conceptually, one take away here is that leverage becomes more passÃƒÂ©. Borrowing funds via repo or FHLB, for example, increases a bank's funding cost at a faster rate relative to the old calculation. Given proper loan growth, this may be a non-event, as the additional assessment will be dwarfed by a quality loan with the proper risk-adjusted loan pricing. However banks that utilize leveraged investment programs will see those become even more uneconomical.

The new calculation methodology should be a source of additional savings next year for community bankers and we cheer the tireless work done by the ICBA in this endeavor. As we work with community banks, we hope to better document the effective savings, as well as highlight different loan and reserve strategies to help you take advantage of this new structure. In a continuing theme for 2011, look for regulatory changes, both positive and negative, to constantly take center stage.

BANK NEWS

Large Bank FDIC Assessment

We ran out of room in our opening story, but note the FDIC also released the calculation methodology for large banks. This new methodology implements a scorecard-based assessment rate for banks over $10B. The scorecard was designed to be predictive of long-term bank performance and will be the subject of future analysis in this publication.

Small Biz Picture Mixed

A survey by National Federation of Independent Business finds small business confidence has reached its highest level in 5 months. Unfortunately, the survey also found only 47% of small businesses have made capital outlays in the past 6 months, just barely above a 35Y low; and only 22% of owners reported higher sales over the past 3 months. More important to community bankers, 91% said all of their credit needs were met and they were not interested in borrowing (a record 52% said they did not want a loan at all).

Unemployment/GDP Projection

A Bloomberg survey of economists predicts the unemployment will fall to 9.3% in 2011 from 9.6% currently and that GDP will continue to grow from 2.2% this quarter to 3.2% by the end of 2011.

QE2

Goldman Sachs indicated in a Bloomberg article that the latest quantitative easing move by the Fed is a good thing because it will drive higher GDP, reduce the risk of deflation and improve the odds of recovery over time. Goldman also indicated inflation is "unlikely to become a problem for years."